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OXFORD CITY COUNCIL

To: **City Executive Board**

Date: **1 September 2010** **Item No: 17**

Report of: **Corporate Director of Finance and Efficiency**

Title of Report: **Treasury Management Annual Report 2009/2010**

Summary and Recommendations

Purpose of report: The Treasury Management Annual report sets out the Council's treasury management activity for 2009/2010, together with its achievement against prudential indicator targets for 2009/2010

Key decision No

Executive lead member: Councillor Ed Turner

Report approved by:

Finance: Sarah Fogden
Legal: Jeremy Thomas

Policy Framework:

Recommendation(s):

The City Executive Board is asked to recommend to Council:
1) that it notes the Treasury Management Annual Report for 2009/2010

Executive Summary

1. The financial year 2009/2010 was another difficult year with regard treasury management. Base rates remained at an all time low resulting in low returns on our investments.

2. Icelandic investments remain an issue for the Council, as although £1.05m of our original investment had been returned at the end of 09/10 £3.45m remains outstanding.

3. The Council had outstanding debt of £6.7m as at 31 March 2010, £5.0m of this is held with the public works loan board (PWLB) at a fixed interest rate and £1.7m is held with South Oxfordshire District Council (SODC). The total interest paid on this debt in 2009/2010 was £755k.

4. The Council also had investments totalling £31.4m as at 31 March 2010, this includes £3.45m which is our remaining investment with the Icelandic banks. The remaining balance of investments are with the Debt Management Office (DMO) and Money Market Funds (MMF) for periods less than 90 days. The total interest earned on these investments was £337k.

5. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return is also a key consideration. After this main principle the Council will ensure:
   I. It has sufficient liquidity in its investments; and that
   II. It maintains a policy covering both the categories of investment and criteria for choosing investment counterparties.

6. In relation to the Council's debt strategy the factors taken into account are prevailing interest rates, the debt profile of the Council's portfolio and the type of asset being financed.

7. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2009/2010.

8. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of authorities are affordable, prudent and sustainable.

9. The prudential indicators detailed in the body of this report look back at the results for 2009/2010, and are designed to Compare the Council's outturn position against the target set..

The Council's Capital Expenditure and Financing 2009/2010

10. The Council undertakes capital expenditure on long-term assets. These activities may be financed by either:
    I. capital receipts, capital grants, other external funding;
    II. Revenue contribution; or
    III. borrowing.

11. Part of the Council's treasury function is to address any 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 flow, its previous borrowing activities and the investment of surplus funds. These

activities are structured to manage risk foremost, and then optimise performance.

12. As part of the emergency budget announced by the new coalition government they have indicated they will look at reviewing Prudential Borrowing for local government.

13. Actual capital expenditure forms one of the required prudential indicators. Table 1 below shows actual spend and how it has been financed compared to what was originally planned.

Table 1

Capital Expenditure	2008/2009 Actual £ 000's	2009/2010 Estimate £ 000's	2009/2010 Actual £ 000's
Non- HRA Capital Expenditure	7,777	12,790	8,283
HRA Capital Expenditure	11,184	15,027	9,024
Total Capital Expenditure	**18,961**	**27,817**	**17,307**
Resourced by:			
Capital Receipts	9,052	6,385	1,948
Capital Grants	8,207	10,827	9,686
Revenue	476	5,101	1,607
Total Capital Resources	**17,735**	**22,313**	**13,241**
Unfinanced Capital Expenditure (Additional Need To Borrow)	**1,226**	**5,504**	**4,066**

N.B. The figures in this table can be seen in the Statement of Accounts for 2009/2010 in the Balance Sheet note 6.13.

The Council's Overall Borrowing Need

14. The underlying need to borrow or Capital Financing Requirement (CFR) is a gauge of the Council's debt position. It represents all prior years net capital expenditure which has not been financed by other means (revenue, capital receipts, grants etc.).

15. The CFR can be reduced by:
    I. The application of additional capital resources, such as unapplied capital receipts; or
    II. By holding a voluntary revenue provision (VRP) or depreciation against it.

16. Table 2 below shows the Council's CFR position, this is a key prudential indicator

Table 2.

CFR	31st March 2009 Actual	31st March 2010 Estimate	31st March 2010 Actual
	£ 000's	£ 000's	£ 000's
Opening Balance	9,565	10,553	10,553
Plus Unfinanced Capital Expenditure	1,209	8,030	4,066
Minus MRP / VRP	(221)	(221)	(232)
CFR Closing Balance	**10,553**	**18,362**	**14,387**

Treasury Position at 31 March 2010

17. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual borrowing position by either:
    I. Borrowing to the CFR;
    II. Choosing to utilise some temporary cash flow funds, which will reduce our investment balance, instead of borrowing (under borrowing);
    III. Borrowing for future increase in the CFR (borrowing in advance of need*)*

18. It should be noted that accounting practice requires financial instruments (debt, investments, etc.) to be measured in a method compliant with National Financial Reporting Standards. The figures in this report are based on the actual amounts borrowed and invested and therefore may differ slightly to those in the Statement of Accounts.

