THE HIGHLAND COUNCIL

RESOURCES COMMITTEE

Wednesday 1st October 2008

Agenda Item	
Report No	

Treasury Management Report – 2007/08

Report by Director of Finance

Summary

The attached Treasury Management Report for 2007/08 is prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) revised Code of Practice on Treasury Management in Local Authorities. The Code was adopted by the Council on 26th February 2002.

The report highlights the Council's Treasury Management activities undertaken in the year and compares them to the expected activities contained in the annual Treasury Strategy Statement which was presented to, and approved by, the Resources Committee on 21st March 2007.

In addition the Prudential Code requires the Council to report the actual prudential indicators after the financial year end and they are contained in this report.

This report demonstrates achievement of efficiencies in the delivery of the Council's treasury management activities in accordance with the Council's Programme for Administration.

Annual Report on the Treasury Management Service - 2007/08

1. Introduction

1.1 In December 2001, CIPFA published a Revised Code of Practice on Treasury Management with a suggested implementation date of 1 April 2002. The Council adopted the revised Code in February 2002 and fully complies with its requirements.

1.2 The primary requirements of the Code are the;

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the Council of an Annual Strategy Report for the year ahead and an Annual Review Report of the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.3 Treasury Management in this context is defined as;

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks".

1.4 This report sets out:

- The Strategy agreed for 2007/08
- Performance Measurement
- The Council's treasury position at the year end
- A summary of the economic factors affecting the Strategy over 2007/08
- Treasury decisions taken and revenue effects
- Performance and Risk
- Compliance with the Council's procedures and Prudential Indicators

2. The Strategy for 2007/08

2.1 The treasury strategy for 2007/08 was based on the expectation that the 50 year Public Works Loan Board (PWLB) rate would generally remain flat at around 4.25%. The 25-30 year PWLB rate was expected to stay at 4.50% throughout the year and the 10 and 5 year rates would also fall during 2007/08 to a low of 4.5%.

2.3 Assuming that the 50 year PWLB rate fell back in line with the central forecast rate of 4.25 % borrowing should be made in this area of the market at the appropriate time in the financial year.

2.4 The strategy for 2007/08 estimated borrowing of £18.7m being required during the year after allowing for grants and other external funding, loan maturities and budgeted instalments.

3. Performance Measurement

3.1 One of the key changes in the revisions of the Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, the traditional average portfolio rate of interest remains the principal debt performance indicator (as incorporated in the table at section 4.1)

4. The Council's treasury position at the year end

4.1 The treasury position at the 31 March 2008 compared with the previous year was:

	31 March 2008		31 March 2007	
	Principal £m	**Average Rate (%)**	**Principal £m**	**Average Rate (%)**
Fixed Interest Rate Debt	478.3	5.48	570.96	5.30
Variable Interest rate Debt	96.2	4.47	10.47	7.24
Total Debt	574.5	5.31	581.43	5.34

Fixed Interest Investments	34.2	5.81	44.30	5.47
Variable Interest Investments	13.5	5.57	15.10	5.35
Total Investments	47.7	5.74	59.40	5.44

4.2 The figures highlight a welcome reduction in the average interest rate on external borrowings from 5.34% at March 2007 to 5.31% at March 2008 and a welcome increase in the average investment rate from 5.44% to 5.74%

5. A Summary of the economic factors affecting the Strategy over 2007/08

5.1 Economic Trends for 2007/08

5.2 2007/08 was a year of considerable volatility caused by a serious loss of liquidity in the banking and mortgage sectors as a result of the "Credit Crunch". In addition some commodity prices, and in particular, oil created concerns about supply led inflation. The combination of these factors raised the spectre of recession in many western countries.

5.3 The Federal Reserve in the US and the European Central Bank injected significant sums into the markets to try and increase liquidity. However, this had little effect and between the 17th August and 11th December 2007 the Federal Reserve cut interest rates from 5.75% to 4.25% in a further attempt to stimulate lending.

5.4 The Bank of England was more reluctant to inject cash into the markets and initially only made cash available at a penal rate of 1% above Bank Rate. However on 14th September the Bank of England announced that it had provided billions of pounds of financial support to Northern Rock. On 17th September the Chancellor announced a Government guarantee for all deposits held at the stricken bank, and on 18th February the Government announced that it would nationalise Northern Rock.

5.5 The PWLB 45-50 year rate started the year at 4.45% and fell to a low of 4.38% in March 2008. The high point for rates in this period was 4.90% and the rate at the end of the year was 4.42%. This volatility in yields was a direct reflection of the massive turnaround in interest rate sentiment brought about by the sub-prime crisis in the US.

