Cheltenham Borough Council

Treasury Management Panel – 14th June 2010

Treasury Outturn 2009/10

Report of the Chief Finance Officer

1. Introduction

1.1 Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and this Council has adopted the Code and complies with its requirements, one of which is the receipt by Treasury Management Panel/Cabinet/Council of an Annual Review Report after the financial year end.

2. Economic Outlook for 2009/10

2.1 At the time of determining the Treasury Strategy Statement for 2009/10 in February 2009, the outlook for the economy and interest rates was as follows.

2.2 The UK, Eurozone and US economies were contracting and globally economies faced a prolonged recession or period of weakness following the financial market meltdown in the autumn of 2008. Availability of credit was restricted as banks undertook to repair their balance sheets.

2.3 Asset values were falling and were forecast to drop further, particularly those which related to commodities and housing. The increase in food and energy inflation which had exerted a powerful squeeze on real incomes in 2008, but was expected to fade in 2009. Wage inflation was forecast to remain low and the labour market to remain weak with the threat of thousands of job losses.

2.4 The UK Bank Rate had been cut to 0.5% in March 2009 and the Bank of England also announced its initial £75bn of Quantitative Easing (QE).

2.5 After the particularly torrid economic recession and a severe downturn in growth that extended into early 2009, there were reports of an emerging recovery. The Bank of England forecast UK growth to fall by 3.9% in 2009, whist inflation was forecast to be heading lower and staying lower for longer. In order to stimulate growth, the Bank of England maintained the Bank Rate at 0.50% throughout the financial year. The Bank also took extreme measures on an extraordinary scale to revive the economy through its QE programme. Financed by the issuance of central bank reserves QE was initially announced at £75bn, and then extended in stages to £200bn.

2.6 Consumer Price Inflation, having hit a high of 5.2% in September 2008, began at the start of the year at 3.2% and then fell to a low of 1.1% in September 2009 as the oil, commodity, utility and food prices (main drivers of high inflation in 2008) fell out of the year-on- year statistical calculations. Thereafter inflation pushed higher with rising oil and transport costs and VAT reverting back to 17.5%. Consumer Price Inflation at the year end was 3.4% (March 2010 data).

2.7 The November 2009 Budget was primarily about public debt. The Chancellor's forecast for net public sector borrowing in 2009/10 was £175bn or 12.4% of Gross Domestic Product. Standard and Poor's responded to the debt that UK government was building up and a lack of a credible plan to reduce the debt burden by changing the UK's rating outlook from stable to negative

2.8 The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by high unemployment. The UK fiscal deficit remained heightened and cuts in public spending and tax increases were becoming inevitable and a credible plan to reduce the deficit was urgently required after the May General Election.

2.9 LIBOR and LIBID rates (i.e. the rates at which banks are willing to borrow and lend to other banks) which had been very high in early 2009, slowly reverted towards the Bank Rate of 0.5%.

3. Portfolio position 1/4/09-31/3/10

Movements in the Council's borrowing during 2009/10 can be seen in the table below. Long term loans are deemed to be those repayable over a period of more than one year.

Source of Loan	Balance at 1 April 2009 £	Raised during the year £	Repaid during the year £	Balance at 31 March 2010 £
Temporary Borrowing				
- Building Societies	18,400,000	12,900,000	30,100,000	1,200,000
- Banks	0	0	0	0
- Local Authorities	1,700,000	156,995,000	142,895,000	15,800,000
Temporary Investment	(17,261)	3,295,389	2,663,825	614,303
Total Short Term Borrowing	**20,082,739**	**173,190,389**	**175,658,825**	**17,614,303**
Long Term Borrowing				
- Public Works Loan Board	11,000,000	0	0	11,000,000
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**26,900,000**	**0**	**0**	**26,900,000**
Total External Borrowing	**46,982,7390**	**173,190,389**	**175,658,825**	**44,514,303**

3.1 In 2009/10 the Council's actual debt management costs (borrowing) were £1,229,912 compared to a revised budget of £1,225,900, a small variance in terms of the amount of temporary borrowing undertaken in the year (£170m).