19. During 2009/2010 no new debt was taken out. At the end of 2009/2010 the Council's total debt was £6.7m. The debt relates wholly to the Housing Revenue Account (HRA) and repayment of it is provided for within our Housing Subsidy. This means there is no financial benefit to the Council in repaying the debt early, as any premiums associated with early repayment are not covered by housing subsidy and will be a charge on the General Fund. The Council's treasury position as at the 31 March 2010 compared with the previous year is set out in Table 3 below:

20. **Table 3**

Treasury Position	31st March 2009 Principal £ 000's	31st March 2009 Average Rate	31st March 2010 Principal £ 000's	31st March 2010 Average Rate
Borrowing				
Fixed Interest Rate Debt	7,180	10.79%	5,056	11.25%
Other Long-term Liabilities	1,889	6.23%	1,657	0.72%
Variable Interest Rate Debt	0	0.00%	0	0.00%
Total Debt	**9,069**	**8.51%**	**6,713**	**5.99%**
Investments				
Fixed Interest Investments	24,640	5.14%	31,376	1.52%
Variable Interest Investments	0	0.00%	0	0.00%
Total Investments	**24,640**	**5.14%**	**31,376**	**1.52%**
Net Borrowing Position	**(15,571)**		**(24,663)**	

N.B. The figures in this table can also be found in the Statement of Accounts in the following areas:

I. Fixed interest rate debt - Balance Sheet note 6.23 plus short-term borrowing Balance Sheet note 5.5.
II. Deferred liabilities - note 6.25
III. Fixed interest investments - Balance Sheet note 5.5 in the line 'investments',
IV. Differences are due to the changes made to how the accounts are produced to be compliant with International Financial Reporting Standards

Prudential Indicators and Compliance Issues

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

22. 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. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is well below the limit.

Table 4.

Net Borrowing & CFR	31st March 2009 Actual £ 000's	31st March 2010 Estimate £ 000's	31st March 2010 Actual £ 000's
Total Debt	9,069	7,180	6,713
Total Investments	24,640	42,417	31,376
Net Borrowing Position	**(15,571)**	**(35,237)**	**(24,663)**
CFR	**10,553**	**15,825**	**14,387**

23. The Authorised Limit – the authorised limit is the 'affordable borrowing limit' required by S3 of the Local Government Act 2003. The Council does not have the power to borrow above this level unless it explicitly agrees to do so. Table 5 below demonstrates that during 2009/2010 the Council has maintained gross borrowing within its authorised limit. The authorised limit allows the Council to borrow to the future CFR if required, and this has been reflected in the limit itself, with a little headroom built in.

Table 5

Authorised Borrowing	31st March 2009		31st March 2010	
	Estimate	Actual	Estimate	Actual
	£ 000's	£ 0000's	£ 000's	£ 0000's
Borrowing	15,000	7,180	10,000	5,056
Other Long-Term Liabilities	2,200	1,889	1,900	1,657
Total Borrowed	**17,200**	**9,069**	**11,900**	**6,713**
Amount Under Limit	6,631		8,987	

24. The operational Boundary – the operational boundary limit is the expected borrowing position of the Council during the year. It is possible to exceed the operational boundary limit providing that the authorised borrowing limit is not breached.

Table 6

Operational Boundaries	31st March 2009 Estimate	31st March 2010 Estimate
	£ 000's	£ 000's
Borrowing	14,000	8,000
Other Long-Term Liabilities	1,900	1,900
Totals	**15,900**	**9,900**

25. 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 costs net of investment income) against the net revenue stream.

Table 7

Actual Finance Costs	2008/09 £ 000's	2009/10 £ 000's
Indicators		
Original Indicator - Authorised Limit	17,200	11,900
Original Indicator - Operational Boundary	14,700	9,900
Actuals		
Minimum Gross Borrowing Position	10,937	6,713
Maximum Gross Borrowing Position	9,857	9,069
Average Gross Borrowing Position	0	0
Financing Costs As A Proportion Of Net Revenue Stream - General Fund	3.82%	1.50%
Financing Costs As A Proportion Of Net Revenue Stream - HRA	5.69%	5.20%

Economic Background for 2009/2010

26. During 2009/10 the Bank Base Rate remained at an unprecedented historical low of 0.5% all year, the MPC also pumped liquidity into the economy through quantitative easing, i.e. by purchasing £200bn gilts and corporate bonds. This had the effect of boosting prices for gilts and corporate bonds and therefore bringing down yields, so also reducing borrowing costs for both the corporate and public sector.

