Open Agenda

Council Assembly

Wednesday 14 July 2010
7.00 pm
Town Hall, Peckham Road, London SE5 8UB

Supplemental Agenda No.2

List of Contents

Item No.	Title	Page No.
5.1.	**Treasury Management Performance - 2009/10 Annual Report and Prudential Indicators for Capital Finance and Treasury Management**	1 - 11

Contact

Sean Usher on 020 7525 7228/ 7222 or email: lesley.john@southwark.gov.uk; sean.usher@southwark.gov.uk / Webpage: http://www.southwark.gov.uk

Date: Tuesday 6 July 2010

Agenda Item 5.1

Item No: 5.1	Classification: Open	Date: 14 July 2010	Meeting Name: Council Assembly
Report title:		Treasury Management Performance - 2009/10 Annual Report and Prudential Indicators for Capital Finance and Treasury Management	
Wards or Groups affected:		All	
From:		Finance Director	

RECOMMENDATIONS

1. That the council assembly note this 2009/10 outturn report on debt, investments and prudential indicators.

BACKGROUND INFORMATION

2. The council holds some £212m in investments (as detailed in note to paragraph 10) and £762m in debt as at 31 March 2010. The debt arises from past borrowing to pay for capital spend which was not otherwise financed from capital receipts, grants or revenue. A sum is paid off, in the form of minimum revenue payments, each year, but the bulk is replaced with new borrowing as it matures. Cash received and not yet spent is placed on deposit with banks or held in UK government or supranational bonds until it is spent.

3. The borrowing and investment activity is supported by a series of prudential indicators (estimates and limits on capital finance, debt and investments) and a treasury strategy agreed by council assembly. The 2009/10 indicators and strategy were reported to council assembly in February 2009 and this report sets out the economic background, the outturn indicators and the treasury activity carried out, under financial delegation by the finance director, over the course of the year. This area of finance falls under the Local Government Act 2003, supplemented by investment guidance issued by the Government and codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

4. In November 2009 CIPFA published updates to its “Treasury Management in the Public Sector Code of Practice” and “Prudential Code for Capital Finance in Local Authorities” following problems with Icelandic banks. Southwark did not have exposure to these banks. The Department for Communities and Local Government also reviewed its investment guidance. Whilst the basis of the guidance was unchanged, the importance of security and liquidity over investment yield was made even clearer. The updated codes also reflected that and extended formal reporting and scrutiny of treasury management. At Southwark, council assembly agreed, as part of 2010 constitutional changes, that in addition to a strategy report (which it considers before the start of each year and an annual report after the close of the year), it would also receive a mid year report, with additional quarterly monitoring of treasury management going to cabinet and review and scrutiny being carried out by the audit and governance committee. But, as now, council assembly would remain responsible for agreeing the policy and strategy, which the finance director would manage.

KEY ISSUES FOR CONSIDERATION

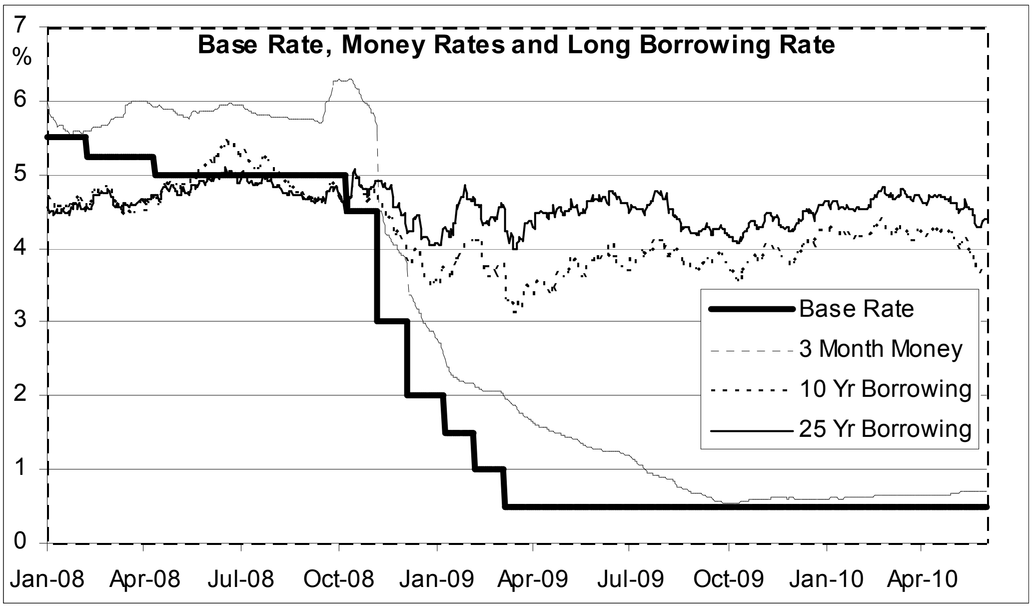
Treasury Management Borrowing and Investments

