Agenda Item No.7.2.

**WYRE FOREST DISTRICT COUNCIL**

**CABINET**
**23RD OCTOBER 2008**

# Report on Treasury Management Service and Actual Prudential Indicators 2007/2008

| OPEN | |
|---|---|
| **SUSTAINABLE COMMUNITY STRATEGY THEME:** | Internal Organisational Theme |
| **CORPORATE PLAN AIM:** | Improving Corporacy & Performance |
| **CABINET MEMBER:** | Councillor John Campion |
| **HEAD OF SERVICE:** | David Buckland, Head of Financial Services |
| **CONTACT OFFICER:** | David Buckland, Ext. 2100<br>david.buckland@wyreforestdc.gov.uk |
| **APPENDICES** | None. |

## 1. PURPOSE OF REPORT

1.1 The annual treasury report is a statutory requirement of the Council's reporting procedures. It covers the treasury activity for 2007/08 and the actual Prudential Indicators for 2007/08.

1.2 The report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

## 2. RECOMMENDATIONS

**The Cabinet is asked to DECIDE:**

1. **The actual 2007/08 Prudential Indicators detailed within the report be approved.**

2. **The Treasury Management Service Report for 2007/08 be approved.**

## 3. EXECUTIVE SUMMARY

3.1 During 2007/08 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

| Actual Prudential Indicators | 2006/07 £'000 | 2007/08 £'000 |
|---|---|---|
| Actual Capital Expenditure | 4,615 | 3,959 |
| Capital Financing Requirement | 1,485 | 1,900 |
| Financing Costs as a proportion of net revenue stream (this is a negative indicator as the Authority is in a net investment position) | (9.70%) | (10.56%) |

3.2 The Head of Financial Services also confirms that prudential borrowing was only undertaken for a capital purpose and the Statutory borrowing limit, the Authorised Limit, was not breached.

3.3 At 31st March 2008, the Council's external debt was £40,862 (£43,847 at 31 March 2007) and its investments totalled £23.828m (£26.557m at 31st March 2007).

## 4. BACKGROUND

4.1 Introduction

This report summarises:

- the capital activity for the year
- how this activity was financed
- the impact on the Council's indebtedness for capital purposes
- the Council's overall treasury position
- the reporting of the required prudential indicators
- a summary of interest rate movements in the year
- debt activity
- investment activity

4.2 Council's Capital Expenditure and Financing 2007/08

4.2.1 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through capital receipts, capital grants, direct revenue financing etc.; or
- If insufficient financing is available the expenditure will give rise to a borrowing need.

4.2.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. Wider information on the regulatory requirements is shown in paragraph 4.10.

4.2.3 The actual capital expenditure forms one of the required prudential indicators. The table below also shows how this was financed.

| | **2006/07 Actual £'000** | **2007/08 Estimate £'000** | **2007/08 Actual £'000** |
|---|---|---|---|
| **Total capital expenditure** | **4,615** | **5,464** | **3,959** |
| Resourced by: | | | |
| Capital receipts | 3,134 | 2,945 | 1,914 |
| Capital grants | 942 | 1,396 | 1,278 |
| Revenue | 181 | 132 | 39 |
| **Unfinanced capital expenditure (additional need to borrow) Relates to Vehicle, Equipment & Systems Renewals Schedule** | **358** | **991** | **728** |

4.3 <u>The Council's Overall Borrowing Need</u>

4.3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. The Council's CFR for the year is shown below, and represents a key prudential indicator.

| **CFR** | **31 March 2007 Actual £'000** | **31 March 2008 Original Indicator £'000** | **31 March 2008 Actual £'000** |
|---|---|---|---|
| Opening balance | 1,359 | 1,485 | 1,485 |
| Add: unfinanced capital expenditure | 358 | 991 | 728 |
| Less: VRP* | (232) | (346) | (313) |
| **Closing balance**<br>**Relates to Vehicle, Equipment & Systems Renewals Schedule** | **1,485** | **2,130** | **1,900** |

- A Voluntary Revenue Provision is made to link the annual charge to revenue with the life of the asset.

4.3.2 The Balance Sheet CFR is reviewed annually by the Head of Financial Services, in liaison with Butlers (the Council's Treasury Consultants), and kept at a manageable level.

