Agenda Item No. 8.2

WYRE FOREST DISTRICT COUNCIL

CABINET
21ST SEPTEMBER 2010

Annual Report on Treasury Management Service and Actual Prudential Indicators 2009/10

OPEN	
SUSTAINABLE COMMUNITY STRATEGY THEME:	Stronger Communities
CORPORATE PLAN AIM:	A Well-Run and Responsive Council
CABINET MEMBER:	Councillor N J Desmond
DIRECTOR:	Director of Resources
CONTACT OFFICERS:	David Buckland Ext. 2100 david.buckland@wyreforestdc.gov.uk Tracey Southall Ext. 2125 tracey.southall@wyreforestdc.gov.uk
APPENDICES:	None

1. PURPOSE OF REPORT

1.1 The annual Treasury Management Stewardship Report is a statutory requirement of the Council's reporting procedures. It covers the treasury activity for 2009/10 and the actual Prudential Indicators for 2009/10.

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. During 2009/10 the minimum reporting requirements were that the Council receive an annual treasury strategy in advance of the year and an annual report following the year describing the activity compared to the strategy (this report). In the future the Council will also receive a mid year treasury report following regulatory changes.

The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

2. RECOMMENDATION

The Cabinet is recommended to:

1. **Approve the actual 2009/10 Prudential Indicators detailed within this report.**

2. **Note this Treasury Management Stewardship Report for 2009/10.**

3. EXECUTIVE SUMMARY

3.1 During 2009/10 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	2008/09 £'000	2009/10 £'000
Actual Capital Expenditure	4,391	6,147
Capital Financing Requirement	1,829	1,697
Financing Costs as a proportion of net revenue stream (this has changed from negative to positive due to the large reduction in investment income in 2009/10)	(3.51%)	1.80%

3.2 The Director of Resources also confirms that prudential borrowing was only undertaken for capital purposes and the Statutory borrowing limit, the Authorised Limit, was not breached.

3.3 At 31st March 2010, the Council's external debt was £0.035m (£0.038m at 31st March 2009) and its investments totalled £13.179m including an accounting adjustment of £2.256m in respect of Icelandic investments (the investments as at 31st March 2009 were £17.096m including an accounting adjustment in 2008/09 of £3.316m in respect of Icelandic investments). The change in Icelandic accounting adjustments represents an improvement in the anticipated impairment, coupled with a capitalisation of the impairment after the approval of a Capitalisation Direction. This allows the anticipated impairment to be written off over a number of years to minimise the impact on the revenue account.

3.4 The financial year 2009/10 continued the challenging environment of the previous year, although the second half of the year did see the United Kingdom (UK) economy recovering, albeit weakly. The main implications of the exceptional circumstances were deteriorating investment returns, continuing counterparty risk and sums at risk with Icelandic institutions.

3.5 A further Treasury Management Update report was taken to Cabinet on 21st July 2009 to extend the Counterparties with whom the Council can place investments since the lending list had become unmanageable. This Treasury Management Strategy took into account revisions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice. It was considered by the Treasury Management Review Panel and included recommendations from the scrutiny of this Review Panel.

3.6 In 2009/10 the Council received interim distributions in respect of the Icelandic investments totalling £2,165,400. This represents principal totalling £2,099,760 and interest totalling £65,640.

4. BACKGROUND

4.1 Introduction

This report summarises:

- capital activity for the year
- resources the Council applied to pay for this activity
- the impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement)

- the reporting of the required prudential indicators
- overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- a summary of interest rate movements in the year
- the detailed debt activity; and
- the detailed investment activity.

4.2 Council's Capital Expenditure and Financing 2009/10

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

- Financed immediately through the application of capital receipts, capital grants, direct revenue financing etc, which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital 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.

	2008/09 Actual £'000	**2009/10 Estimate £'000**	**2009/10 Actual £'000**
Total capital expenditure	**4,391**	**10,782**	**6,147**
Resourced by:			
Capital receipts	2,893	8,497	4,077
Capital grants	1,131	1,334	1,630
Revenue	55	84	139
Unfinanced capital expenditure (additional need to borrow) Relates to Vehicle, Equipment & Systems Renewals Schedule	**312**	**867**	**301**

4.3 The Council's Overall Borrowing Need

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. It represents 2009/10 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

4.3.2 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. Whilst the Council has a borrowing need, it has sufficient cash resources to postpone any borrowing activity in the near term.

4.3.3 **Reducing the CFR** – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need.

