BLACKBURN with DARWEN BOROUGH COUNCIL

REPORT OF:	DIRECTOR OF FINANCE
TO:	COUNCIL
ON:	30th September 2010

SUBJECT : TREASURY MANAGEMENT ANNUAL REPORT 2009-10 AND MID-YEAR REVIEW FOR 2010-11

1. PURPOSE OF THE REPORT

1.1 To advise Members of Treasury Management performance for 2009-10, and update Members with regard to the position to date in 2010-11.

2. RECOMMENDATIONS

2.1 The Council is recommended to note this report.

3. BACKGROUND

3.1 In March 2009, the Council agreed a Treasury Management Strategy for 2009-10.

3.2 In March 2010 the Council adopted the 2009 edition of the *CIPFA Treasury Management in the Public Services: Code of Practice*, and agreed a Treasury Management Strategy for 2010-11.

4. RATIONALE

4.1 The CIPFA Treasury Management Code requires the Council to approve a Treasury Management Strategy (including various Treasury Management indicators) before the start of each financial year, and to consider both the outturn after each year end, and the mid-year position in each current year. The Council agreed to combine the outturn and mid-year review into a single report.

5. KEY ISSUES

5.1 The Council has operated within CIPFA and statutory guidance and requirements in respect of Treasury Management practice. The approved Treasury Management Policy Statement, and more detailed Treasury Management Practices, and each year's Annual Strategy, have all emphasised the importance of Security and Liquidity over Yield.

5.2 **2009/10 - Treasury Management Strategy**

The Council approved the 2009/10 Treasury Management Strategy at its meeting on 2nd March 2009. The Council's stated borrowing strategy was to take up borrowing to cover capital programme funding requirements, of mixed duration, dealing pragmatically with changing circumstances, such as actual or anticipated movements in interest rates.

The Council's stated investment strategy was to optimise returns within the constraints of prioritising security and yield, though it was recognised that interest rates were likely to be very low.

However it was also anticipated that the Council may "borrow internally" i.e. not take on new long term borrowing and reduce the Council's investment portfolio, because long term borrowing rates were expected to be higher than rates on the loss of investment income. This would also have the benefit of reducing exposure to interest rate and credit risk.

5.3 **2009/10 - Economic Review**

By the start of the financial year in April 2009, the UK economy had already contracted by around 5%, due to a sharp fall in private sector spending. The financial crisis in late 2008 had prompted the Government to implement of a number of extraordinary government measures, including capital injections in some banks and the Credit Guarantee Scheme, to keep the banking system afloat amidst a wave of mistrust in financial markets.

In an attempt to avoid a more severe recession and possible deflation, the Bank of England had cut Bank Rate to 0.5% in March, where it remained for the whole year. To further loosen monetary policy, the Bank initiated a policy of quantitative easing. By using newly-created central bank reserves to purchase £200 billion of government and commercial financial assets, policymakers hoped to stimulate spending and economic activity.

As the financial year progressed and the effects of fiscal and monetary stimulus were more widely felt, the pace of economic contraction gradually declined. However, despite improving business survey evidence, the UK economy continued to contract until quarter four.

As a consequence of the recession and the various fiscal stimulus packages, UK Government borrowing soared. By the end of year, the national debt had reached £890 billion (62% of GDP).

By the end of the year, the UK economy was undergoing a limited recovery, as weak domestic demand persisted into the medium term. Elevated spare capacity is expected to reduce inflationary pressure, giving the Bank flexibility to maintain loose monetary policy. This could prove useful because the UK and other national governments are under intense pressure to engage in fiscal consolidation, cutting spending and raising taxes in order to control debt levels. Although fears of a double-dip recession may eventually prove unfounded, austerity measures introduced by national governments will weigh on future economic activity.

Market interest rates fell markedly over the year, as set out in the table of London Interbank Offer Rate (LIBOR) rates below, and this impacted on the interest earned on the Council's investments.