4.4 Treasury Position at 31st March 2008

4.4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Head of Financial Services can manage the Council's actual borrowing position by either borrowing to the CFR, choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing), or borrowing for future increases in the CFR (borrowing in advance of need). During 2007/08 the Head of Financial Services managed the debt by the use of temporary cashflow funds and did not utilise external borrowing. The treasury position as at 31st March 2008 compared with the previous year was:

| **Treasury position** | **31st March 2007** | | **31st March 2008** | |
|---|---|---|---|---|
| | **Principal £'000** | **Average Rate** | **Principal £'000** | **Average Rate** |
| **Total Debt** | **44** | **6.08%** | **41** | **6.07%** |
| Fixed Interest Investments | (26,557) | 4.90% | (23,828) | 5.72% |
| Variable Interest Investments(included in fixed) | - | - | - | - |
| **Total Investments** | **(26,557)** | **4.90%** | **(23,828)** | **5.72%** |
| **Net investment position** | **(26,513)** | | **(23,787)** | |

4.5 Prudential Indicators and Compliance Issues

4.5.1 Some of the required prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

4.5.2 **Net Borrowing Levels and the CFR** - In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, exceed the CFR for 2007/08 plus the expected changes to the CFR over 2008/09 and 2009/10. Since the Council's investments considerably exceed the minimal amount borrowed, the net position is well below the CFR. The table below highlights that the Council has complied with this requirement.

| | **31 March 2007 Actual £'000** | **31 March 2008 Original Indicator £'000** | **31 March 2008 Actual £'000** |
|---|---|---|---|
| **Net investment position** | **(26,513)** | **(24,958)** | **(23,787)** |
| **CFR** | **1,485** | **2,130** | **1,900** |

4.5.3 **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2007/08 the Council has maintained gross borrowing within its Authorised Limit.

4.5.4 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

4.5.5 **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| | **2007/08** |
|---|---|
| **Original Indicator - Authorised Limit** | **£3.50m** |
| **Maximum gross borrowing position during 2007/08** | **£788,135** |
| **Original Indicator - Operational Boundary** | **£0.50m** |
| **Average gross borrowing position during 2007/08** | **£55,322** |
| **Minimum gross borrowing position** | **0** |
| **Actual Financing Costs as a proportion of net revenue stream** | **(10.56%)** |

4.6 <u>Economic Background for 2007/08</u>

4.6.1 The rising trend in UK interest rates continued in the first half of the 2007/08 financial year. The domestic economic backdrop continued to present problems for the Monetary Policy Committee, notably in the early summer. CPI inflation breached the 3% upper limit of the Government's target range in April (reported in May), consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices.

4.6.2 Official Bank Rate was raised to 5.5% in May and 5.75% in July in response to the deteriorating inflation outlook. In addition, the Bank of England's May and August Inflation Reports hinted that more hikes might be necessary.

Interest Rates

| End Qtr | Bank Rate | LIBOR | | | PWLB Rates | | |
|---|---|---|---|---|---|---|---|
| | | 3mth | 6mth | 1yr | 5yr | 20yr | 50yr |
| 2007 Mar | 5.25 | 5.6 | 5.8 | 5.9 | 5.35 | 4.80 | 4.45 |
| Jun | 5.50 | 6.0 | 6.1 | 6.3 | 5.80 | 5.20 | 4.80 |
| Sep | 5.75 | 6.3 | 6.3 | 6.2 | 5.25 | 5.00 | 4.75 |
| Dec | 5.50 | 6.0 | 6.0 | 5.8 | 4.64 | 4.63 | 4.47 |
| 2008 Mar | 5.25 | 6.0 | 6.0 | 5.8 | 4.14 | 4.70 | 4.43 |

4.6.3 The market was plunged into chaos in late August as the tightening of credit conditions, triggered initially by the failure of a selection of US mortgage lending institutions, undermined investor confidence. LIBOR rates rose to well over 6.5% as financial organisations' reluctance to lend money to counterparties sparked a severe shortage of funds in the market. In the UK, the crisis came to a head with the failure of the Northern Rock Bank (September) and while the danger of potential meltdown was defused by the Government's decision to guarantee all deposits with this institution, this failed to prevent a prolonged tightening of credit conditions.