The interest repaid from the HRA for the use of debt balances amounted to £528,432 against a revised budget of £624,300. The primary reason for this shortfall is that the calculation for the HRA to repay the General Fund at revised budget estimated the consolidated rate of interest to be 3.32% on all borrowing, but the rate came in lower at 2.81%. Interest paid to the HRA for revenue balances amounted to £40,178 compared with the revised budget of £28,800. The reason for this variance was that the HRA required lower use of revenue balances for capital expenditure in 2009/10.

3.2 No Debt rescheduling was undertaken in 2009/10 as the PWLB repayment rates made the premium costs payable too expensive. The Council's debt portfolio will continue to be reviewed by Arlingclose for debt rescheduling opportunities which has assisted us in the past.

4. Investments

The DCLG's Guidance on Local Government Investments in England was revised during 2009/10, reiterating security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance becomes operative on 1st April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three agencies – Fitch, Moody's and Standard & Poor's be taken into account and the lowest rating be used. Managing counterparty risk continued to be the Council's overwhelming investment priority. Financial markets remained in a flushed state particularly at the beginning of 2009/10. Against this backdrop, the Council continued to place investments with a small, select list of counterparties. Specified investments were determined for use having assessed their risks and benefits in relation to the Council's circumstance, risk threshold and investment objectives. New investments were restricted to the DMO, a small number of banks and one building society, which are all eligible institutions under the UK Government's 2008 Credit Guarantee Scheme and with a long-term AA-(AA minus) rating. The Council accepted the reduction in investment return from investing with highly rated counterparties as an acceptable risk-reward trade-off.

4.1 Investments - Movements in the Council's investment portfolio during 2009/10 can be seen in the table below.

Source of Loan Temporary Lending	Balance at 1 April 2009 £	Raised during the year £	Repaid during the year £	Balance at 31 March 2010 £
- Building Societies	0	0	0	0
- Banks	5,000,000	2,000,000	4,300,000	2,700,000
Santander Business Account	0	42,310,000	42,310,000	0
Debt Management Office	0	4,000,000	4,000,000	0
	0			
Total Short Term Lending	**5,000,000**	**48,310,000**	**50,610,000**	**2,700,000**
Long Term Lending	**Balance at 1 April 2009 £**	**Raised during the year £**	**Repaid during the year £**	**Balance at 31 March 2010 £**
- Building Societies	2,000,000	0	2,000,000	0
- Banks	16,000,000	0	2,600,000	13,400,000
Total Long Term Lending	**18,000,000**	**0**	**4,600,000**	**13,400,000**
Total External Investments	**23,000,000**	**48,310,000**	**55,210,000**	**16,100,000**

4.2 The Council had £10.1 million deposited in the collapsed Icelandic banks as at 31st March 2010. The Council has received £900,000 from the administrators of Kaupthing Singer & Friedlander in 2009/10, which relates to 30p in the pound. Another payment of £150,000 has been received in early April 2010 and notification has just given of a fourth distribution in July 2010. Recent information provided by the administrators have indicated a recovery rate of 65p to 78p in the £ (up from the original estimate of 50p in the £).

4.3 The deposits with Glitnir and Landbanki banks are each in receivership and are being run by winding up boards in Iceland. In December 2009 the Glitnir bank announced that local authority claims in the bank would be treated as general unsecured, rather than priority claims. This reduces the percentage likely to be recoverable from 100% to an estimated 29%. Lawyers are working on behalf of all local authorities to try to get the deposit status changed to priority status and are proceeding to refer the decision to court in due course. In contrast to Glitnir winding up board, Landsbanki winding up board has recognised local authorities' claims as having priority status, but other creditors have filed objections to this decision. Every effort is being made by the LGA and the lawyers to ensure that the decision is upheld. The expected recovery rate for Landsbanki claims having priority status is estimated to be 94.86% however general unsecured claims recovery rate is estimated at 38.19%.

