Report to: **Cabinet**

Subject: **Annual Treasury Activity Report 2009/10**

Date: **5 August 2010**

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1. PURPOSE OF REPORT

To inform Members of the Annual Treasury Activity Report as required by the Treasury Management Strategy, and the outturn in respect of the Prudential Indicators.

2. BACKGROUND

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by the Council on 3 March 2010, and the Council fully complies with its requirements.

The primary requirements of the Code are as follows:

a. The creation and maintenance of a Treasury Management Policy Statement (TMSS) which sets out the policies and objectives of the Council's treasury management activities.

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

c. The receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

d. 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.

e. 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 Audit Committee.

Treasury management in this context is defined as:

“The management of the local authority’s investments and 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. ”

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2009/10.

3. ANNUAL TREASURY ACTIVITY REPORT 2009/10

3.1 The Council’s current treasury position

The Council’s debt and investment position at the beginning and end of the year 2009/10 is shown at Appendix 1.

3.2 Performance Measurement

The Code of Practice requires performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria are well developed and universally accepted, debt performance indicators continue to be more problematic, with the traditional average portfolio rate of interest acting as the main guide.

The use of benchmarks such as the 12-month LIBID for investments may be inappropriate for local authorities with relatively small cash balances, as they are generally able to place funds for only short periods and often at lower rates. The 7-day LIBID rate is considered more appropriate as the relevant benchmark for Gedling’s investments. The 7 day uncompounded LIBID rate for 2009/10 was 0.42% and the Council’s in-house managed funds achieved an overall equated rate of 1.69%, out performing the benchmark by 1.27%. As a further comparison, the 3 month uncompounded LIBID rate was 0.72%. This out-performance was largely the result of several investments made towards the top of the market, timed in accordance with advice from the Council’s treasury advisers.

During 2009/10, significant core balances and the active management of cash-flows resulted in no temporary borrowing being undertaken. Gedling’s limited number of borrowing transactions and the absence of average borrowing rates for model portfolios, means that the Council needs to develop benchmarks in this problematic area. Similar to investments, the market does produce a 7-day LIBOR rate for the annual cycle and this is suggested as the benchmark against which future temporary borrowing should be measured.

The Council's treasury management borrowing performance is in reality dominated by its long-term borrowing activity. The amount to be borrowed is directed by the Council's capital expenditure plans approved as part of the annual budget, therefore, performance is best measured by looking at the timing of long-term borrowing, which can be controlled by use of temporary treasury activity.

During 2009/10, no new long-term borrowing was undertaken. The Council continues to take advice with regard to its borrowing activity from Sector Treasury Services.

3.3 The treasury strategy for 2009/10

The Sector recommended treasury strategy for 2009/10, (issued in December 2008), was based on the view that there was an intensifying global recession which would not only require central bank rates to be cut to unprecedented historically low levels, but could also require further action from central banks to reverse the downward path of economies.

Bank Rate was expected to continue falling from 2.0% in December 2008 to 0.5% in March 2009 and then stay there throughout 2009/10 before starting to rise in the second quarter of 2010. However, there was a downside risk to this forecast if the recession proved even deeper and longer than expected at that time, in which case the first rise in Bank Rate would be delayed.

The effect on interest rates for the UK was therefore expected to be as follows:

- **Shorter-term interest rates** - The "average" City view anticipated that Bank Rate would fall to 0.5% and remain there at the end of 2009 due to the scale of the recession before starting to rise back towards more normal levels in 2010, though it would be 2012 before Bank Rate returned to around 4.5%.
- **Longer-term interest rates** - The view on longer-term fixed interest rates, 50 years, was that they would remain around 3.90 – 3.95% during 2009/10 with the 25 year rate being about 10 – 15 basis points (bps) higher.

  The strategy adopted by the Council based upon the above forecast, was:

- That the next financial year was expected to be a time of historically and abnormally low Bank Rate, which would open up an opportunity for the authority to fundamentally review its strategy of undertaking external borrowing.
- That with investments in excess of the borrowing requirement over the next year, and with access to cash from maturing investments within the financial year, consideration would be given to the potential merits of internal borrowing.
- That long-term borrowing rates were expected to be higher than rates on the loss of investment income, and looked likely to be so for the next

couple of years, therefore all new external borrowing in the next financial year might be avoided in order to maximise savings in the short term.

- That investments may be run down, to take advantage of reduced exposure to interest rate risk and credit risk.