Financial Market Backdrop

5. The collapse of Lehman Brothers, the US investment bank, in 2007 and the near collapse of major financial institutions across developed countries brought about a severe downturn in economic activity. Governments and central banks around the world responded by providing substantial support to their banking system, relaxing fiscal policy, slashing official interest rates and supporting capital markets with new forms of monetary easing. This succeeded in avoiding the worst of the immediate downside risk to activity and unemployment. The economy has been growing slowly since late 2009.

6. In the UK, base rates were held at historic lows throughout 2009/10 and as financial markets stabilised and bank funding improved the spread of short term rates (3 month rates) to base rates also narrowed; see chart below. In common with other major sovereigns, UK Government debt yields rose over most of 2009 as investors moved out of government backed debt and became more willing to purchase riskier assets. Rates on new long term borrowing from the Public Works Loans Board (the principal source of local authority borrowing) also followed yields up – see rate chart below.

7. Growth, however, still remains weak, and how quickly it can strengthen and become durable remains uncertain. The banking system is still in the process of repairing its balance sheet and that is likely to restrain credit to businesses and households that depend on it. More recently, fiscal austerity here and across Europe, following a reassessment of sovereign risk in Greece and other euro nations, potentially adds further uncertainty to the near term outlook.

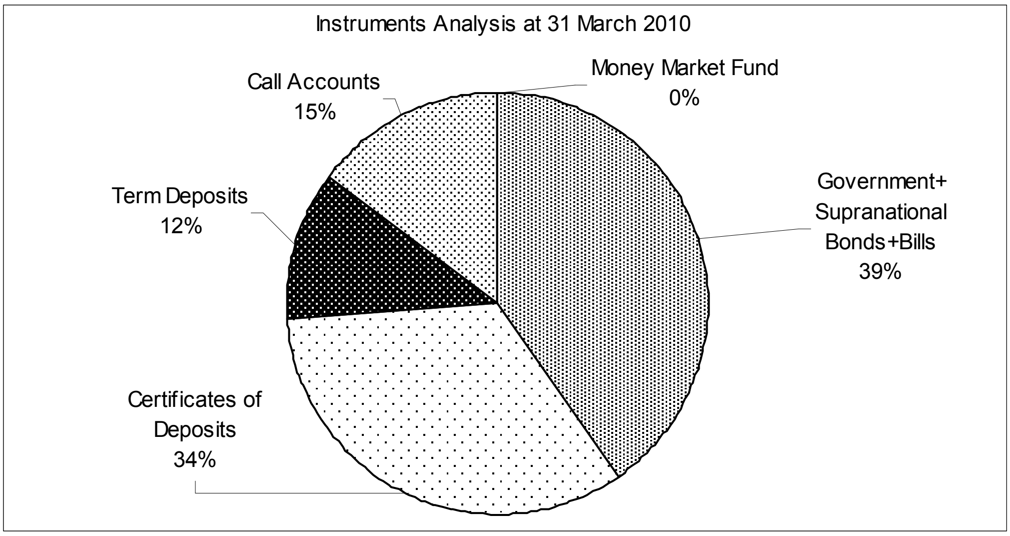


Investment Activity and Position

8. During 2009/10 and throughout the market turmoil, investments were managed prudently, with principal protection a high priority, as required under the Annual Investment Strategy agreed by council assembly in February 2009. Investment exposure was biased towards major high rated banks, UK Government debt and bonds issued by the European Investment Bank and the World Bank (the International Bank for Reconstruction and Development). Bank exposure was in the form of call accounts, short term deposits and certificates of deposits (liquid term deposits).

9. Investments are managed by an in-house operation and three investment management firms: Invesco Asset Management Ltd, AllianceBernstein Ltd and Aberdeen Fund Management Ltd. Aberdeen took over the investment business of Credit Suisse Asset Management in July 2009. The fund managers provide access to liquid instruments, sovereign bonds and maturities beyond one year and expertise to help the council enhance long term returns, with capital preservation, liquidity and low market risk as priorities. In-house funds focus on meeting day to day cash volatility using a number of call accounts and short term deposits.