LIBOR Rates for 2009/10 were:-

	Opening	Closing	High	Low	Average
Call/over night	0.62%	0.54%	0.62%	0.50%	0.53%
1 month	1.01%	0.55%	1.01%	0.50%	0.59%
3 months	1.63%	0.65%	1.63%	0.54%	0.85%
12 months	2.05%	1.32%	2.05%	1.08%	1.41%

The cost of **long term borrowing,** measured by movements in PWLB rates, tended to rise somewhat across the year, peaking in late February/early March, before falling a little towards year end. These rates are driven by the demand for gilts – government debt financing instruments.

PWLB maturity loan interest rates for 2009/10 were: -

	Opening	Closing	High	Low	Average
4.5–5 years	2.54%	2.89%	3.29%	2.47%	2.90%
9.5–10 years	3.36%	4.19%	4.42%	3.30%	3.93%
24.5–25 years	4.28%	4.67%	4.83%	4.07%	4.49%
49.5–50 years	4.57%	4.70%	4.85%	4.18%	4.52%

5.4 **2009/10 - Summary of Treasury Management transactions / performance report**

Debt and investment positions at the start and end of the year were as follows:

	31st Mar 2010 Principal	Rate/ Return	*Av Life yrs*	31st Mar 2009 Principal	Rate/ Return	*Av Life Yrs*
Fixed Rate Funding:						
- PWLB	£88.8m	5.04%	*33.3*	£88.8m	5.04%	*34.3*
- Market	£10.4m	4.10%	*44.7*	£10.4m	4.10%	*45.7*
	£99.2m			£99.2m		
Variable Rate Funding						
- PWLB	£2.0m	0.65%	*1.0*	£2.0m	1.50%	*2.0*
- Market	£13.5m	6.28%	*21.2*	£15.5m	6.28%	*22.2*
	£15.5m			£15.5m		
Total Debt managed by BwDBC	**£114.7m**	**5.03%**	***33.3***	**£114.7m**	**5.04%**	***33.3***
Other Long Term Liabilities – Debt managed by LCC	£21.3m	Actual LCC 09/10 rate 4.45%		£22.2m	Actual LCC 08/09 rate 5.05%	
Total Debt	**£136.0m**			**£136.9m**		
Total Investments	**£14.0m**	1.31%		**£26.6m**	5.02%	

Borrowing Rates are NOT weighted for duration
Average Lives are for PWLB & Money Market Borrowing only (excluding £0.4m irredeemable stock)
Investment Rates show return across the year

Other than the reduction in the element managed by LCC, there was no change in the Council's debt position across the year. Interest paid on that debt was around £6.65 million, compared to the original budget of around £7.6 million. The saving was as a result of taking on no new debt, either short or long-term.

No debt restructuring was undertaken in the year, as no opportunities for achieving material benefits from doing so were identified.

There was no material change in the interest rate payable on the Council's debt across the year.

The decision to take on no new debt, and borrow internally by managing down investment balances instead, meant that by the end of the year, the Council's borrowing was around £24 million less than its Capital Financing Requirement (outstanding indebtedness arising from the Capital Programme), and investment balances were, therefore, significantly lower than they would otherwise have been. This, combined with the fall in interest rates available, together with the adoption of a more cautious and short-term approach to investment, significantly reduced the amount of interest earned on balances.

The average investment balance across the year was around £37 million (2008/09 around £50 million). Balances tend to fall to their lowest point at the start and end of each year. The gross interest earned in year was around £0.48 million (2008/09 £2.53 million) at an average rate of 1.3% (2008/09 5.0%). The original 2009/10 budget for gross interest earned was around £0.63 million.

The average rate of return on investments was protected somewhat by the Council benefiting from deals entered into before rates fell to their lowest points. This effect will be less marked in 2010/11, as the full impact of the fall in interest rates will be felt.

The position with regard to performance against Prudential Indicators is summarised in the Appendix. There are no material issues to highlight.

The only breach of the Indicators set was in respect of the Variable Interest Rate Exposure. This limit was set at zero, but the actual position became a net positive exposure by the end of the year, as a result of the variable part of our investment balance (effectively all funds maturing in the year) having fallen to a smaller amount than the variable part of our debt. In terms of interest rate risk management, this was very much a "technical" breach of the indicator, as not only was none of the nominally variable debt "called" this year, but a large part of it was at such interest rates that it was never likely to be called. No further action was therefore required in respect of the breach.