Major issues for treasury management during 2009/10 have been the huge difference between investment rates and borrowing rates during the recession, due to the unprecedented fall in Bank Rate, and to the disappearance during the year of the margins over more normal investment rates caused by the credit crunch, as the Bank of England's quantitative easing operations had the desired effect of easing the supply and cost of credit in the economy during 2009.

A further strong theme has been the major emphasis on mitigating risk by giving heightened preference to security and liquidity at a time when the world banking system was still under stress, and pending the issue later in 2009, of new CIPFA and statutory guidance on investing.

Consequently, in order to balance the impact of the loss in investment income, there was a major re-evaluation of the benefits of new borrowing, whereby significant treasury management savings could be achieved by running down investment balances instead of taking new borrowing in order to finance new capital expenditure or to replace debt maturing during the year. Whilst this has provided savings during 2009/10 in terms of debt management costs, the Council must be mindful of both interest rate risk and refinancing risk moving forward, in the event that interest rates start to rise. There is a risk that borrowing costs may start to rise due to market concerns regarding sovereign debt levels, and the re-emergence of inflationary pressures. The Council is continuing to proactively monitor this position in association with its treasury management advisors.

3.4 The Economy and Interest Rates in 2009/10

During 2009/10 the Monetary Policy Committee (MPC) was focused on helping the economy to turn around from plunging into the deepest and longest recession the UK economy had experienced for many years.

Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year, the MPC also had to resort to extreme measures in terms of pumping liquidity into the economy through quantitative easing 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.

It was notable that the increase in money supply in the economy generated by this programme brought the credit crunch induced 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.

The dominant focus in 2009/10 was on quarterly GDP growth figures. The recession bottomed out in Quarter 1 of 2009. There was then major disappointment that the end of the recession failed to materialise in Quarter 3 2009 but the fourth quarter of 2009 did then see economic growth return at +0.4%.

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.

3.5 Borrowing and investment rates in 2009/10

Variations in most PWLB rates this year have been within a fairly limited band compared to previous years with the largest spread being 1.12% in the 10 year.

5 year PWLB rate. This started the year at 2.54% and then fell to a low for the year of 2.47% on the following day before then rising sharply to hit a peak of 3.29% in July. From there it fell till until reaching 2.54% in October and then rose back up to a peak of 3.13% in January. It finished the year at 2.89%.

10 year PWLB rate. This started the year at 3.36% and then fell to a low for the year of 3.30% on the following day before then rising sharply and rose to hit a peak of 4.15% in July. From there it fell until reaching 3.55% in October and then rose back up to a peak of 4.42% in February. It finished the year at 4.19%.

25 year PWLB rate. This started the year at 4.28% and then peaked in the 4.70s during June – August before falling back to a bottom of 4.07% in October. From there it rose again towards the end of the year to return to the 4.70s and peaked at 4.83% in February. It finished the year at 4.67%.

50 year PWLB rate. This started the year at 4.57% and then peaked at 4.85% in June before falling back to a bottom of 4.18% in October. From there it rose again towards the end of the year and peaked at 4.79% in March. It finished the year at 4.70%.

	PWLB BORROWING RATES 2009/10 for 1 to 50 years								
	1	2	3	4	5	10	25	50	1 month variable
1. 4.2009	0.83%	1.41%	1.89%	2.26%	2.54%	3.36%	4.28%	4.57%	0.80%
31.3.2010	0.83%	1.41%	1.95%	2.45%	2.89%	4.19%	4.67%	4.70%	0.65%
HIGH	1.20%	1.91%	2.48%	2.94%	3.29%	4.42%	4.83%	4.85%	0.80%
LOW	0.68%	1.29%	1.79%	2.20%	2.47%	3.30%	4.07%	4.18%	0.55%
spread	0.52%	0.62%	0.69%	0.74%	0.82%	1.12%	0.76%	0.67%	0.25%
average	0.90%	1.53%	2.08%	2.53%	2.90%	3.93%	4.49%	4.51%	0.63%
high date	09/06/2009	12/06/2009	12/06/2009	24/07/2009	28/07/2009	22/02/2010	22/02/2010	02/06/2009	01/04/2009
low date	16/09/2009	09/10/2009	09/10/2009	02/04/2009	02/04/2009	02/04/2009	09/10/2009	09/10/2009	17/07/2009

3.6 The Borrowing outturn for 2009/10

The Council undertook no new borrowing during 2009/10 and the average debt portfolio interest rate remained at 4.07%. The approach during the year was to use cash balances to finance new capital expenditure, and minimise counterparty risk incurred on investments. This also maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

An underlying need to borrow can still be demonstrated by the Capital Financing Requirement, and advice will continue to be taken from Sector Treasury Services with regard to the timing of any future borrowing.