4.3.4 This statutory revenue is called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

4.3.5 The Council's 2009/10 MRP Policy (as required by Communities & Local Government (CLG) Guidance) was approved by Council on 25th February 2009.

4.3.6 The Council's CFR for the year is shown below and represents a key prudential indicator.

CFR	**31 March 2009 Actual £'000**	**31 March 2010 Original Indicator £'000**	**31 March 2010 Actual £'000**
Opening balance	1,900	1,829	1,829
Add: unfinanced capital expenditure	312	367	301
Less: MRP*	(383)	(487)	(433)
Closing balance **Relates to Vehicle, Equipment & Systems Renewals Schedule**	**1,829**	**1,709**	**1,697**

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

4.3.7 The Balance Sheet CFR is reviewed annually by the Director of Resources, in liaison with the Council's Treasury Consultants, and kept at a manageable level.

4.4 <u>Treasury Position at 31st March 2010</u>

4.4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Director of Resources can manage the Council's actual borrowing position by either

- borrowing to the CFR; or
- choosing to utilise some temporary internal cash flow funds in lieu of borrowing (under-borrowing); or
- borrowing for future increases in the CFR (borrowing in advance of need).

4.4.2 The figures in this report are based upon the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

4.4.3 During 2009/10 the Director of Resources managed the debt by the use of temporary cashflow funds and did not utilise external borrowing. The treasury position at the 31st March 2010 compared with the previous year is shown below and highlights the significant fall in investment income:

Treasury position	31st March 2009		31st March 2010	
	Principal £'000	Average Rate	Principal £'000	Average Rate
Total Debt	**38**	**6.11%**	**35**	**6.03%**
Fixed Interest Investments	(17,096)*	4.73%*	(13,179)*	0.94%*
Variable Interest Investments(**included within fixed investments, detailed above**)	-	-	-	-
Total Investments	**(17,096)***	**4.73%***	**(13,179)***	**0.94%***
Net investment position	**(17,058)**		**(13,144)**	

*Principal at 31st March 2009 & 2010 includes Icelandic investments at impaired values. The average rate achieved excludes Icelandic investments.

4.5 Prudential Indicators and Compliance Issues

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

4.5.2 **Net Borrowing 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 2008/09 plus the expected changes to the CFR over 2009/10 and 2010/11. 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 2009 Actual £'000	31 March 2010 Original Indicator £'000	31 March 2010 Actual £'000
Net investment position	**(17,058)**	**(15,964)**	**(13,144)**
CFR	**1,829**	**1,709**	**1,697**

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 2009/10 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. It is not a statutory limit, but represents local expectation. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached and close monitoring.

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.

	2009/10
Original Indicator - Authorised Limit	**£5.0m**
Maximum gross borrowing position during 2009/10	**£2.5m**
Original Indicator - Operational Boundary	**£0.80m**
Average gross borrowing position during 2009/10	**£0.029m**
Minimum gross borrowing position	**0**
Actual Financing Costs as a proportion of net revenue stream	**1.80%**

4.6 Economic Background for 2009/10

4.6.1 Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. UK Gross Domestic Product (GDP) data for the first half of 2009 registered its sharpest fall for over 20 years.

4.6.2 It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more ‘normal’ behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor United States (US) banks continued to fail and the troubles of a number of building societies continued to make the headlines.

4.6.3 The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle was passed during the third quarter of the year but the return to positive growth proved stubborn; for the UK this would not materialise until the fourth quarter of 2009/10.

4.6.4 Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector’s striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

4.6.5 The bias of Monetary Policy Committee (MPC) decisions remained directed towards policy ease throughout the year (0.5% Bank Rate) in March 2009; monetary relaxation took the form of the extension of the Quantitative Easing (QE) programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November.