10. Cash balances averaged £274m over the course of 2009/10, a fall of £16m over the previous year reflecting spending of previously received cash. The cash held in investments at the end of March 2010 was £212m. A counterparty, instrument, rating and maturity analysis of these investments is set out below. The average return for 2009/10 was 1.57%, much lower than the 5.50% earned in 2008/09, reflecting the prolonged period of very low money market rates.



COUNTERPARTY EXPOSURE AND RATINGS										
	FUND					RATING				
COUNTERPARTY	ABERDEEN	ALLIANCE BERNSTEIN	INVESCO	IN-HOUSE	Total £m	Long	Short	Support	Country	Country Rating
BARCLAYS BK	7.0	0.5	7.0	10.0	24.5	AA-	F1+	1	UK	AAA
CREDIT AGRIC CIB			7.0		7.0	AA-	F1+	1	FRANCE	AAA
CREDIT INDST COMRCL	5.4				5.4	AA-	F1+	1	FRANCE	AAA
DEXIA BK			2.1		2.1	A+	F1+	1	BELGIUM	AA+
HSBC	0.1				0.1	AA	F1+	1	UK	AAA
ING BK	5.0	0.5	7.0		12.5	A+	F1+	1	NETHERLANDS	AAA
LLOYDS/BK SCOTLAND	4.5	0.5			5.0	AA-	F1+	1	UK	AAA
NATIONWIDE B/SOC	3.2	0.4			3.6	AA-	F1+	1	UK	AAA
NORDEA BK	4.0	0.5	7.0		11.5	AA-	F1+	1	FINLAND	AAA
RBS/NATWEST				30.0	30.0	AA-	F1+	1	UK	AAA
SANTANDER UK	7.4			4.0	11.4	AA-	F1+	1	UK	AAA
SOCIETE GENERALE			7.0		7.0	A+	F1+	1	FRANCE	AAA
DANSKE		0.5			0.5	A+	F1+	1	DENMARK	AAA
GLOBAL TREAS FNDS MMF					-	AAA	F1+		MONEY MKT FUND	
INTL BK RECON & DEV	1.2	1.6			2.8	AAA	F1+		INTERNATIONAL	AAA
EUROPEAN INVST BK	7.7	7.8			15.5	AAA	F1+		EUROPEAN	AAA
LCR FINANCE UK GTD	6.8	4.2			11.0	AAA	F1+		UK	AAA
UK TREASURY	4.7	40.6	5.4		50.7	AAA	F1+		UK	AAA
Total £m	57.0	57.1	42.5	44.0	200.6					

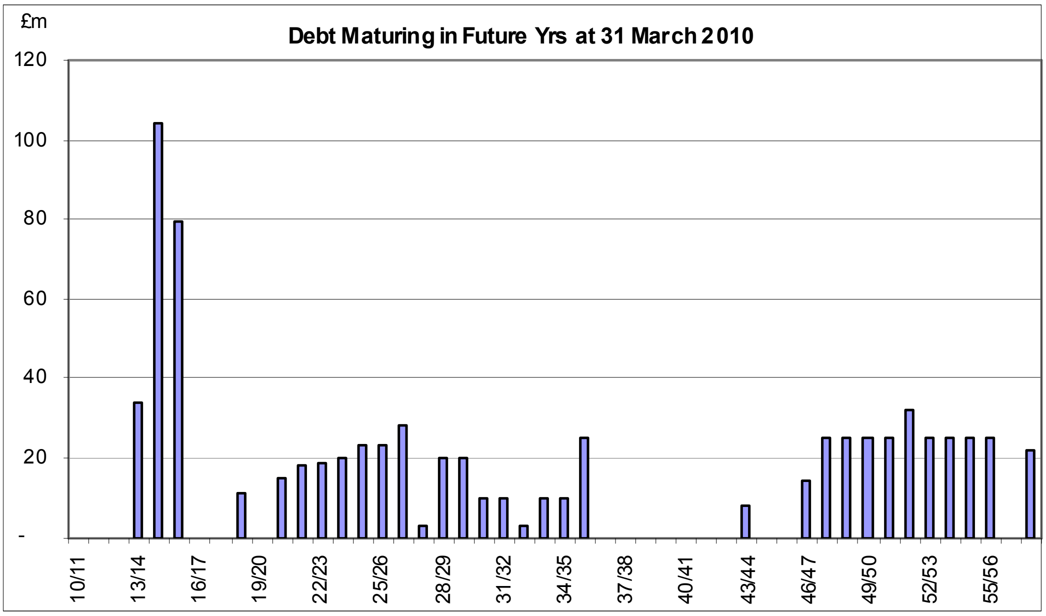
Note: The £212m investment figure quoted in paragraph 2 of this report is made up of the £200.6m detailed in the table above plus £13m in UK Treasury investments sold on 31 March 2010 but not due to settle until 8 April 2010 less £1.5m held on behalf of trust funds.