No temporary borrowing was undertaken during the year 2009/10.

3.7 Debt Rescheduling

The Council's treasury management advisors, Sector, started 2009-10 with the expectation that longer-term PWLB rates would be on a rising trend during the year, and that shorter term rates would be considerably cheaper. However, moving from long term to short term debt would mean taking on a greater risk exposure to having to re-borrow longer term in later years at considerably higher rates than most of the long term debt currently in the debt portfolio. Short term savings could be achieved by internally financing new capital expenditure and replacing maturing debt by running down existing cash balances which were only earning minimal rates of interest due to the fact that Bank Rate was kept at 0.5% all year. Running down cash balances also meant reduced counterparty risk on the investment portfolio.

On 1st November 2007 the PWLB imposed two rates for each period, one for new borrowing and a new, significantly lower rate for early repayment of debt. The differential between the two rates ranged from 26bp (basis points) in the shorter dated maturities to over 40bp in the longer ones. They also introduced daily movements of 1bp instead of 5 bps and rates in half year periods throughout the maturity range (previously had been mainly in 5 year bands). These changes effectively prevented the Council from restructuring the portfolio into new PWLB borrowing.

Accordingly, no debt rescheduling was undertaken during 2009/10.

3.8 Compliance with treasury limits and Prudential Indicators

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Management Strategy Statement (TMSS). The outturn for the Prudential Indicators for 2009/10 is shown at Appendix 3.

3.9 Investment activity and outturn for 2009/10

At the start of 2009/10, investment rates were enhanced by a substantial credit crunch induced margin. However, the Bank of England's quantitative easing operations had the desired effect of improving the supply of credit in the economy and so these margins were eliminated by half way through the year. Consequently, investment rates fell markedly during the first half of the year,

Overnight rate: this varied little during the year within a range of 0.38 to 0.49%.

3 month rate: from a high point for the year of 1.50% on 1 April 2009, the rate fell gradually to reach a low of 0.42% in September before finishing the year at 0.52%,

12-month rate: this started the year at a credit crunch enhanced rate of 1.85% and fell steadily until reaching 0.85% in September. Since then it has risen to finish the year at 1.15% as the market looked ahead to when the MPC would have to start raising Bank Rate from its then current rate of 0.50%.

	INVESTMENT RATES 2009-10					
	Overnight	7 Day LIBID	1 Month	3 Month	6 Month	1 Year
01-Apr-09	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
31-Mar-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	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009
low date	09/09/2009	02/10/2009	18/09/2009	29/09/2009	29/09/2009	28/09/2009

The Council manages all its investments in-house and invests only with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days, dependent 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.

During the year all investments were made in full compliance with this Council's treasury management policies and practices. Details of the investment activity for the year can be found at Appendix 1, and details of key dates and interest rates at Appendix 2.

3.10 Investment strategy

Pending the issuance of revised CIPFA and statutory investment guidance expected towards the end of the year, and in the light of continuing stresses on the world banking system, enhanced priority was given to security and liquidity in order to reduce counterparty risk to the maximum possible extent.

As noted earlier in this report, the opportunity was also taken to reduce the need for new borrowing by running down investment balances, which also minimised exposure to counterparty risk.

In order to counter the downturn in investment rates and earnings explained above, and following advice from Sector, a substantial part of the investment portfolio was held in liquidity accounts with main UK banks. These accounts offered both instant access and rates which were often double those available in the money markets through brokers for overnight money.

3.11 Investment performance

The Council's in-house managed funds achieved an overall equated rate of 1.69% during 2009/10, outperforming the 7 day uncompounded LIBID rate of 0.42% by 1.27% and the 3-month uncompounded LIBID rate by 0.97%.

No institutions in which investments were made during 2009/10 had any difficulty in repaying investments and interest in full during the year.

3.12 Icelandic bank defaults

The Council had no investments in any Icelandic bank at the time of the banking collapse in October 2008.

3.13 Other Issues

During 2009/10, training was provided by Sector Treasury Services for relevant Members of the Council and its neighbouring authorities, in recognition of the increasingly important role such members play in the financial arrangements of the Council.

No other significant treasury management issues arose during the year.

RECOMMENDATION

Members are asked to:

Note the above Annual Treasury Activity Report for 2009/10 together with the appendices, and to refer it to Council for approval.

