Item No: 6.4	Classification: Open	Date: July 8 2009	Meeting Name: Council Assembly
Report title:		Treasury Management Performance - 2008-09 Annual Report and Prudential Indicators for Capital Finance and Treasury Management	
Wards or Groups affected:		All	
From:		Finance Director	

RECOMMENDATION

1. That Council Assembly notes this outturn report on borrowing, investments, capital finance and prudential indicators for 2008/09.

BACKGROUND INFORMATION

2. The Council borrows money to fund capital spend that is not otherwise met from capital receipts, grants or revenue and re-finances debt as it matures. Any cash that is not consumed in spending is placed on deposits or held in bonds to earn interest. This activity is supported by a series of prudential indicators (estimates and limits on capital finance borrowing and investments), and an investment strategy agreed by Council Assembly. The indicators and activities are backed up by the Local Government Act 2003 and codes of practice issued by the Chartered Institute of Public Finance and Accountancy.

3. Under financial delegation the Finance Director is responsible for executing all policy, executive and managerial decisions on borrowings and investments within prudential indicators and strategy agreed by Council Assembly. The 2008/09 indicators and strategy were agreed in February 2008 and updated in February 2009 and this report sets out the activity carried out in 2008/09 and the economic background that affected it.

KEY ISSUES FOR CONSIDERATION

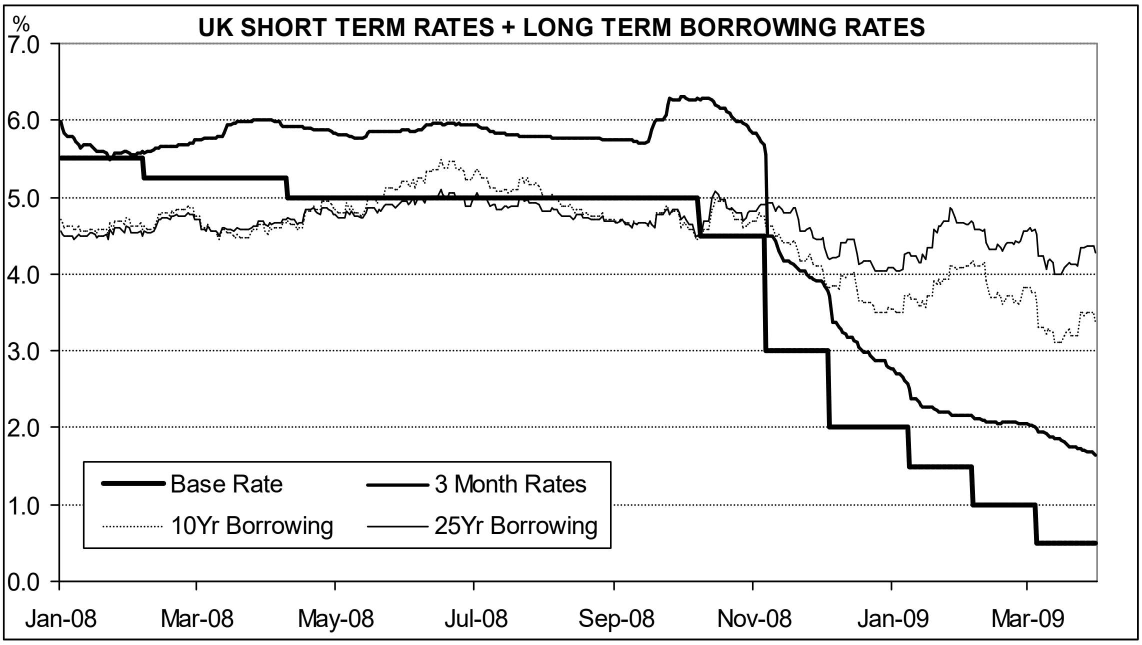
Background - Developments in Financial Markets

4. Treasury management was carried out against a background of unusually high instability in the financial markets. What started in the summer of 2007 as losses from rising rates of mortgage delinquencies (particularly US sub-prime mortgages and related products), turned a year later, in September 2008, into a general loss of confidence in the global banking system after the failure of the US Government to secure Lehman Brothers (the large US based investment bank). Central banks responded to the first signs of the crisis in 2007 by supplying extensive liquidity to banks, and supporting institutions on a case by case basis. This seemed to calm the markets, which right up to summer 2008 were focused on risks to inflation from rising oil and food prices and resilient emerging market demand.