5.6 A summary of the interest rate movements throughout 2007/08 is provided in the Table below;

End Period		Bank Rate	LIBOR*			PWLB		
			3 mth	6 mth	12 mth	5 yr	10-15 yr	20-25 yr
2007	Mar	5.25	5.56	5.66	5.68	5.25	4.95	4.66
	Jun	5.50	5.88	6.03	6.24	5.82	5.59	5.18
	Sep	5.75	6.64	6.56	6.43	5.23	5.13	4.88
	Dec	5.50	6.36	6.18	5.92	4.74	4.80	4.65
2008	Mar	5.25	5.42	6.14	6.29	4.23	4.67	4.59

* LIBOR – London Inter-bank Offered Rate

6. Treasury decisions taken and revenue effects

6.1 **Borrowing-**. The initial estimated borrowing requirement for 2007/08 of £18.7m was based on a net capital expenditure estimate of £45.5m. This borrowing requirement was revised during the year to £22.3m to reflect an increased capital expenditure programme. On 2nd August 2007 a loan of £10m at a rate of 4.55% was secured and on 21st August another £5m was borrowed at a rate of 4.45%. On 13 March 2008 a further £5m was borrowed taking advantage of a drop in the 4 year PWLB rate to 3.99%.

In the event, due to slippage in the capital programme, actual net capital expenditure for the year was £30.4m and maturing long-term debt was £0.2m. Budgeted loan charge instalments funded £27.3m giving a net borrowing requirement of £3.3m. The excess borrowing during the year against the out-turn borrowing requirement has been offset against the 2008/09 borrowing requirement in accordance with the Prudential Code.

Borrowing Requirement	2007/08 Estimate £m	2007/08 Actual £m
Net Capital Expenditure	45.5	30.4
Add Loan maturities	0.2	0.2
Less Loan Instalments	27.0	27.3
Net Borrowing Requirement	18.7	3.3
Long Term Borrowing	18.7	20.0

6.2 **Rescheduling**

6.2.1 In July 2007 the Council, in consultation with its treasury advisors, undertook a loan rescheduling exercise to take advantage of lower interest rates. Four PWLB loans totalling £67,399,117, with an average remaining life of 25.3 years and an average interest rate of 5.36%, were repaid and replaced with one fixed rate maturity loan repayable over 49.5 years at a rate of 4.80% per annum and generating annual savings of £376.7k for 17 years. Breakage costs were minimal.

6.2.2 In October 2007 a fixed rate maturity PWLB loan of £11,540,076 with a remaining life of 24.95 years and an interest rate of 4.85%,was repaid. This generated a discount of £245,215 and enabled investment levels to be reduced, thus reducing risk.

6.2.3 A summary of Outstanding Deferred Revenue Costs attributable to debt rescheduling exercises undertaken to date is provided in the table below.

	Outstanding 31 March 2007 £'000	Incurred 2007/08 £'000	Written off 2007/08 £'000	Outstanding 31 March 2008 £'000
Premiums	45,509	2,687	(4,765)	43,431
Discounts	(1,337)	(3,088)	3,167	(1,258)
Net Deferred Revenue Costs	44,172	(401)	(1,598)	42,173

These costs are written off over the maturity periods of the new rescheduled loans.

6.3 The Council's average loans fund interest rate for the year was 5.36% against a budgeted rate of 5.60%. This contributed to a General Fund budgetary saving on loan charges, together with debt rescheduling, of £1.93m in the year which strengthened the Council's balances.

6.4 **Investments Held by The Council** –

Short-term investments (other than overnight placements with the Council's bankers) can be placed for periods up to 364 days dependent on the Council's cash flows and the interest rates on offer. In practice however, virtually all investments are transacted for short-term portfolio management purposes and are managed in- house to limit risk and optimise returns. Investments are restricted to institutions listed in the Council's standard lending list which incorporates strict credit- worthiness criteria.

6.4.1 Summary of Investments made during the year:-

Managed	No.	Average Sum Invested (£m)	Average Duration (Days)	Average Return %	Benchmark Return %
Internally	167	3.5	61	5.84	5.58

6.4.2 A positive return of 5.84% on these investments was achieved during the year. This performance exceeded the comparable indicator which is the average 7-day London Inter-bank Bid Rate (LIBID).

6.4.3 No institutions in which investments were made showed any difficulty in repaying the investment and interest in full during the year.

7. Performance and Risk

7.1 The Council's debt portfolio has been proactively managed over the year and Officers have continued to take advantage of the relatively low interest rates on offer to favourably position the debt portfolio against potential adverse interest rate movements.

7.2 As a consequence, there is limited risk of volatility of costs in the current debt portfolio as the interest rates are predominantly at attractive, fixed long-term levels (£529.14m representing 92.11% of the total portfolio).

7.3 All major borrowing, rescheduling and restructuring decisions were undertaken after prior consultation with the Council's treasury advisers. Current indications are that assumptions made on future long term interest rate movements are still in line with subsequent market movements, taking into account the recent unexpected volatility in short term rates.

7.4 Returns on the Council's investments are predominantly determined by short-term variable rates. Whilst this can introduce an element of volatility to returns, it is minimal in terms of the total debt portfolio. Risk, in relation to the potential loss of principal, is minimised through the Council's restricted lending list.