Fitch Long Term Rating as at 31 March 2010				
Rating	AAA	AA+ to AA-	A+	Total
Period Remaining				
2-5 years	7%			7%
1-2 years	1%			1%
Less than 1 year	26%	46%	10%	82%
Total	34%	46%	10%	90%

Debt Activity and Position

11. Debt outstanding at the end of March 2010 was £762m. No new loans were needed in 2009/10 as the borrowing undertaken in 2008 met that year's capital finance requirements.

12. All debt is at fixed rates from the Public Works Loans Board (PWLB, HM Treasury's local authority lending arm and typically a competitive source of long term borrowing). The average life of the debt is 22 years and the amounts falling for repayment in the future is set out in the chart below. No loans fall for repayment until 2014 and, when they do, they can be replaced with new loans. The average rate of interest across all loans is 6.94% and reflects a long period between the 1970's and early 1990's when high capital spending and debt funding (backed by government support) coincided with years of high inflation and high interest rates.



13. Currently most of the debt interest is supported though cash transfers from the government. Interest on around 80% of the debt is attributable to the housing revenue account (HRA) and reimbursable in subsidy and an allowance for the remainder is included in Formula Grant. However under proposals issued in March 2010 by the last government, support for HRA debt may change in the future if implemented.

14. The current HRA financing system is based on the government's assessment of notional income and costs associated with operating the HRA. The income is calculated on the basis of guideline rents and the costs include allowances for management, maintenance, major repairs and interest on debt. Under this assessment as Southwark's assumed costs are greater than assumed income, government subsidy is provided to make up the shortfall. Details of the proposed reforms were set out in a report to cabinet on 15 June 2010 and if implemented, would reduce Southwark's HRA share of debt so as to leave notional income and expenditure in balance and this together with other changes would form the basis of a self financing regime. Debt interest would then be met entirely from rents collected. The analysis in the cabinet report foresees benefits in the long term, but highlights near term concerns over income, funding for backlog repairs and debt interest, all issues which are being raised with the government.

Prudential Indicators

15. Prudential indicators bring together elements of capital finance, borrowing and investment in a series of estimates and limits to give a general picture of the affordability, prudence and sustainability of financing activities. The outturn for each indicator is set out in Appendix A and includes the authorised borrowing limit, which is a self imposed cap on borrowing outstanding on any one day. The limit for 2009/10 was £885m and included operational flexibility for temporary borrowing and prudent refinancing in a risk controlled framework. With current interest rates well below average loan rates, refinancing costs were high and not affordable. The actual level of debt therefore remained at £762m throughout the year.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Strategic Director of Communities, Law & Governance

16. The constitution determines that agreeing the treasury management strategy is a function of council assembly.

17. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Code of Practice on Treasury Management, both published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

18. Reference should also be made to the Department of Communities and Local Government Guidance on Local Authority Investments updated November 2009. The council assembly should determine borrowing limits annually before the start of the year the limits relate to and approve the prudential indicators and borrowing and investment management strategies.

19. Members are advised to give approval to the recommendations contained in paragraph one of this report ensuring compliance with Government Guidance and CIPFA's codes.

REASONS FOR URGENCY

20. The council assembly must in accordance with Financial Standing Orders consider an annual report on treasury management following the end of the year it relates to and it normally considers such a report before 30 September. This year, the council assembly meeting of 14 July 2010 presents the earliest opportunity that this report can be considered.

21. As discussed in this annual report, the council agreed to more reporting on treasury management. From this year in addition to receiving an annual report and the report on treasury strategy in advance of the year, the council assembly would also receive a half-year report and the cabinet would consider quarterly reports. The first such quarterly report is due to go to cabinet in August and in the interest of proper reporting it is advisable that the annual report for 2009/10 be considered at the 14 July meeting rather than postponed to the October meeting.