5. But when in September 2008, the US government rescued its large mortgage finance companies (Fannie Mae and Freddie Mac), but then failed to stop Lehman Brothers filing for bankruptcy, investors picked up this inconsistency, panicked, deserted the capital markets and headed for the relative safety of government bonds. Governments across the world then stepped in by supplying unprecedented sums in liquidity to all banks, helping major banks re-capitalise, deal with problem loans and provide deposit guarantees, but

many smaller banks, notably in the US, filed for bankruptcy, and three Icelandic banks, in which more than 100 UK local authorities had deposits, went into administration - Southwark was not one of those.

6. The loss of confidence in the financial markets was also threatening a tight squeeze on credit to household and businesses. As oil and commodity prices fell, inflation expectations turned downwards and opened the way for globally coordinated interest rates cuts in October 2008. In the UK, the base rate fell from 5.00% in September 2008 to just 0.50% by March 2009. Euro rates came down to 1.00% by May 2009 and the main US bank rate was brought down to between zero and 0.25% by December 2008. The long term borrowing rates also fell as investors preferred government debt over commercial debt; refer chart below for UK short and long term interest rates.



7. Governments also brought in fiscal stimulus packages to help reduce the effects of tighter credit as well as measures to support credit markets and relieve banks of impaired assets. These measures should boost confidence in the financial system, but they will take time to work though the economy. Until then, the squeeze on credit and loss in wealth thus far is expected to lead to a marked downturn in economic activity in the UK, US and the Euro zone, and a slowdown in growth elsewhere.

Investment Management

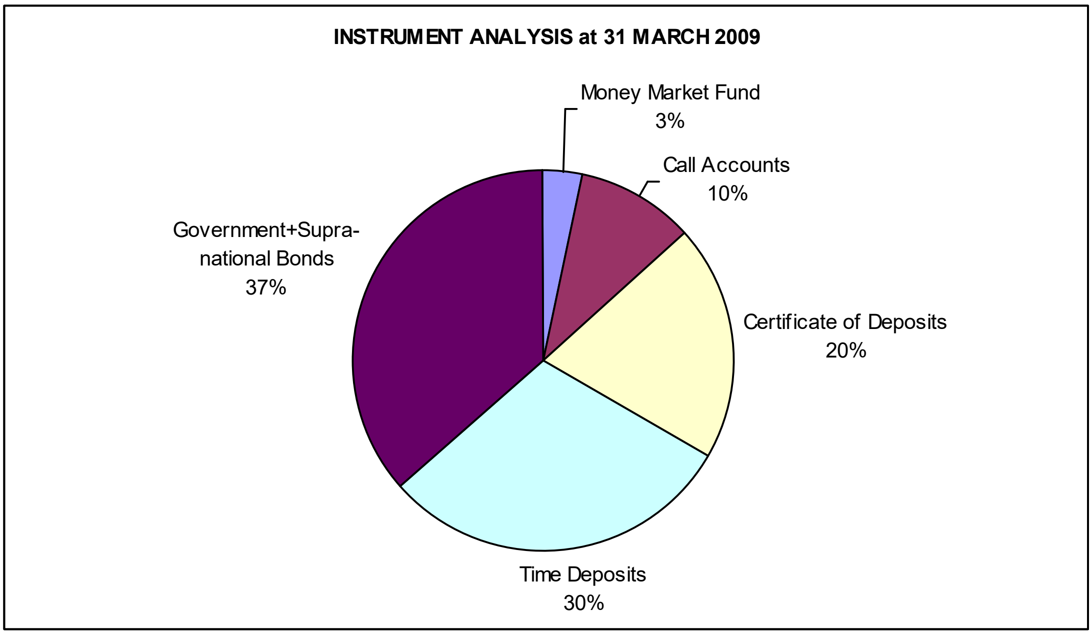
8. The basic approach to lending in the financial crisis was to bias lending in favour of major banks in major economies where the likelihood of support, in the event it were needed, was high. Holding of UK Government and Supranational bonds was also increased. This helped the Council avoid credit losses which many other councils suffered and helped slow down the adverse effects of falling interest rates. The approach is consistent with the Government's own investment guidelines on local authority investments and is recognised in the Council's Annual Investment Strategy approved each year.