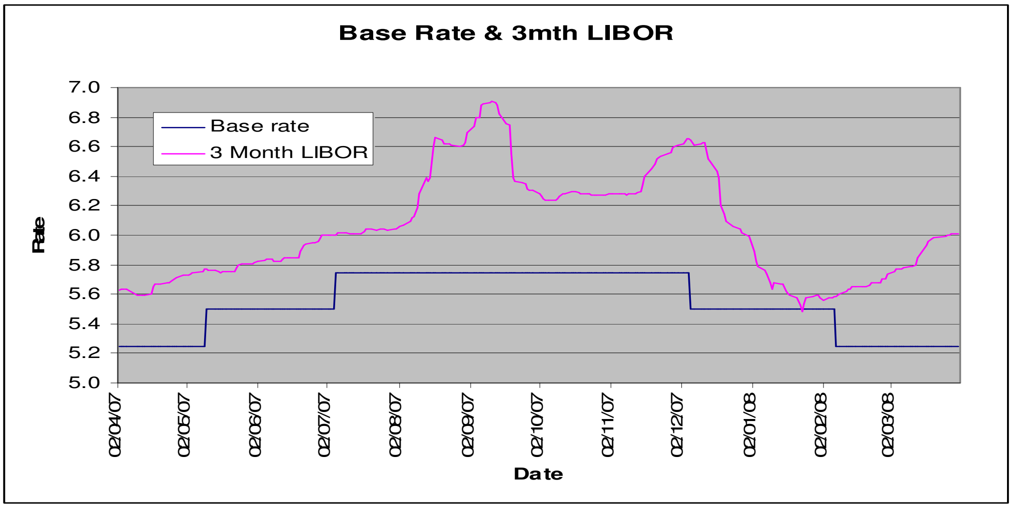
4.6.4 Central banks strove to boost market liquidity via the injection of funds to the banking system and there were signs that this might be working in January. But a series of disappointing financial results and a persistent undercurrent of mistrust ensured a wide margin between official and market rates continued to year end.

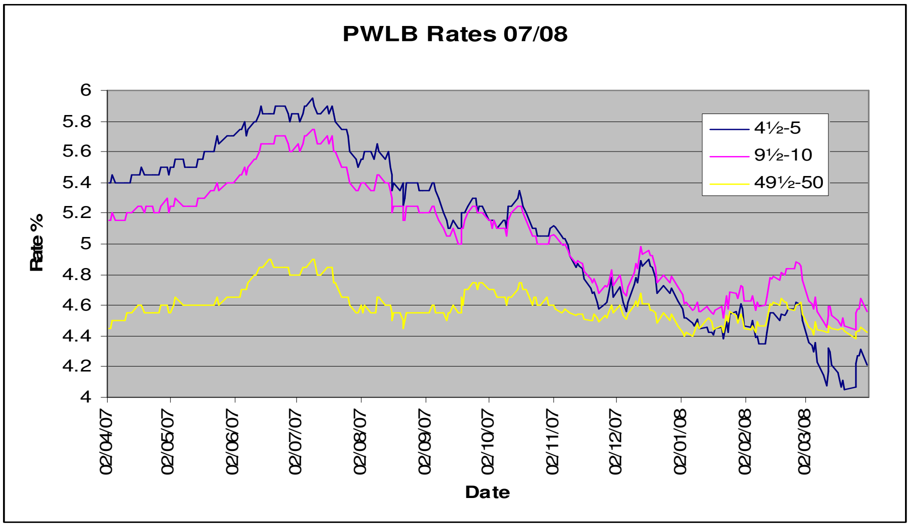
4.6.5 The credit crisis provoked a significant change in the Bank of England's assessment of UK economic prospects over the medium term. It was clearly concerned that the tightening of liquidity and the consequent rise in borrowing rates across the entire economy could lead to a rapid slowdown in activity. This would help to contain inflation pressures. Bank Rate was cut by 0.25% on two occasions, December and February, to end the year at 5.25%.

4.6.6 Long-term rates (gilt yields & PWLB rates) charted an erratic course. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into the new year as concerns persisted that international interest would need to rise further to combat mounting inflation pressures.

4.6.7 Gilt yields peaked in late June and started to slip lower in the summer months. The flight to safe investments triggered by the financial crisis placed strong downward pressure upon gilt-edged yields in August/September notably at the short end of the maturity range and the rally in this part of the market gained momentum as the year drew on.

