



REPORT TO COUNCIL

28 OCTOBER 2009

LEADER
*Councillor Stephen
Greenhalgh*

**TREASURY MANAGEMENT OUTTURN
REPORT**

WARDS
All

Summary

This report provides information on the Council's debt, borrowing and Investment activity for the financial year ending 31st March 2009

The report is to note the borrowing and investment activity for the period 1st April 2008 to 31st March 2009.

CONTRIBUTORS

DFCS
ADLDS

RECOMMENDATION:

The Council is asked to note the borrowing and investment activity for the period 1st April 2008 to 31st March 2009.

1.0 INTRODUCTION AND BACKGROUND

- 1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by this Council in January 2002 and this Council Fully complies with its requirements.
- 1.2 It is a statutory requirement to report to full Council the results of the Council's Treasury Management activities in the preceding financial year. This report deals with 2008/09.

This annual report covers:

- The Council's treasury position as at 31 March 2009 (Para. 3)
- Economic Review (Para.4)
- Interest rates (Para. 5)
- Performance measurement (Para. 6)
- Investment and borrowing outturn for 2008/09 (Para. 6)
- Debt rescheduling (Para. 7)
- Compliance with treasury limits and Prudential Indicators (Para. 8)

2. CURRENT TREASURY POSITION

The Council's borrowing position at the beginning and end of the year is set out in Table 1.

Borrowing by the Housing Revenue Account (HRA) increased by £59.7million in 2008/09. However, total external borrowing by the Council increased by only £10million in 2008/09 reflecting the decision to delay external borrowing both in the expectation of lower future interest rates and to reduce the holding of cash balances. The reduction in General Fund borrowing of £49.7million represents a reduction of £12.2million in the General Fund borrowing requirement and £37.5million in the use of internal cash balances (internal borrowing).