9. Cash balances averaged £292m over the course of 2008/09 (£298m in 2007/08). Day to day investment management is carried out by an in-house operation and three investment management firms: Invesco Asset

Management Ltd, AllianceBernstein Ltd and Credit Suisse Asset Management Ltd.

10. External managers provide access to liquid instruments and maturities beyond one year and expertise to help the Council enhance long term returns, with capital preservation, liquidity, low market risk and prudence as priorities, all within an agreed investment strategy. In-house funds focus on meeting day to day cash volatility using a number of call accounts, money market funds and short term deposits.

11. The actual sum held in instruments at 31 March 2009 stood at £253m (£274m March 2008) and was spread across instruments, counterparties and rating detailed in the chart and tables below.



INVESTMENT MATURITY PROFILE AND RATING				
Year Maturing	**Fitch Long Term Rating at 31 March 2009**			
	AAA	**AA+ to AA-**	**A+**	**Total**
5-10 Years	5%			5%
2-5 Years	9%			9%
1-2 Years	11%			11%
Less than 1 Year	15%	54%	6%	75%
Total	**40%**	**54%**	**6%**	**100%**

INVESTMENT POSITION AND RATING at 31 MAR 2009						
COUNTRY/ COUNTERPARTY	FITCH RATING	ALLIANCE BERNSTEIN	CREDIT SUISSE	INVESCO	IN-HOUSE	TOTAL
AUSTRALIA	**AAA**					
WESTPAC BK CORP	AA-			5.5		5.5
FINLAND	**AAA**					
NORDEA BANK FINLAND	AA-		4.0			4.0
FRANCE	**AAA**					
SOCIETE GENERALE	AA-	0.5		5.0		5.5
CREDIT AGRIC IND	AA-			5.2		5.2
GERMANY	**AAA**					
DZ BANK AG	A+		3.5			3.5
IRELAND	**AAA**					
GLOBAL TREAS FNDS (Money Mkt Fund)	AAA				8.7	8.7
ITALY	**AA-**					
INTESA SANPAOLO SPA	AA-		5.0			5.0
UNICREDITO ITALIANO	A+		3.5			3.5
NETHERLANDS	**AAA**					
ING	AA-	0.5		5.0		5.5
RABOBANK	AA+	0.5		5.5		6.0
NORWAY	**AAA**					
DNB NOR BANK	A+	0.5				0.5
SWITZERLAND	**AAA**					
CREDIT SUISSE	AA-	0.6		5.3		5.9
UBS	A+		8.0			8.0
UK	**AAA**					
BARCLAYS	AA-		7.0	5.3	15.8	28.1
HSBC	AA	0.1				0.1
LLOYDS TSB	AA-	0.5	3.6		15.3	19.4
NATIONWIDE	AA-	0.3			5.1	5.4
NATWEST	AA-				40.6	40.6
LCR FINANCE UK GUARNTD	AAA	5.5				5.5
EXPORT FIN CORP UK GUARNTD	AAA	4.5				4.5
UK HM TREASURY	AAA	30.7	13.7	18.5		62.9
SUPRANATIONAL	**AAA**					
EUROPEAN INVESTMENT BK	AAA	5.1	7.8			12.9
INTER BK RECON+DEVT	AAA	6.7				6.7
TOTAL		**56.0**	**56.1**	**55.3**	**85.5**	**252.9**

In the table, the counterparty rating refers to long term rating issued by Fitch, a rating agency, and in the case of the Money Market Fund, the Fund's rating. Bonds guaranteed by the UK Government are treated as having the same rating as bonds issued by the Government itself.

12. The average return for 2008/09 was 5.5% against average base rates of 3.6%. The return reflects past activity and as investments mature, and are reinvested, future returns will be considerably weaker, reflecting the steep fall in base rates. Prudential Indicators in relation to investment management are set out in Appendix A.