REASONS FOR LATENESS

22. This outturn report on treasury management was prepared once the 2009/10 statement of accounts were completed and presented to the audit and governance committee on 30 June 2010. The report was finalised as soon as possible thereafter.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Prudential Code for Capital Finance in Local Authorities - CIPFA. Treasury Management in the Public Services Code of Practice - CIPFA DCLG Guidance on Local Authority Investments. Guidance on Minimum Revenue Provision - Issued by the Secretary of State – SI No. 2008/414	Finance and Resources Department	Dennis Callaghan, Chief Accountant (020 7525 4375)

APPENDIX

No.	Title
Appendix A	Prudential Indicators 2009/10 Outturn

AUDIT TRAIL

Lead Officer	Duncan Whitfield, finance director	
Report Author	Dennis Callaghan, chief accountant	
Version	Final	
Version Date	6 July 2010	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Strategic Director of Communities, Law & Governance	Yes	Yes
Final Report Sent to Constitutional Support Services		6 July 2010

APPENDIX A

PRUDENTIAL INDICATORS 2009/10 OUTTURN

PRUDENTIAL INDICATORS

1. Capital finance, borrowing and investment arrangements are brought together in a series of prudential indicators and limits to give a general picture of the affordability, prudence and sustainability of financing activities. The indicators and limits are grouped into three broad areas: affordability, prudence and treasury management.

2. The indicators are drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice both published by CIPFA and updated in November 2009. The Local Government Act 2003 requires that councils have regard to these codes.

3. This appendix sets out the outturn indicators for 2009/10 drawn from the council's accounts for the year.

CRITERIA ONE: AFFORDABILIY AND PRUDENTIAL INDICATORS ON AFFORDABILITY

INDICATOR ONE: RATIO OF FINANCING COSTS TO NET REVENUE STREAM

The financing ratio reflects financing costs arising from capital expenditure funded from borrowing and income from cash balances. The outturn ratio for the Housing Revenue Account (HRA) and the General Fund (GF) are set out below. The difference in scale between the HRA and the GF is due to the different way the two services are organised. (NB. The negative figure in 2008/09 for the GF represents more GF investment income than GF debt expense in that year).

Financing Ratios	2008/09 Actual	**2009/10 Actual**
HRA	32.0%	**33.0%**
GF	-0.7%	**2.5%**

INDICATOR TWO: THE INCREMENTAL IMPACT OF CAPITAL INVESTMENT ON THE COUNCIL TAX AND HOUSING RENTS

This ratio is about the impact on council tax and rents of the capital programme. No increase in council tax or rent in 2009/10 arose as a result of the programme.

APPENDIX A

PRUDENTIAL INDICATORS 2009/10 OUTTURN

CRITERIA TWO: PRUDENCE AND PRUDENTIAL INDICATORS FOR PRUDENCE

INDICATOR THREE: CAPITAL EXPENDITURE

The actual capital expenditure for 2009/10 was £202m, an overall increase of £11m from the previous year as set out below.

Capital Expenditure	2008/09 Actual £m	**2009/10 Actual £m**
HRA	116	**97**
GF	75	**105**
Total	191	**202**

INDICATOR FOUR: CAPITAL FINANCING REQUIREMENTS.

The capital financing requirement (CFR) reflects the use of borrowing to pay for past capital expenditure. In 2009/10 the HRA CFR rose by £13m, the sum supported by capital expenditure approvals, and the GF CFR fell by £5m, the sum set aside as minimum revenue provision (MRP) in accordance with the MRP policy agreed by council assembly annually.

CFR	2008/09 Actual £m	**2009/10 Actual £m**
HRA	626	**639**
General Fund	131	**126**
Total	757	**765**

INDICATOR FIVE: ACTUAL DEBT- THE AUTHORISED AND OPERATIONAL LIMITS

The limits are for the maximum sum that may be outstanding on debt and long term liabilities on any one day. The lower limit is the operational boundary and takes account of ordinary activity. The authorised limit is the higher limit to accommodate unexpected borrowing that may be needed for very short periods. The total authorised limit is the limit councils have to determine under the Local Government Act 2003.

APPENDIX A

PRUDENTIAL INDICATORS 2009/10 OUTTURN

The limits are related to the CFR and average borrowing is usually close to that. However actual borrowing on any one day may be higher or lower than that depending on cash flow needs and refinancing activity. The limits accommodate such variations where prudent and taken in a risk controlled framework. With interest rates well below average loan rates, refinancing costs were high and not affordable. And as borrowing needed for capital spend in 2009/10 was taken in 2008/09, the actual debt, as shown in the table below, remained unchanged over the course of the year.