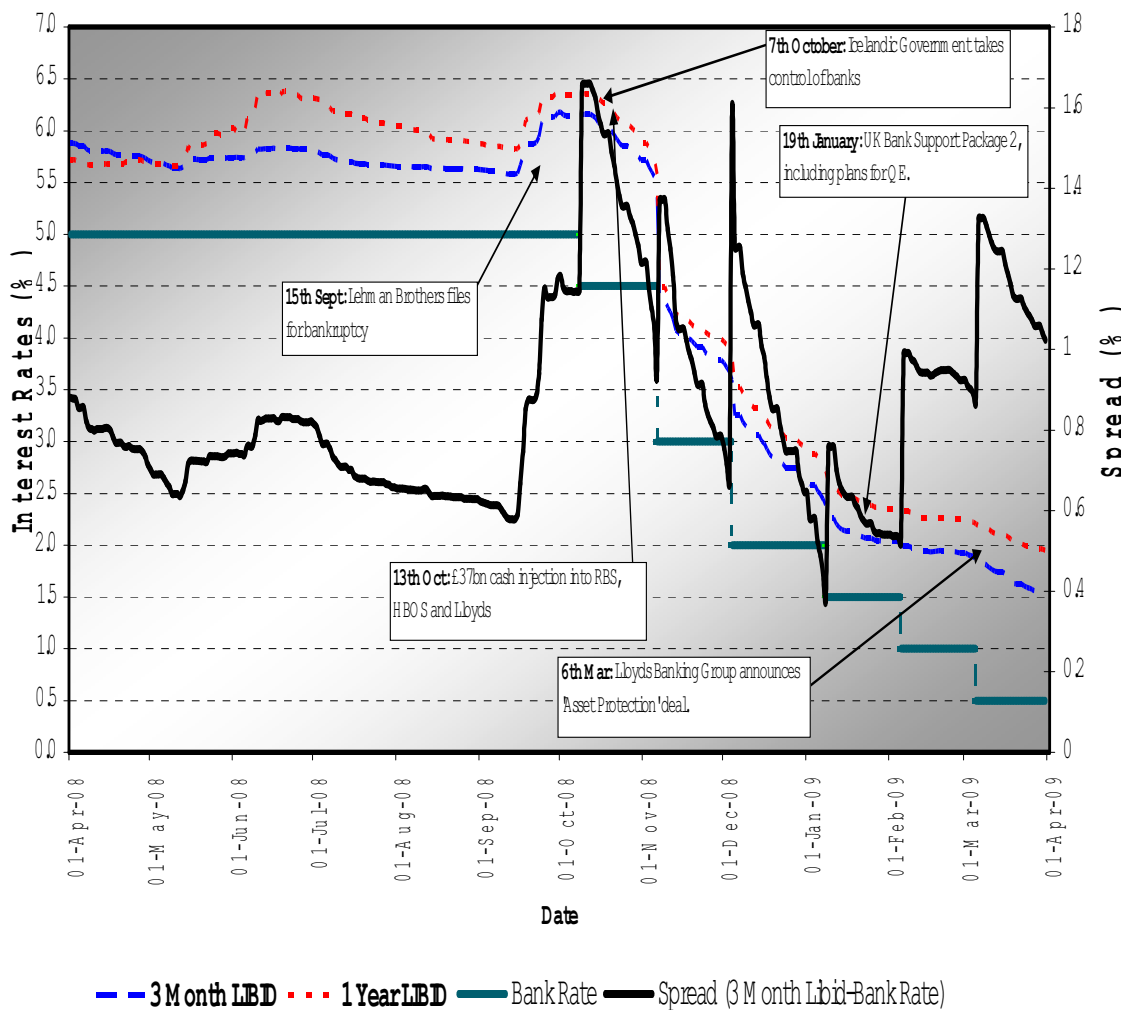
Table 1 – Outstanding Debt

	31 March 2008		31 March 2009	
	Principal	Ave. Rate	Principal	Ave. Rate
	£000's		£000's	
Fixed Rate - PWLB	388,520		398,520	
Variable Rate - PWLB	Nil		Nil	
Market & Temporary Loans	Nil		Nil	
Total	388,520	6.09%	398,520	6.06%
HRA Borrowing	293,699		353,440	
Non HRA Borrowing	94,821		45,080	
Balance	388,520		398,520	
Total Investments	111,700	5.86%	76,000	4.94%

3. ECONOMIC REVIEW

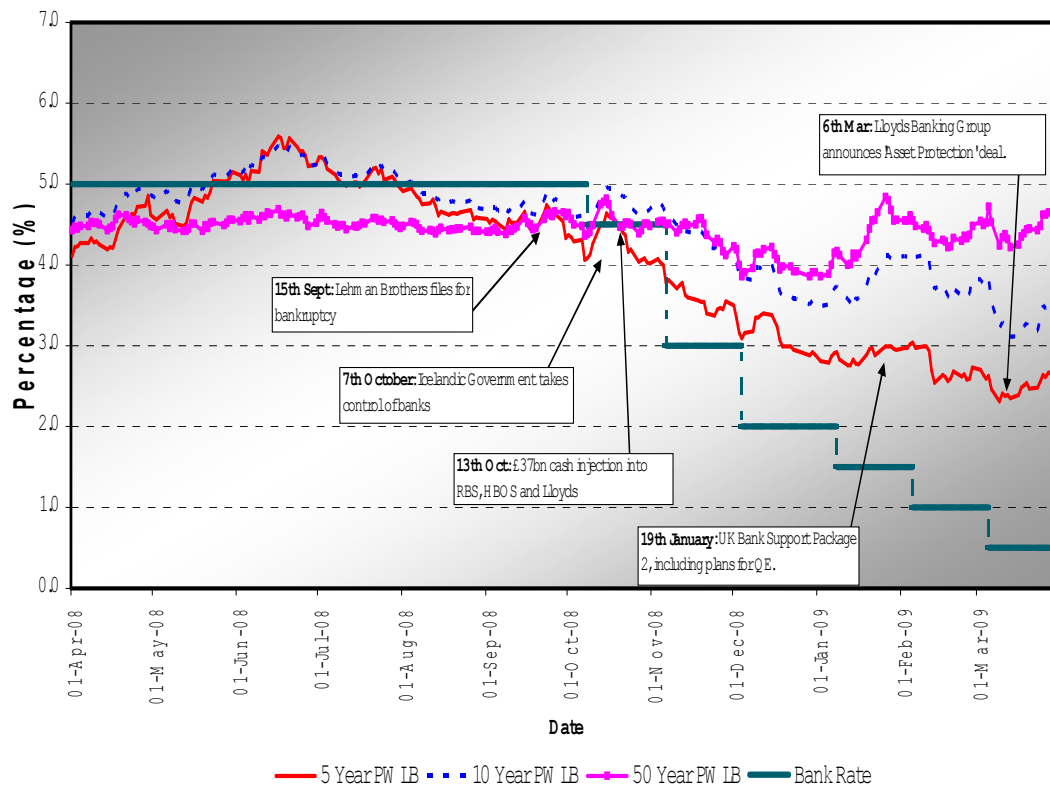
3.1 In a year that can only be described as unparalleled and extraordinary the Annual Treasury Report for 2008/09 is summarised in the graphs below. These graphs show the major events of the financial year and the impact they had on both PWLB and investment rates. The financial crisis, commonly known as the 'credit crunch', had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England.

