
REPORT FOR RESOLUTION

REPORT TO: Audit Committee - 3 June 2010
SUBJECT: Treasury Management Annual Report 2009-10
REPORT OF: City Treasurer

PURPOSE OF REPORT:

To report the Treasury Management activities of the Council during 2009-10

RECOMMENDATIONS:

The Audit Committee is asked to note the report which, subject to the comments of the Committee, will be sent to Full Council on 14 July 2010.

FINANCIAL CONSEQUENCES FOR THE REVENUE BUDGET

None directly.

FINANCIAL CONSEQUENCES FOR THE CAPITAL BUDGET

None.

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BACKGROUND DOCUMENTS

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2009/10 (Executive Committee 11 February 2009)

WARDS AFFECTED

Not Applicable

IMPLICATIONS FOR:

Anti Poverty	Equal Opportunities Employment	Environment	
None	None	None	None

1 Introduction and Background

- 1.1 Treasury Management in Local Government is regulated by the CIPFA Code of Practice on Treasury Management in Local Authorities. The City Council has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Chief Financial Officer responsibilities, and delegation and reporting arrangements. This was approved by the Council on 8 October 2003.
- 1.2 In 2009 CIPFA revised the Code of Practice on Treasury Management, this was adopted by the Council on 3 March 2010 and the Council fully complies with the requirements of both the original and revised codes.

The primary requirements of the Code are as follows:

- I. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- II. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- III. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a midyear review report and an annual review report of the previous year.
- IV. 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.
- V. 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 Resource and Governance Overview and Scrutiny Committee. The responsible body for receiving and reviewing regular monitoring reports and scrutinising treasury management performance 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, 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 inform members of the treasury management activity undertaken in the financial year 2009/10, in accordance with the CIPFA code.

1.3 This annual report covers:

Section 1.	Introduction and Background
Section 2.	The Council's treasury position as at 31 st March 2010
Section 3.	The strategy for 2009-10
Section 4.	Treasury Borrowing in 2009-10
Section 5.	Compliance with treasury limits and prudential indicators
Section 6.	Investment strategy for 2009-10
Section 7.	Temporary Borrowing and Investment Outturn for 2009-10
Section 8.	Debt rescheduling
Section 9.	Conclusion
Appendix A	PWLB interest rates
Appendix B	Treasury Management Prudential Indicators
Appendix C	Glossary of Terms

2 Current Portfolio Position

2.1 The last year has seen an interest rate differential between the cost of long term debt (4% to 4.5%) and the return available from short term investments (Under 1%) which led to the council following a strategy of running down investments and borrowing internally (using cash backed reserves). As well as the cost of carry (paying out more interest on long term borrowing than could be earned from short term investing), there was also a difficulty in finding suitable organisations to lend surplus cash as fewer of them met our counterparty criteria since the banking crisis.

2.2 As outlined in the approved Treasury Management Strategy for 2009/10 there was an ongoing need to undertake some permanent borrowing in 2009/10 to fund the capital programme. Some of this borrowing has now been taken however the policy remains to keep cash low and minimise temporary investments.

2.3 The Council's debt position at the beginning and end of year was as follows:

Loan Type	31 March 2009		31 March 2010	
	Principal £m	Average Rate %	Principal £m	Average Rate %
PWLB	100.3	8.87	131.1	3.96
Temporary	24.6	0.50	0.7	0.49
Market Loans	549.6	4.89	549.6	4.89
Stock	8.2	3.36	8.2	3.36
Gross Total	682.7	5.30	689.6	4.69
Temporary Deposits	(6.2)	0.45	(17.2)	0.75
Net Total	676.5	5.34	672.5	4.79

- 2.4 The table above shows that the average rate of interest paid has decreased over the course of the year, from 5.34% to 4.79%. On 30 March 2009 the East Manchester LSVT took place which led to the DCLG repaying £94.1m of our PWLB debt on 2 April 2009, with an average interest rate of 8.87%. £125M of new PWLB debt has since been taken on at much lower rates as outlined in Section 4.
- 2.5 The temporary borrowing and deposit figures fluctuate daily to meet the daily cashflow requirements of the council. The temporary figures in the table above are therefore only a snapshot at a particular point in time.