7.5 The Council uses three firms of money market brokers to facilitate short-term borrowing and investment deals. This ensures competitive market rates are obtained. In 2007/08 the new deals transacted through brokers were shared in the ratio 52%, 36% and 12%. All brokers charged the same level of commission per transaction and performed satisfactorily. In addition, the Council's treasury management staff have direct lines to a few major banks to facilitate investment business.

8. Compliance with the Council's procedures and Prudential Indicators

8.1 The Council has complied with its internal procedures and the requirements of the CIPFA Code of Practice on Treasury Management. The Council is bound by best practice requirements, which involve limits to be set and adhered to in relation to short-term borrowing and exposure to variable interest rates. The following table identifies the Council's limits that apply to these requirements.

8.2

Requirement	Council Limit £m	Maximum 2007/08 £m	Position 31/3/08 £m
The maximum the Council may have outstanding by way of short term borrowing (net of investments) - (25% of the outstanding long-term debt).	143.60 (25.00%)	-35.6 (-6.3%)	-47.6 (-8.49%)
The total amount of exposure to variable interest rates (net of investments)- (35% of the total outstanding loan advances).	210.9 (35.00%)	30.9 (5.13%)	30.9 (5.13%)

8.3 The Council complied with both these limits for the course of the year.

9. The Prudential Code – Indicators

9.1 The Council is required by the Prudential Code to report the actual prudential indicators compared with actual treasury positions at the year-end. Appendix A provides details of all the mandatory, estimated and actual prudential indicators for the year 2007/08. The indicators which provide either an overview or a limit on treasury activity are shown below:

	31 March 2008 Actual	31 March 2008 Estimated Indicator
Net borrowing position	£525m	£585m
Capital Financing Requirement (General Fund and HRA)	£567.7m	£589.6m

9.2 The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is a gauge for the Council's debt position shown above. In order to ensure that over the medium term borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short term, exceed the CFR for 2007/08. The table above highlights that the Council has complied with this requirement.

	2007/08
Original Indicator - Authorised Limit	£640.2m
Original Indicator - Operational Boundary	£607.8m
Maximum borrowing position during the year	£590.5m
Minimum borrowing position during the year	£571.6m

9.3 The Council is required to agree an Authorised Limit for borrowing for the year. This figure provides for estimated contingencies which may require to be funded in the year in addition to planned capital expenditure. The table demonstrates that during 2007/08 the Council maintained its gross borrowing within its Authorised Limit.

9.4 The Operational Boundary, also approved by the Council in compliance with the Code, is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

Recommendation

Members are asked to note the report.

This Treasury Management Report is a document impacting on the whole of the Highland population and therefore all aspects of equalities have to be cross referenced against all duties which apply. This Treasury Management Report has been screened for its impact on equalities groups and does not require a full equalities impact assessment.

Signature:	
Designation:	Depute Chief Executive and Director of Finance
Date:	10th September 2008
Author:	Brian Williams, Head of Corporate Finance
Direct Tel. No.:	01463 702427

Appendix A

Estimated and Actual Treasury Position and Prudential Indicators

	Figures are for financial year unless otherwise titled in italics	2007/08 Actual	2007/08 Original Indicator	2006/07 Actual
1	Capital Expenditure (Gross)			
	General Fund	£56.5m	£56.37m	£52.1m
	Housing Revenue Account	£12.7m	£12.65m	£13.47m
2	Capital Financing Requirement (CFR) at 31 March			
	General Fund	£421.4m	£440.3m	£408.8m
	Housing Revenue Account	£146.3m	£149.3m	£153.4m
	Total	£567.7m	£589.6m	£562.2m
3	Treasury Position at 31 March			
	Borrowing	£573.3m	£590.5m	£581.4m
	Other Long Term Liabilities	-	-	-
	Total Debt	£573.3m	£590.5m	£581.4m
	Investments	£47.7m	£5.0m	£59.4m
	Net Borrowing	£525.6m	£585m	£522.0m
4	Authorised Limit (against maximum position)	£590.5m	£640.2m	£586.5m
5	Operational Boundary	£590.5m	£607.8m	£586.5m
6	Ratio of financing costs to net revenue stream			
	General Fund	8.05%	8.24%	8.08%
	Housing Revenue Account	35.4%	37.7%	37.29%
7	Incremental impact of capital investment decisions on the Band D council tax	Nil	£21.08	£11.47
8	Incremental impact of capital investment decisions on the housing rent levels	Nil	£5.95	Nil
9	Interest rate exposures of debt net of investments			
	Upper Limit (Fixed)	£539.1m	£624.5m	£535.9m
	Upper Limit (Variable)	£30.9m	218.6m	£12.4m
10	Maturity structure of fixed rate borrowing (against maximum position)			
	Under 12 months	3.7%	10%	2.9%
	12 months to 2 years	0%	10%	0.1%
	2 years to 5 years	0.9%	30%	0.1%
	5 years to 10 years	0.1%	50%	0.1%
	10years and above	99.3%	100%	99.9%
11	Upper limit for the maturing of investments made for periods longer than 364 days(against maximum position)	0%	100%	0%

In addition to the above the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice.
- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR).

The compliance for these indicators is highlighted in the body of the report.