Bank Rate vs. Investment Rates 2008-09 and Spread Between 3 Month Libid & Bank Rate



This graph shows that whilst base rates were substantially reduced over the period October 2008 to March 2009, LIBID rates reduced at a much slower rate and remained higher than base rates by around 0.5% to 1.0% over the period. (See para 4.2 below)

PW LB Borrowing Rates vs. Bank Rate 2008-09



This graph shows that whilst base rate reduced over the period October 2008 to March 2009, long term PWLB rates remained largely unchanged, although there was some fluctuation whereas short term PWLB rates reduced sharply (see para. 4.3 below).

- 3.2 On the 1st April 2008 Bank Rate was 5% and the Bank of England was focused on fighting inflation. Market fears were that rates were going to be raised as CPI (Consumer Price Index), the Government's preferred inflation target, was well above the 2% target (two years ahead). The money market yield curve reflected these concerns with one year deposits trading well above the 6% level. Public Works Loan Board rates in both 5 and 10 years edged above Bank Rate during the summer as markets maintained the belief that inflation was the major concern of the monetary authorities. The money markets were reflecting some concerns about liquidity at this time and, as shown in the graph, the spread between Bank Rate and 3 month LIBOR was greater than had historically been the case.
- 3.3 This phase continued throughout the summer until the 15th September when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. As can be seen from the charts this also led to an immediate spike up in investment rates as markets grappled with the implications this might have on other financial institutions, their credit standing and indeed their viability. On 7th October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping a massive £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried

up. The Monetary Policy Committee meantime had reduced interest rates by 50bp on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out. On the other hand the short end of the Public Works Loan Board fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower.

- 3.4 Market focus now shifted from inflation concerns to concerns about recession, depression and deflation. Although CPI was still well above target it was seen as no barrier to interest rates being cut further. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities across the curve, at the front end because of credit concerns and the longer end because of the economic consequences reducing inflation, driving yields in 10 year Public Works Loan Board temporarily below 4% and 5 years to around 3.5%. In December as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates to 2%-a drop this time of 1%. The whole interbank yield curve shifted downwards but the 'disconnect' at the short end remained very wide, negating to some degree the impact of the cuts in Bank Rate. 50 year Public Works Loan Board rates dropped below 4% at the turn of the year, marking the low point, as it turned out, in this maturity.
- 3.5 The New Year of 2009 brought little relief to the prevailing sense of crisis and on 8th January the Monetary Policy Committee reduced rates by 0.5% to 1.5%, a record low. More Government support for the banking sector was announced on 19th January 2009. The debt markets had a sharp sell-off at this stage as they took fright at the amount of gilt issuance likely to be needed to finance the help provided to the banks. There was also discussion about further measures that could be introduced to kick start lending and economic activity. These included quantitative easing by the Bank of England, effectively printing money.
- 3.6 In February 2009 the Monetary Policy Committee adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Interbank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The Monetary Policy Committee cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. This scheme would focus on buying up to £75bn of gilts in the 5-25 year maturity periods and £10 -15bn of corporate bonds. This led to a substantial rally in the gilt market, particularly in the 5 and 10 year parts of the curve, and PWLB rates fell accordingly. Finally at the end of March it was announced that the Dunfermline Building Society had run into difficulties and its depositors and good mortgages were taken over by Nationwide whilst the Treasury took on its doubtful loans.
- 3.7 The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place.

4. BORROWING AND INVESTMENT RATES 2008/09

- 4.1 **12- month bid:** One year LIBID fluctuated between around 5.7% to 6.4% with two peaks driven by credit crunch fears in June and September. Bank Rate had been held at 5.0% until October 9 when the first of a series of major cuts caused 12 month LIBID in 2008-09 to be on a rapidly falling trend to the end of the financial year, reaching 1.85% at the end.
- 4.2 **Long-term interest rates** – The PWLB 45-50 year rate started the year at 4.43% (25 years at 4.62%) and was then generally within a band of 4.3% - 4.6% (4.6% - 5.0%) until mid October when there was a spike up to 4.84% (5.08%) followed by a plunge down to 3.86% (4.03% late December. Further spikes of 4.84% (4.86%) and 4.72% (4.69%) occurred in late January and early February with the year closing out at 4.58% (4.28%). It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year.