In summary, the outturn position in respect of interest income and costs is as follows:

	Original Budget 2009/10	Revised Budget 2009/10	Outturn 2009/10
	£000	£000	£000
External interest payments	7,596	6,892	6,687
Interest receipts	(559)	(431)	(459)
Provision for debt repayment	6,498	6,035	6,002

5.5 **2010/11 - Treasury Management Strategy**

The Treasury Management Strategy for 2010/11 was approved by Council on 1st March 2010.

With short-term interest rates expected to continue to be lower than long-term rates, it was acknowledged that it may continue to be more cost effective to not borrow and reduce the level of investments instead. However it was recognised that long-term interest rates were expected to rise in the future, so the short-term savings would need to be balanced against potential longer term costs.

Cash balances would need to be maintained for managing short-term Council cashflow, with any balances over and above that being invested either in the medium term (out to a year) or in the longer term (over a year). Throughout, priority to be given to security of funds and liquidity (accessibility) over yield (or return).

The limits to investment by reference to amount, duration and credit rating were revised from those applying in previous years, but were mainly unchanged or tightened slightly. The main difference was the addition of certain unrated building societies - with tight limits as to duration and amount invested – with a view to diversifying the overall investment portfolio.

5.6 **2010/11 - Mid-year review of strategy**

Interest rates have continued to remain very low, and current expectations are that they will remain low for longer than previously projected.

In the light of the anticipated significant reductions in funding for local authorities, there has already been a review of the timing and extent of planned capital spending. This, together with lower than anticipated borrowing requirements for capital spending in 2009/10, will reduce the expected borrowing needs this year. As yet, there has still been no need to undertake any borrowing, but, it is expected that the Council will need to do so in the current year.

It has already been reported through Corporate Revenue Budget Monitoring that interest costs will be lower as a result of lower borrowing. This has been partly offset by lower returns on investments, because interest rates remain exceptionally low and because cash balances have continued to be managed downwards.

There is no need, at this stage, to reframe the overall strategy set at the start of the year.

5.7 **Risk Management**

The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. The majority of its surplus cash is therefore held as short-term investments with the UK Government, highly rated banks and pooled funds. In addition, the Council holds some investments that entail a slightly higher level of risk, including callable deposits (where there is a risk that changing interest rates may mean that the loan does not run to full term) and unrated building society deposits (where risks have been mitigated by limiting the amount and duration of exposure).

The Council's primary objective for the management of its debt is to ensure its long-term affordability. The majority of its loans (£88.8 million) have therefore been borrowed from the Public Works Loan Board at long-term fixed rates of interest.

The other significant element of the Council's debt is £23.5 million of "lender's option, borrower's option" (LOBO) loans with initially fixed (and initially low) rates of interest. This exposes the Council to some risk of rising long-term interest rates, but that is mitigated by the fact that £10 million of this debt (forming a large part of the lowest interest rate elements) can only be "called" once in every five years.

The combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. This risk is partially mitigated by the inclusion of some longer-term investments and some variable rate borrowing.

6. POLICY IMPLICATIONS

None

7. FINANCIAL IMPLICATIONS

The financial implications arising from the 2009/10 Treasury Outturn and latest position for 2010/11 have been incorporated into Corporate Budget Monitoring Reports in 2010/11

8. LEGAL IMPLICATIONS

Under the Local Government Act 2003, local authorities determine locally their levels of capital investment and associated borrowing. The Prudential Code has been developed to support local authorities in taking these decisions, and the Council is required by Regulation to have regard to the Code when carrying out its duties under Part 1 of the Local Government Act 2003.

The Department for Communities and Local Government has issued Guidance on Local Government Investments, under the Local Government Act 2003, effective from 1st April 2010. Under this, authorities should manage their investments within an approved strategy, setting out what categories of investment they will use and how they assess and manage the risk of loss of investments.

9. RESOURCE IMPLICATIONS

None as a direct consequence of this report.

10. CONSULTATIONS

None

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Background Papers:	Treasury Management strategies for 2009/10 and 2010/11 approved at Council 2nd March 2009 and 1st March 2010 respectively