Operational Boundary and Authorised Limits for External debt -	2008/09 Actual £m	2009/10 Limit £m	**2009/10 Actual £m**
Operational Boundary for Debt			
Borrowing	762	845	762
Other long term liabilities	0	20	0
Total Operational (*)	762	865	**762**
Authorised Limit for Debt -			
Borrowing	762	885	762
Other long term liabilities	0	20	0
Total Authorised (*)	762	905	**762**

CRITERIA THREE: TREASURY MANAGEMENT

INDICATOR SIX: ADOPTION OF THE CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT IN THE PUBLIC SERVICES

This indicator is about confirming that CIPFA's treasury management code has been adopted. The code was updated in November 2009 and council assembly agreed its additional recommendations on reporting and scrutiny at its meeting in February 2010.

INDICATOR SEVEN: INTEREST RATE EXPOSURES – FIXED
INDICATOR EIGHT: INTEREST RATE EXPOSURES - VARIABLE
INDICATOR NINE: MATURITIES

Council debt currently consists entirely of fixed rate loans, with very little falling for repayment over the next few years. As with the authorised and operational limits, the interest rate exposure limits include flexibility for debt to vary prudently should financing conditions prove favourable. As no new borrowing or refinancing was carried out, the 2009/10 outturn fixed, variable and maturity indicators, set out below, reflect the existing debt structure.

LIMITS ON FIXED AND VARIABLE RATES	2008/09 Actual £m	2009/10 Limit £m	**2009/10 Actual £m**
Upper limit for fixed interest rate exposure	762	885	**762**
Upper limit for variable rate exposure	0	220	**0**

APPENDIX A

PRUDENTIAL INDICATORS 2009/10 OUTTURN

Maturity structure of fixed rate borrowing	2008/09 Actual	2009/10 Lower Limit	2009/10 Upper Limit	**2009/10 Actual**
Under 12 months	0%	0%	30%	**0%**
12 months and within 24 months	0%	0%	30%	**0%**
24 months and within 5 years	0%	0%	60%	**4%**
5 years and within 10 years	29%	0%	80%	**26%**
10 years and above	71%	0%	100%	**70%**

INDICATOR TEN: TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS.

Cash balances are invested across a number of counterparties which include the Government, local authorities, and major high rated banks and building societies. Exposures to investments beyond one year were managed within a risk controlled framework by fund managers and were held in UK Government debt or supranational bonds. Actual exposure against the limits is set out below.

Upper limit on investments greater than 1 yr	2008/09 Actual	2009/10 Limit	**2009/10 Actual**
Upper limit / Actual	Actual max exposure 25% of investments greater than 1 year Overall maximum average maturity 1.1 years Longest Investment 10 years	Up to 50% of investments. Greater than 1 year Overall average maturity 3 years, but any one investment may be longer as referred to in the Annual Investment Strategy	**20% of investments greater than 1 year** **Overall maximum average maturity 8 months** **Longest investment 10 yrs**

This page is intentionally blank.

COUNCIL ASSEMBLY AGENDA DISTRIBUTION LIST (OPEN)
(SUPPLEMENTAL AGENDA)
MUNICIPAL YEAR 2010-11

NOTE: Original held by Constitutional Team; all amendments/queries to Lesley John Tel: 020 7525 7228/7236

ONE COPY TO ALL UNLESS OTHERWISE STATED	Copies	To	Copies
All Councillors	**63**	**Others**	
Political Assistants		Shahida Nasim, Audit Commission Ground Floor, Tooley Street	**1**
Dan Falchicov, Liberal Democrat Political Assistant	**1**	Doreen Forrester-Brown	**1**
John Bibby, Labour Group Political Assistant	**1**		
Libraries (1 each)	**4**		
Albion / Dulwich / Newington / Local Studies Library			
Press	**2**		
Southwark News South London Press			
Corporate Management Team	**7**		
Annie Shepperd Deborah Collins Gill Davies Richard Rawes Romi Bowen Duncan Whitfield Susanna White			
Other Officers			
Robin Campbell	**1**		
Sonia Sutton	**1**		
Ian Millichap	**1**		
5 copies to Lesley John , 2nd Floor, Hub 4 Tooley Street and 15 copies to Lesley John, Town Hall Peckham)	**20**		
		Last Updated: May 2010	
		Total:	**103**