5. PERFORMANCE MEASUREMENT

- 5.1 Debt Performance - As shown in para 2.1 the average debt portfolio rate has reduced over the course of the year from 6.09% to 6.06%.
- 5.2 An analysis of the Council's long term (PWLB) borrowings by maturity (i.e. date of repayment) is as follows:

PWLB	31 March 2008 £000s	31 March 2009 £000s
Up to two years	0	0
Between two and five years	16,174	36,430
Between five and ten years	78,282	66,026
More than ten years	<u>294,064</u>	<u>296,064</u>
Total	<u>388,520</u>	<u>398,520</u>

- 5.3 An analysis of movements on loans and investments during the period is shown below:

	Balance 31.03.08 £000s	Loans/Invs Raised £000s	Loans/Invs Repaid £000s	Balance 31.03.09 £000s
PWLB	388,520	10,000	0	398,520
Temporary loans	0	0	0	0
Total debt	<u>388,520</u>	<u>10,000</u>	<u>0</u>	<u>398,520</u>
Investments	<u>111,700</u>	<u>806,250</u>	<u>841,950</u>	<u>76,600</u>

- 5.4 From 1 April 2008 to 31 March 2009 the Council took 1 new Public Works Loan Board loans of £10 million.

- 5.5 Investment Performance – The Council manages its investments in-house and invests with the institutions listed in the Council’s approved lending list. The Council invests for a range of periods from over night to 364 days, dependent on the Council’s cash flow, its interest rate view and the interest rates on offer.

	Average Investment	Average Interest Rate	Benchmark Return
Internally Managed	£123,000,000	4.94%	3.56%

- 5.6 The benchmark for internally managed funds is the weighted average 7-day LIBID rate sourced from the Financial Times.
- 5.7 Investments as at 31 March 2009 stood at £76,000,000, whilst the average for the year was £123,000,000. The Council exceeded the benchmark return by 1.38%.
- 5.8 Following the failure of the Icelandic banks in October 2008 the Council took a cautious approach to lending and is operating a restricted lending list in that we would only lend to UK Government guaranteed financial institutions, top 3 Irish Banks covered by the Irish Government guarantee plus the UK government. Subsequently, we stopped making any new investments to Irish Banks, following the down grading of the sovereign credit rating for Ireland.
- 5.9 The Council has also looked to increase it’s credit criteria by not only looking at the long term ratings but other rating components that the rating agencies use such as short term, individual and support rating plus the country sovereignty rating. This methodology was approved at Council on 25th February 2009.
- 5.10 Since the report to Council the banking sector has remained an area of uncertainty and the current policy is that whilst we maintain our lending list in accordance with agreed limits, We continue to operate a more restricted lending list and are only lend to UK Government guaranteed institutions and the UK Government.

6. DEBT RESCHEDULING

- 6.1 The strategy for 2008/09 assumed that 25 and 50 year PWLB rates would vary little during the year. The main way for making savings was therefore to consider the potential for moving from PWLB debt to LOBOs at lower rates. This did not prove to be viable as due to the credit crunch, the supply of LOBO finance generally dried up during the year.
- 6.2 After the Icelandic banks defaulted in October, the Council undertook a review of its investing and borrowing strategies. In the light of the perceived increased risk around holding spare cash as investments and the likely poor rate of return available on such investments once the Monetary Policy Committee had made further cuts in Bank Rate, it was decided to run down cash balances by not undertaking new borrowing from the PWLB to finance capital expenditure. It

was also expected that interest rates were likely to reduce over the next financial year and it was decided to delay borrowing.

- 6.3 On 1st November 2007 the PWLB imposed two rates for each period, one for new borrowing and a new, significantly lower rate for early repayment of debt. The differential between the two rates ranged from 26bp (basis points) in the shorter dated maturities to over 40bp in the longer ones. They also introduced daily movements of 1bp instead of 5bp and rates in half year periods throughout the maturity range (previously had been mainly in 5 year bands). These changes effectively meant that from restructuring the portfolio into new PWLB borrowing would not produce savings.

7. COMPLIANCE WITH TREASURY LIMITS

- 7.1 During the financial year the Council operated within its treasury limits and the Prudential Indicators as set out in the Council's Treasury Strategy Report. The Prudential Indicators were reported to Value for Money Scrutiny Committee every 3 months and the limits have not been exceeded.

8. COMMENTS OF THE DIRECTOR OF FINANCE

- 8.1 The comments of the Director of Finance are contained within this report.

9. COMMENTS OF THE ASSISTANT DIRECTOR (LEGAL AND DEMOCRATIC SERVICES)

- 9.1 There are no direct legal implications for the purpose of this report.

10. RECOMMENDATIONS

- 10.1 To note the borrowing and investment activity for the period 1st April 2008 to 31st March 2009.

LOCAL GOVERNMENT ACT 2000 - BACKGROUND PAPERS

No.	Brief Description of Background Papers	Name/Ext. of holder of file/copy	Department/Location
1.	Loans and Investments Ledger	Rosie Watson Ext: 2563	2 nd Floor Town Hall Ext.
2.	Treasury Management documents	Rosie Watson Ext: 2563	2 nd Floor Town Hall Ext.