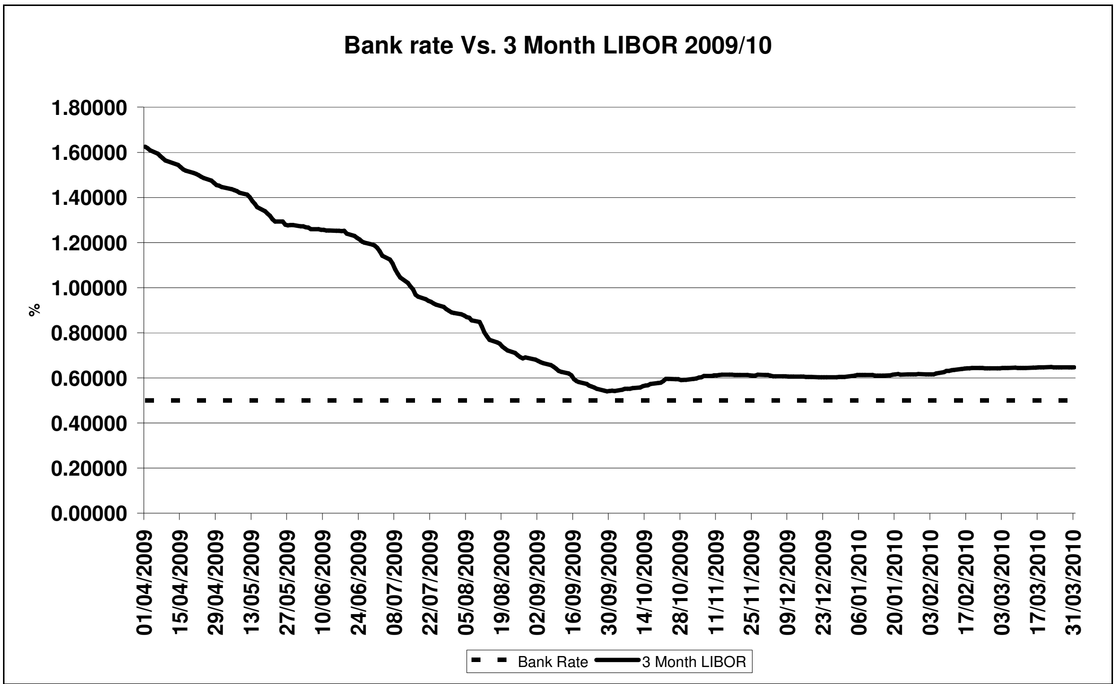
4.6.6 The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between London Interbank Offered Rate (LIBOR) and London Interbank Bid Rate (LIBID) rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematical through to year-end.

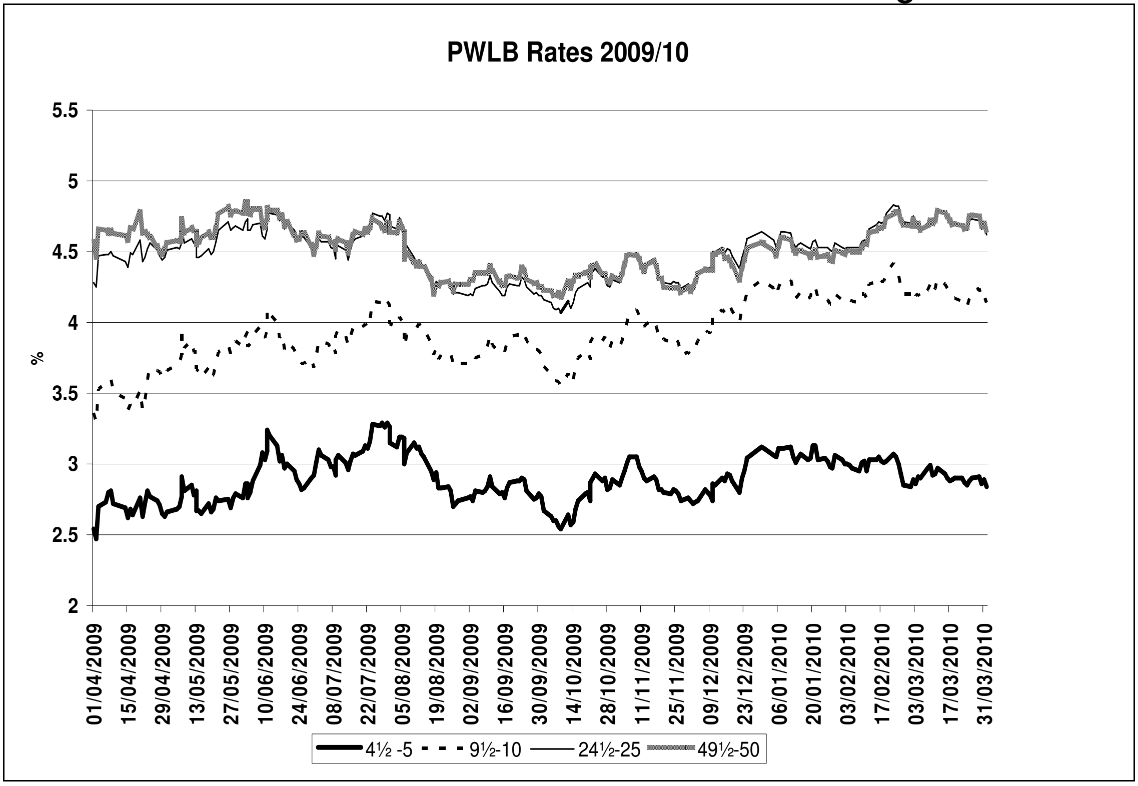
4.6.7 Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The QE programme was the principal source of market support. The large-scale purchasing of stock that this element of monetary policy required meant the Bank of England was to absorb virtually all of the year's supply.

