

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

## RECOMMENDATIONS

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

## BACKGROUND INFORMATION

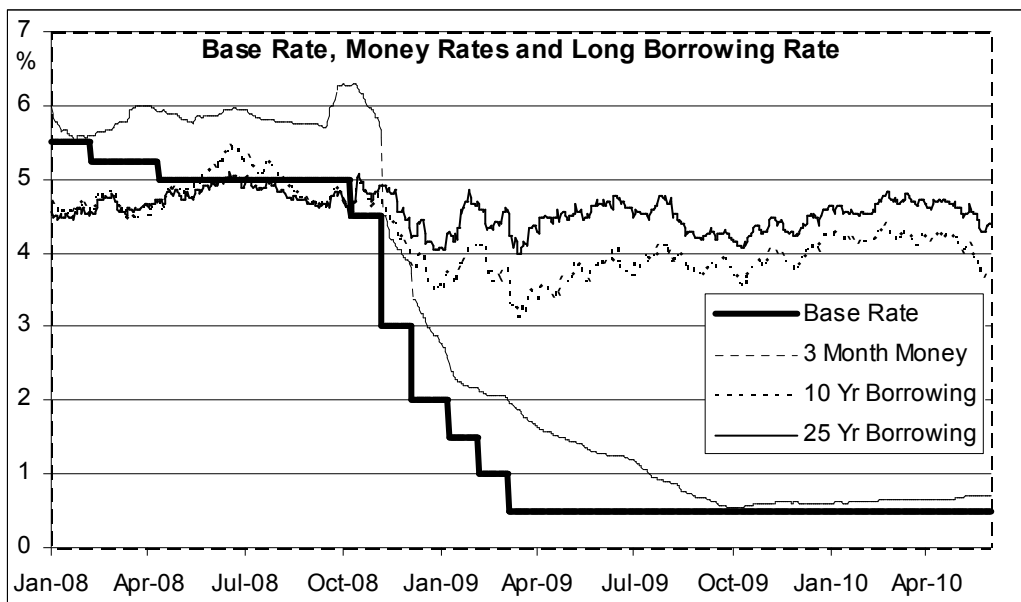
2. The council holds some £212m in investments (as detailed in note to paragraph 10) and £762m in debt as at 31 March 2010. The debt arises from past borrowing to pay for capital spend which was not otherwise financed from capital receipts, grants or revenue. A sum is paid off, in the form of minimum 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

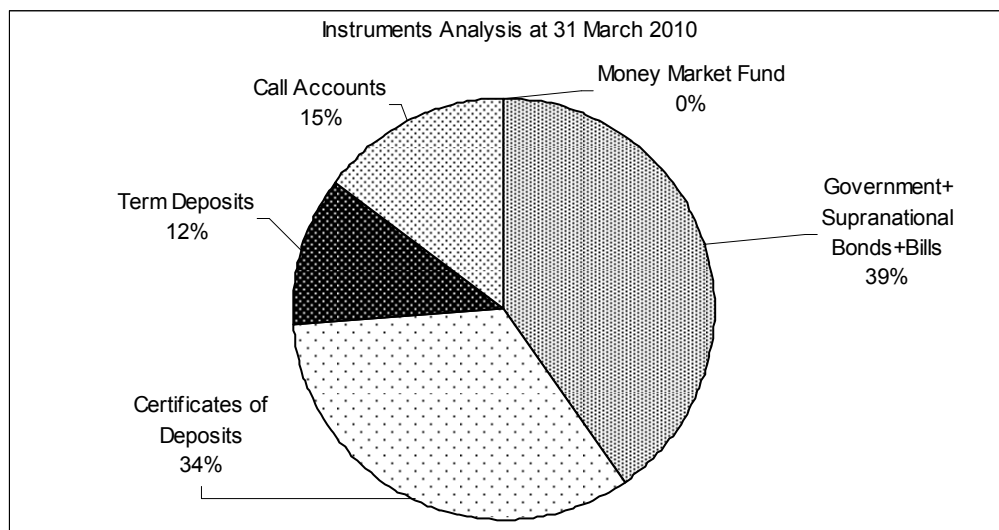
#### Financial Market Backdrop

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.



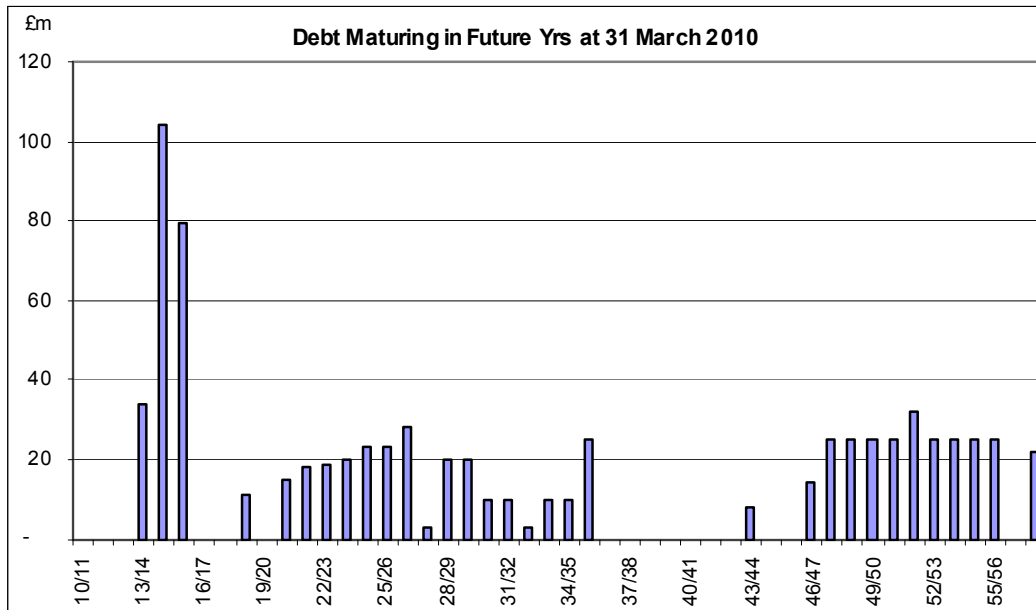
COUNTERPARTY EXPOSURE AND RATINGS										
COUNTERPARTY	FUND					RATING				
	ABERDEEN	ALLIANCE BERNSTEIN	INVESCO	IN-HOUSE	Total £m	Long	Short	Support	Country	Country Rating
BARCLAYS BK	7.0	0.5	7.0	10.0	24.5	AA-	F1+	1	UK	AAA
CREDIT AGRIC CIB			7.0		7.0	AA-	F1+	1	FRANCE	AAA
CREDIT INDST COMRCL	5.4				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 MMIF					-	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
<b>Total £m</b>	<b>57.0</b>	<b>57.1</b>	<b>42.5</b>	<b>44.0</b>	<b>200.6</b>					

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%
<b>Total</b>	<b>34%</b>	<b>46%</b>	<b>10%</b>	<b>90%</b>

## Debt Activity and Position

- 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.
- All debt is at fixed rates from the Public Works Loans Board (PWL, 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.	Finance and Resources Department	Dennis Callaghan, Chief Accountant (020 7525 4375)
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		

## APPENDIX

No.	Title
Appendix A	Prudential Indicators 2009/10 Outturn

## AUDIT TRAIL

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