27. The increase in money supply brought the spread between Bank Rate and 3 month LIBID (investment rate that depositors could earn) down from 0.95% at the beginning of the financial year to zero during August 2009.

28. The dominant focus in 2009/10 was on quarterly GDP growth figures. The recession bottomed out in quarter 1 of 2009, but it wasn't until the fourth quarter of 2009 that economic growth started to return at +0.4%

29. Inflation has not been a major concern of the MPC as it fell back below the 2% target level from June to November. However, it did spike upwards to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as this spike was expected to fall out of the inflation index and inflation was forecast by the Bank of England to fall back under target by the end of 2010.

Icelandic Banks

30. The Council has £1.5m invested with Glitnir Bank HF and £3.0m invested with Heritable Bank Ltd, as at the 31st July we have received £1.25m against our original investment. In relation to both banks, sufficient information is available and the investments have been impaired in line with proper accounting practice and the Department of Communities and Local Government (DCLG) regulations. We have currently received four payments in relation to our Heritable deposit, totalling £1.25m to date which equates to approximately 41%. A fifth payment is due in Oct 2010.

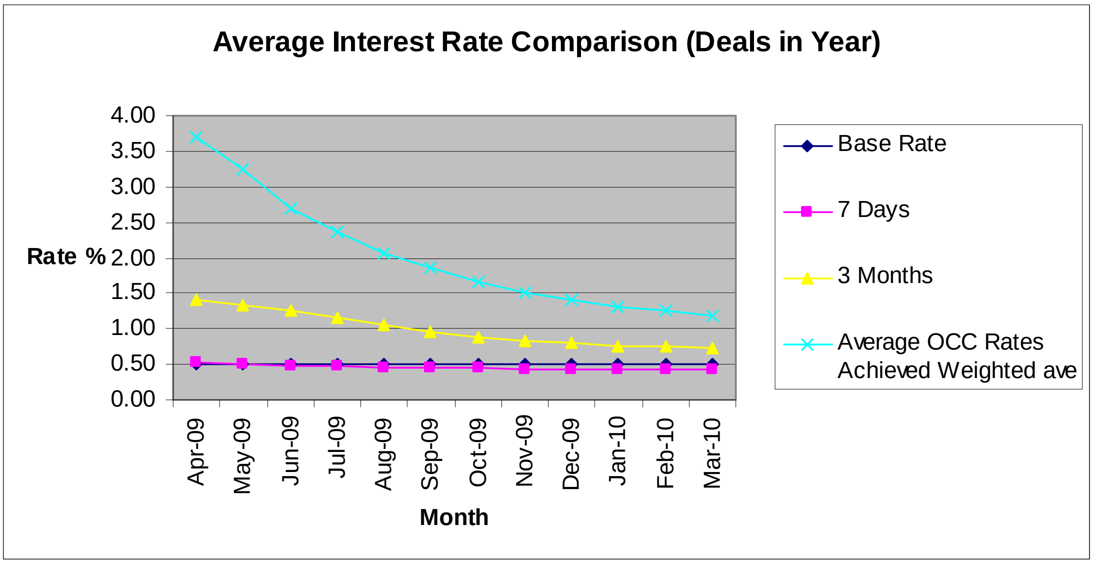
31. The Icelandic bank loss was deferred under Capital Finance Regulations from 2008/09. The Council applied for and received a capitalisation approval that allowed the loss on deposits to be charged to capital, this has led to us capitalising £1.9m of the initial investment.

32. Guidance received to date is indicating that the repayment of the Heritable deposits will continue with an eventual total repayment of approximately 85% of the initial deposit by the end of 2012. The guidance also states that it has yet to be agreed if local authorities are to be treated as preferential creditors and given priority status in regard to Glitnir deposits. If we were to be granted priority status we could expect to see 100% return on our deposits, if we are not this could reduce to approx 29%.

33. To ensure a consistent and prudent approach we have based our calculations on not being granted priority status and therefore have made a further impairment in the accounts of approx £95k, which has an impact on the Income and Expenditure Account, but is mitigated by reserves that were put aside in 2008/09 to cover the loss.

Investment Income

34. The following graph shows the Council's achievement of average interest rate in comparison to the base rate and also in comparison to the benchmarks of 3-month Libid and 7-day Libid.



The graph above shows that the average rates for the Councils return were well above our comparator rates, this is because we had a number of deposits that had originally been invested when rates were much stronger.