4.6.8 Nevertheless, the programme was not sufficient to drive yields below the low point seen immediately after the inauguration of the QE programme in March 2009. Long-term rates remained generally erratic, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end. Indeed, yields returned to a rising trend once QE drew to a close in January 2010.

4.6.9 At 31st March 2010 the Council had £6.9m of investments with Icelandic institutions. All accrued interest up until bank failure date has been accounted for in accordance with CIPFA Local Authority Accounting Panel (LAAP) Bulletin 82. The investments have been impaired in line with proper accounting practice and the CLG Regulations. Further accounting adjustments will be made in subsequent financial years.

4.6.10 The indicative rates for 2009/10 are shown below:





4.7 The Strategy Agreed for 2009/10

4.7.1 The strategy for 2009/10 was approved by Council on 25th February 2009 – Council Minute C.80 (12.2). Following this, there were further reductions in Credit Ratings, most notably Moody's (one of the three credit rating agencies that the Council utilises), leaving only one bank and one building society on the Council's approved Counterparty list. In response, Cabinet on 21st July 2009 recommended to Council to update the lending criteria. The Treasury Management Update was approved by Council on 29th July 2009 – Council Minute CM.43.

4.7.2 Full details of the approved strategy can be found in the Report to Cabinet on 19th February 2009, along with revisions to the strategy on 21st July 2009. In summary the planned treasury activity was as follows:

Borrowing

1. To fund the Capital Programme requirements from the Council's own capital receipts, grants, direct revenue funding and borrowing as appropriate.

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

3. To fund any overdrawn balances by appropriate borrowing.

Investment

1. To lend funds which are surplus (after cash flow requirements have been taken into account) on a short term basis until the banking system returns to 'normal' conditions.

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

4.8 Investment Position

4.8.1 **Investment Policy –** The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by Council on 25th February 2009. The investment activity during the year conformed to the approved strategy, and the only liquidity difficulties were the investments that had been 'frozen' due to the collapse of the Icelandic banking system.

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 2009 £'000	31 March 2010 £'000
General Fund Revenue Balance	2,843	2,976
Earmarked reserves	1,730	1,426
Provisions	238	195
Usable capital receipts	15,328	11,887
Total	**20,139**	**16,484**

4.8.3 **Investments Held by Fund Managers** - The Council did not use Fund Managers during 2009/10.

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 £16.824m excluding Icelandic investments and received an average return of 0.94%. The comparable performance indicator is the average 7 day London Interbank Bid (LIBID) rate, which was 0.37%. External Interest received totalled £157,085 compared to the revised budget of £144,300.

4.8.5 The Economic Background for 2009/10 (see Section 4.6) sets out the continuing difficulties in economic conditions during this period. As a result of the deterioration, interest rates remained at historic lows impacting adversely on investment returns. Concerns over the security of financial institutions continued, resulting in a defensive investment position.

4.8.6 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 2009/10

4.9.1 This service has set the following performance indicator:

- Investments – Internal returns (0.94%) above the 7 day London Interbank Bid (LIBID) rate (0.37%)

4.9.2 Security and liquidity benchmarks are being developed and introduced for 2010/11 and will be reported in the mid year monitoring and the annual stewardship reports in the future.

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 2009/10);
- 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 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 has fully co-operated with a number of internal and external reviews into the Icelandic investments, including a member Treasury Management Review Panel, that showed full compliance with all approved policies and procedures.

4.10.4 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. It should be noted that following a competitive procurement process a new contract with Sector has been awarded, commencing 1st September 2010.

4.10.5 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; as a result, the risk is managed by more frequent and detailed reviews supported by the Treasury Management Panel. 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. EQUALITY IMPACT ASSESSMENT

9.1 This is a financial report and there is no requirement to consider an Equality Impact Assessment.

10. CONCLUSION

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

11. CONSULTEES

11.1 Corporate Management Team
Butlers, Treasury Management Consultants

12. BACKGROUND PAPERS

12.1 Treasury Management Strategy 2009/10 approved by Council on 25th February 2009 - Council Minute C.80 (12.2).

12.2 Treasury Management Update 2009/10 approved by Council on 29th July 2009 - Council Minute CM.43.