4.3 In January 2010 the Council was successful in its application to the Government for a capitalisation direction of £4.43 million for 2009/10 to enable the Council to finance the potential loss of interest and capital arising from the collapse of Icelandic banks over 20 years.

4.4 The Council's investment income for 2009/10 was £461,562 compared to a revised estimate of £483,000. This deficit is a result of a £2m callable deposit from 2006 achieving 6.01% being recalled by the bank. The monies were deposited with another bank at the much lower rate of 1.82%.

4.4 At the year end, the overall treasury management position (external borrowing less external investments) was such that the Council was a net borrower to the sum of £28.4m. The overall interest receivable and payable for 2009/10 was an overspend against revised budget of £132,695 on the General Fund while the Housing Revenue Account (HRA) is £107,425 favourable against revised budget, meaning a shortfall in interest of £25,450 to report for the financial year.

5. Minimum Revenue Provision (MRP)

The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such guidance under section 21 (A) of the Local Government Act 2003.

SI 2008 No.414 replaces the requirement that local authorities undertake detailed formula based calculations in relation to the minimum amount charged to revenue for the redemption of debt related to the financing of capital expenditure (MRP) and instead there is now a statutory requirement to make a "prudent" provision. Statutory guidance issued by the DCLG in March 2008 makes recommendations to local authorities on the interpretation of the term "prudent provision". Local authorities are to have regard to this guidance which provides four options as set out below.

The four options available to the Council are set out as below:-

Option 1: Regulatory Method

Option 2: Capital Financing Requirement (CFR) Method

Option 3: Asset Life Method

Option 4: Depreciation Method

Option 1 Regulatory Method
The authority makes provision in accordance with the revoked Regulations 28 and 29, exactly as if they continued to remain in force. These Regulations were created to ensure that a small number of authorities (including Cheltenham) were not faced with a greater MRP requirement than under the former system, simply due to the technicalities of the transition to the Prudential capital finance system.

Option 2 Capital Financing Requirement (CFR) Method
MRP in any year is equal to 4% of the non-housing CFR at the end of the preceding financial year. If the CFR is nil or negative, no MRP is required.

Option 3 Asset Life Method
Provision for the borrowing used to finance capital expenditure on an asset is made in equal annual installments over the period equal to the estimated life of the asset. This option is considered appropriate, along with option 4, for new self-financed borrowing, whereas options 1 and 2 are more suitable for historic debt.

Option 4 Depreciation Method
The authority makes provision for the borrowing used to acquire an asset in installments determined in accordance with depreciation accounting. This is an alternative to option 3 although it will require the standard depreciation rules to be applied in full, except that, on disposal of the asset; the capital receipt cannot be taken to revenue.

Options 1 and 2 can be used on all capital expenditure incurred before 1st April 2009 and on Supported Capital expenditure on or after that date. Options 3 and 4 are considered prudent options for Unsupported Capital expenditure on or after 1st April 2009 and can be used for Supported Capital expenditure whenever incurred.

The Council's MRP policy for 2009/10 was approved by Council in February 2009. It was determined that Option 1 would be adopted for Supported Borrowing and Option 3 for Unsupported Borrowing.

6. 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 Strategy Statement. In 2009/10 the Council set an authorised limit of £83m and an operational limit for borrowing of £61m, which was not breached during the financial year.

7. Treasury Management Advisors

7.1 Arlingclose were first appointed as the Council's treasury management advisors in April 2007 and the contract was extended for a further two years from 1st April 2009.

During 2009/10 Arlingclose as part of their service they have delivered:-

- Over 80 Counterparty Credit updates
- Held 11 workshops to attend to learn new legislation/changes in treasury management

- Quarterly reviews on the Councils Debt and Investment portfolio
- Attended 3 Treasury Management Panel meetings
- Provide templates for treasury reports – x 2
- Email 2 weekly bulletins – Preview and a review of the week.

7.2 The Council is clear as to the services it expects and is provided under the contract. The Council is also clear that overall responsibility for treasury management remains with the Council.

8 Conclusions

8.1 Members are asked to note the outturn for 2009/10.