4.6.8 Progress to lower levels was erratic and limited in the early months of 2008, but the general trend in yields was to lower levels. The most notable development was the reversion of the yield curve to a strongly-positive incline.






4.7 The Strategy Agreed for 2007/08

4.7.1 The strategy provided for 2007/08 was approved by Council on 28th February, 2007 – Council Minute C.97 (14.2).

4.7.2 Full details of the approved strategy can be found in the Report to Cabinet on 22nd February, 2007. In summary the planned treasury activity was as follows:

Borrowing

1. To fund the Capital Programme requirements from the Council's own capital receipts and grants.

2. The Vehicle, Equipment and Systems Renewals to be funded by means of medium term borrowing and direct revenue financing.

3. To fund any projected overdrawn balances by appropriate borrowing.

Investments

1. To lend funds which are surplus (after cash flow requirements have been taken into account) on a longer term basis where short term interest rates are projected to fall or show little upwards movement.

2. Should investment requirements exceed £10million and market conditions are likely to be favourable, to appoint suitable Investment Managers at the appropriate time in accordance with the Council's Standing Orders Relating to Contracts.

3. Alternatively, should short term interest rates be forecast to move noticeably upwards, to lend surplus funds on a shorter term basis, unless materially higher long term interest rates can be obtained, when surplus funds should be lent on a longer term basis.

4.8 Investment Position

4.8.1 **Investment Policy –** The Council's investment policy is governed by guidance issued by the former Office of the Deputy Prime Minister (ODPM), that has been implemented in the annual investment strategy approved by Council on 28th February,2007. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

4.8.2 **Resources –** The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources, excluding other day to day cashflow balances, comprised:

| **Balance Sheet Resources** | **31 March 2007 £'000** | **31 March 2008 £'000** |
|---|---|---|
| General Fund Revenue Balance | 4,101 | 4,197 |
| Earmarked reserves | 2,183 | 1,756 |
| Provisions | 45 | 40 |
| Usable capital receipts | 19,280 | 18,198 |
| **Total** | **25,609** | **24,191** |

4.8.3 **Investments Held by Fund Managers** The Council did not use Fund Managers during 2007/08.

4.8.4 **Investments Held by The Council** - The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds (whose performance may fluctuate more). The Council maintained an average balance of £32.414m and received an average return of 5.72%. The comparable performance indicator is the average 7 day London Interbank Bid (LIBID) rate, which was 5.6%. This compares with a budget assumption of £29.50m investment balances at 5.75% interest rate. External Interest received totalled £1,859,020 compared to the revised budget of £1,724,090.

4.8.5 The Council holds investments on behalf of a number of related bodies including Parish Councils and Kidderminster Educational Foundation.

4.9 Performance Indicator set for 2007/08

This service has set the following performance indicator :-

- Investments – Internal returns (5.72%) above the 7 day London Interbank Bid (LIBID) rate (5.6%)

4.10 Regulatory Framework, Risk and Performance

4.10.1 The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2007/08);
- Statutory Instrument (SI) 3146 2003, as amended, developed the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA) Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the former ODPM (now CLG) has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

4.10.2 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4.10.3 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position.

4.10.4 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

## 5. KEY ISSUES

5.1 Key Issues are contained within paragraph 4 – background.

## 6. FINANCIAL IMPLICATIONS

6.1 The Financial Implications are contained within paragraphs 4.2, 4.3.1, 4.4.1 and 4.8.4.

## 7. LEGAL AND POLICY IMPLICATIONS

7.1 Legal and Policy Implications are contained within paragraph 4.10.1.

## 8. RISK MANAGEMENT

8.1 Risk Management is contained within paragraphs 4.10.2, 4.10.3 and 4.10.4. As demonstrated within this report the current economic position is very erratic. The Council will continue to invest with only those institutions which have the necessary credit ratings in order to preserve the Council's Capital.

## 9. CONCLUSION

9.1 The Cabinet is asked to approve the recommendations, contained within paragraph 2.

## 10. CONSULTEES

10.1 Corporate Management Team
Councillor John Campion, Leader of the Council
Butlers, Treasury Management Consultants

## 11. BACKGROUND PAPERS

11.1 Treasury Management Strategy 2007/08 approved by Council on 28th February, 2007 Council Minute C.97 (14.2).