Appendix 1

Annual Report on Treasury Activity 2009/10

For the year ended 31 March 2010

	Balance BFwd 1 April 09	Loans made 2009/10	Loans repaid 2009/10	Balance CFwd 31 March 10
Long Term Borrowing:				
PWLB	6,811,577	0	0	**6,811,577**
Temporary Borrowing:				
Banks and other Institutions	0	0	0	**0**
TOTAL BORROWING	**6,811,577**	**0**	**0**	**6,811,577**
Temporary Investment:				
Abbey (Santander)	2,000,000	22,225,000	23,415,000	**1,010,000**
HBOS	2,200,000	29,030,000	30,130,000	**1,100,000**
Royal Bank of Scotland	0	5,000,000	3,605,000	**1,395,000**
Sub Total Banks	**4,400,000**	**82,025,000**	**82,920,000**	**3,505,000**
Nationwide Building Society	1,000,000	8,000,000	9,000,000	**0**
Debt Management Office	0	6,400,000	6,400,000	**0**
TOTAL INVESTMENT	**5,400,000**	**96,425,000**	**98,320,000**	**3,505,000**
Net Borrowing/(Investment)	**1,411,577**	**(96,425,000)**	**(98,320,000)**	**3,306,577**

Analysis of Investment:				
Fixed Rate	4,200,000	51,290,000	55,490,000	**0**
Variable Rate	1,200,000	45,135,000	42,830,000	**3,505,000**
TOTAL INVESTMENT	**5,400,000**	**96,425,000**	**98,320,000**	**3,505,000**

Investment Statistics:

Proportion of fixed rate investment	0%
Proportion of variable rate investment	100%
Temporary investment interest receivable	£177,378
Equated temporary investment	£10,520,669
Weighted average interest rate received	1.69%
7 day LIBID	0.42%
3 Month LIBID	0.72%

Borrowing Statistics:

Weighted average interest rate on PWLB debt 4.07%

Appendix 2

Central Bank Data for information:

Dates of meetings | Rates

	UK	UK	UK	US	EU	UK	US	ECB
	MPC	MPC Minutes	Inflation Report	FOMC	ECB	Bank Rate	Fed. Rate	Refi Rate
2008								
Jan	-	-		22		5.50%	3.50%	4.00%
Jan	9-10	23		29-30	10	5.50%	3.00%	4.00%
Feb	6-7	20	13	21 (mins)	7	5.25%	3.00%	4.00%
Mar	5-6	19		18	6	5.25%	2.25%	4.00%
Apr	9-10	23		29-30	10	5.00%	2.00%	4.00%
May	7-8	21	14		8	5.00%	2.00%	4.00%
Jun	4-5	18		24-25	5	5.00%	2.00%	4.00%
Jul	9-10	23			3	5.00%	2.00%	4.25%
Aug	6-7	20	13	5	7	5.00%	2.00%	4.25%
Sep	3-4	17		16	4	5.00%	2.00%	4.25%
Oct	8-9	22		28-29	2	4.50%	1.50%	3.75%
Nov	5-6	19	12		6	3.00%	1.00%	3.25%
Dec	3-4	17		16	4	2.00%	0-0.25%	2.50%
2009								
Jan	7-8	21		27-28 (7 mins)	15	1.50%	0-0.25%	2.00%
Feb	4-5	18	11		5	1.00%	0-0.25%	2.00%
Mar	4-5	18		17	5	0.50%	0-0.25%	1.50%
Apr	8-9	22		28-29	2	0.50%	0-0.25%	1.25%
May	6-7	20	13		7	0.50%	0-0.25%	1.00%
Jun	3-4	17		23-24	4	0.50%	0-0.25%	1.00%
Jul	8-9	22			2	0.50%	0-0.25%	1.00%
Aug	5-6	19	12	11	6	0.50%	0-0.25%	1.00%
Sep	9-10	23		22	3	0.50%	0-0.25%	1.00%
Oct	7-8	21			8	0.50%	0-0.25%	1.00%
Nov	4-5	18	11	3-4	5	0.50%	0-0.25%	1.00%
Dec	9-10	23		15	3	0.50%	0-0.25%	1.00%
2010								
Jan	6-7	20		27	14	0.50%	0-0.25%	1.00%
Feb	3-4	17	10		4	0.50%	0-0.25%	1.00%
Mar	3-4	17		16	4	0.50%	0-0.25%	1.00%

MPC – Monetary Policy Committee
ECB – European Central Bank
FOMC – Federal Open Market Committee