Debt Management and Capital Finance

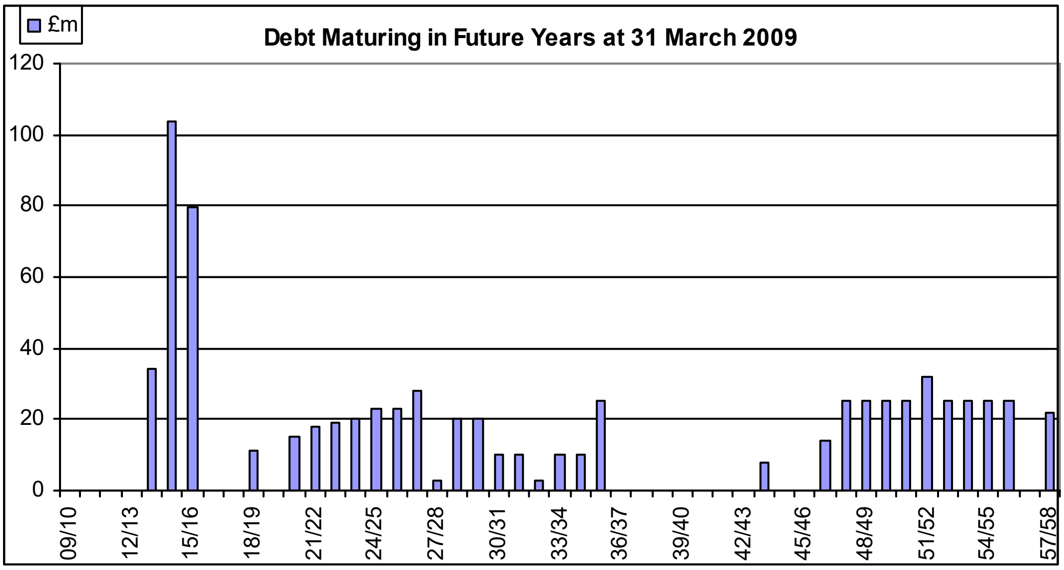
13. Borrowing is undertaken to meet that element of capital spend that is not met from locally available resources (receipts from asset sales, grants and revenue funding). Borrowing for capital takes two forms: supported borrowing (which is associated with support for interest and sums set aside to repay debt) or self-financed prudential borrowing (the cost of which attracts no revenue support from the Government). The principal source of borrowing for

local authorities is the Public Works Loans Board (PWLB, a division of HM Treasury).

14. In December 2008, £32m in new loans were taken up to meet supported capital spend. The loans were for a term of 43 years at a rate of 3.99%, near historical lows for long loans and below the 7.6% average rate on debt interest in 2007/08. As well as providing funding certainty, the loans help reduce the risk of rate rises in the long term.

15. The average rate of interest on long term debt was 7.0% in 2008/09 and remains high relative to current rates and that of many other local authorities. The average reflects a long period between the 1970's and early 1990's, unlike now, when high capital spending and re-financing of debt originally taken on in the 1960's to fund council house building coincided with years of high inflation and high interest rates. However, as around 83% of the debt is attributable to the HRA and reimbursed in subsidy pound-for-pound, and an allowance for the remainder is included in Formula Grant, the impact on Council finances of the high average rate is limited.

16. The level of debt as at 31 March 2009 stands at £762m, an increase of £32m since April 2008. All loans are at fixed rates, from the PWLB and the average life of loans is 23 years. The amount falling out for refinance in futures years is shown in the chart below – the Council has no loans maturing before 2014.



Prudential Indicators

17. Prudential indicators draw out elements of borrowing and investment activities and combine them with capital finance. The indicators include the authorised borrowing limit, which is a self imposed cap on borrowing outstanding on any one day. The Council was within the limit throughout 2008/09. The detailed indicators are set out In Appendix A.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Strategic Director of Communities, Law & Governance

18. 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.

19. Reference should also be made to the Department of Communities and Local Government (DCLG, previously the ODPM) Guidance on Local Authority Investments issued in 2004.

20. The Council Assembly is responsible for determining or changing borrowing limits and indicators. However, no changes are being proposed in this report.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Prudential Code for Capital Finance in Local Authorities. Code of Practice on Treasury Management in the Public Services ODPM - Guidance on Local Authority Investments issued in 2004	Financial Management Services, Strategic Services Department	Dennis Callaghan, Chief Accountant (020 7525 4375)

APPENDICES

No.	Title
Appendix A	Prudential Indicators - 2008/09 Outturn

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Finance Director	
Report Author	Dennis Callaghan, Chief Accountant	
Version	Final	
Version Date	26 June 2009	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Strategic Director of Communities, Law & Governance	Yes	Yes
Final Report Sent to Constitutional Support Services		26 June 2009