Table 8 below shows comparator rates and how they fluctuated during the year

Table 8

	INVESTMENT RATES 2009/10					
	Overnight	7 day LIBID	1 Month	3 Month	6 Month	1 Year
01/04/09	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
31/03/10	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
High	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
Low	0.38%	0.38%	0.38%	0.42%	0.61%	0.96%
Average	0.40%	0.42%	0.47%	0.73%	0.94%	1.29%
Spread	0.12%	0.17%	0.51%	1.09%	1.13%	0.97%
High date	01/04/09	01/04/09	01/04/09	01/04/09	01/04/09	01/04/09
Low date	09/09/09	02/10/09	18/09/09	29/09/09	29/09/09	28/09/09

35. Internally Managed Investments – 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 overnight to 90 days, dependant on the Council's cash flows, its interest rate view, the interest rates on offer and durational limits set out in the approved investment strategy.

36. During 2009/2010 the Council maintained an average invested balance of £44.4m and received an average return of 1.515%. This compares favourably with the average 7-day LIBID target, which was 0.46%.

37. The original budget for interest receivable in 2009/2010 was £800k. A forecast reduction of £500k was made, with a final forecast of £300k at the end of the year. The Council actually achieved interest of £340k, which was slightly above the revised budget, this was due to the additional interest that we accrued for in relation to the Icelandic deposits.

Counterparty Changes Throughout The Year

38. From the 1 April the Council started using the eight Government backed counterparties, as approved as part of the strategy for 2010/11, these counterparties are:
    i. Santander UK
    ii. Barclays Bank
    iii. Bank of Scotland Plc
    iv. HSBC Bank Plc
    v. Lloyds TSB
    vi. Nationwide
    vii. Northern Rock
    viii. Royal Bank of Scotland

39. During the year all investments were made in full compliance with this Council's treasury management policies and practices.

40. Treasury bills – in order to access high security AAA rated UK Government investments offering higher rates than the Government's Debt Management Office DMADF account, the Council is considering the use of Treasury Bills.

New Guidance

41. In March 2009 the CIPFA Treasury Management Panel issued a bulletin of guidance notes (to be used in conjunction with the CIPFA Treasury Management Code of Practice) for local authorities' treasury management activities after the Icelandic banks collapse. The bulletin suggests that the following should be incorporated:
    I. Diversification between counterparties, countries, sectors and instruments
    II. The involvement of Councillors in the decision making process, regular updates and reviews of the activities and function
    III. Formally reporting on treasury activities, at a minimum twice a year (annual treasury report and treasury strategy) and preferably quarterly
    IV. All three rating agencies should be used, with decisions based on the lowest ratings. The ratings should be kept under regular review and 'ratings watch' notices acted on accordingly
    V. Should also systematically review other sources of information. These could include quality financial press, market data and information on government support for banks

VI. Should be clear on the status of service they are receiving from their advisors and satisfy themselves of its appropriateness for their needs
VII. Training of staff should address all of the procedures, practices and processes which are relevant to the Council's treasury management arrangements

42. The Council had already incorporated a number of these recommendations into its treasury management function immediately after the collapse of the Icelandic banks in October 2008. Work has continued to incorporate the remaining recommendations.

43. Prior to the guidance the Council was already using the three major rating agencies and the lowest common denominator (LCD) method, and reviewed the ratings on a daily basis. As well as reviewing individual counterparty limits (amount and period limits) the following limits were also introduced
    I. Counterparty limit of 20% - investments placed with any one counterparty must not exceed 20% of the total amount invested
    II. Country limits: UK – there is no limit in place for the UK
    III. Country limits: Ireland – investments placed with Irish institutions must not exceed 10% of the total amount invested and can only be placed with those institutions covered by the guarantee
    IV. Country limits: Rest of World – currently no investments can be placed with institutions outside the UK or Ireland

44. Councillors have been involved in the decision making process for the strategy for 2009/2010 and 2010/2011, and have received regular reports and updates on key issues as necessary during the year.. A training seminar was also held for members in January 2010 to aid understanding of the treasury management function.

45. CIPFA have teamed together with the Association of Corporate Treasurers (ACT) to provide a qualification that is aimed at public sector organisations. It is recommended that officers who have a responsibility for the treasury management function gain this qualification. CIPFA are intending to release a revised treasury management code of practice and guidance notes in summer 2009. The intention is that the treasury accountant will undertake this training.

46. The council has recently retendered its Treasury Advisor service, and Sector have now been appointed.

Regulatory Framework, Risk and Performance

47. The Council's treasury management activities are regulated by a variety of professional codes and 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, no restrictions were made in 2007/2008;
- Statutory Instrument (SI) 3146 2003, as amended, develops 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 DCLG 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 8 November 2007.

48. 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.

49. The report meets the requirements of both the 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

50. The primary requirements of the Code are as follows:

I. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

II. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

III. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year.

IV. 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.
V. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Value and Performance Scrutiny Committee.

Risk

51. A risk analysis has been carried out and there are no risks to report

Recommendations

52. To note the Treasury Management Annual Report

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Background papers:
Treasury Management Strategy 2009/10 – Executive Board March 2009