3 The Strategy for 2009-10

- 3.1 A strong theme throughout 2009-10 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. This has therefore resulted in more of our investment portfolio being moved into investment instruments with lower rates of return but higher security and liquidity.
- 3.2 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 needs to 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 throughout 2010/11 due to market concerns regarding sovereign debt levels and the re-emergence of inflationary pressures. The Council is continuing to proactively monitor this position.

4 Treasury Borrowing in 2009-10

- 4.1 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 as illustrated in the table below and the graph at Appendix A.

	1	5	10	25	50
1. 4.2009	0.83%	2.54%	3.36%	4.28%	4.57%
31.3.2010	0.83%	2.89%	4.19%	4.67%	4.70%
HIGH	1.20%	3.29%	4.42%	4.83%	4.85%
LOW	0.68%	2.47%	3.30%	4.07%	4.18%
spread	0.52%	0.82%	1.12%	0.76%	0.67%
average	0.90%	2.90%	3.93%	4.49%	4.51%
high date	09/06/2009	28/07/2009	22/02/2010	22/02/2010	02/06/2009
low date	16/09/2009	02/04/2009	02/04/2009	09/10/2009	09/10/2009

- 4.2 Due to the overall financial position as outlined in paragraph 2.1 and the underlying need to borrow for capital purposes, new external borrowing of £125m was undertaken in 2009/2010 from the PWLB.

Some of the borrowing requirement was taken at the shorter term (£30m at 4½ years) to take advantage of the lower rates and reduce debt servicing costs in the short term. The majority of debt is taken on at longer term fixed rate funding to enable the council to have a stable longer term portfolio and take advantage of historically low long term funding costs.

The rates at which the borrowing took place are shown in the table below and marked on the graph at Appendix 1. The majority of the borrowing was at durations of 20-25 years, the rates achieved were between 4.14% and 4.21% close to the lowest points so far this year, (the average rate for these maturities was between 4.45% and 4.49%).

	Start Date	Maturity (Years)	Amount (£M)	Interest Rate	09/10 Average Rate
A	02/09/2009	20	20	4.14%	4.45%
B	02/09/2009	25	10	4.21%	4.49%
C	18/09/2009	21.5	10	4.16%	4.47%
D	18/09/2009	24	10	4.18%	4.48%
E	13/10/2009	4.5	30	2.38%	2.72%
F	13/10/2009	20	20	4.01%	4.45%
G	01/12/2009	50	25	4.21%	4.51%

5 Compliance with Treasury Limits

- 5.1 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. The outturn for the Prudential Indicators is shown in Appendix 2.

6 Investment Strategy for 2009-10

- 6.1 The Treasury Management Strategy Statement (TMSS) for 2009/10 was approved by Council on 11th February 2009. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as (a) the security of capital and (b) liquidity of investments.
- 6.2 In order to achieve a higher level of security the City Treasurer introduced the following measures:
- Investments to be restricted to UK banks, building societies, local authorities and government institutions.
 - Diversify the investment portfolio into more secure UK government and government backed institutions.
 - Although the investment strategy allows investments up to 364 days, restrict

deposits to a short a time period as feasible.

- 6.3 The City Council's temporary cash balances are managed by the City Treasurer in-house and invested with those institutions listed in the City's Approved Lending List. Officers can confirm these institutions meet the security criteria set out in the Annual Investment Strategy and the approved limits were not breached in 2009/10.

7 Temporary Borrowing and Investment Outturn for 2009/10

- 7.1 As illustrated in the economic background section, investment rates available in the market are at an historical low point. The average level of cash available for investment purposes in 2009/10 was £17.177m. This can vary considerably on a day by day basis depending on the timing on large cash outflows and inflows such as precept payments, progress on the Capital Programme, salary payments, receipt of grants and dates at which long term external borrowing was taken.
- 7.2 Detailed below is the result of the temporary investment and borrowing undertaken by the Council. As illustrated, the authority outperformed the benchmark by 24bp on investments and 15bp on borrowing.

	Average temporary Investment /borrowing	Net Return / Cost	Benchmark Return / Cost *
Temporary Investments	£17.177m	0.66%	0.42%
Temporary Borrowing	£11.531m	0.40%	0.55%

* *Average 7-day LIBID / LIBOR rate sourced from Sector*

- 7.3 None of the institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year. The list of institutions in which the Council invests is kept under continuous review.

8 Debt Rescheduling

- 8.1 No loan rescheduling was undertaken during the year.

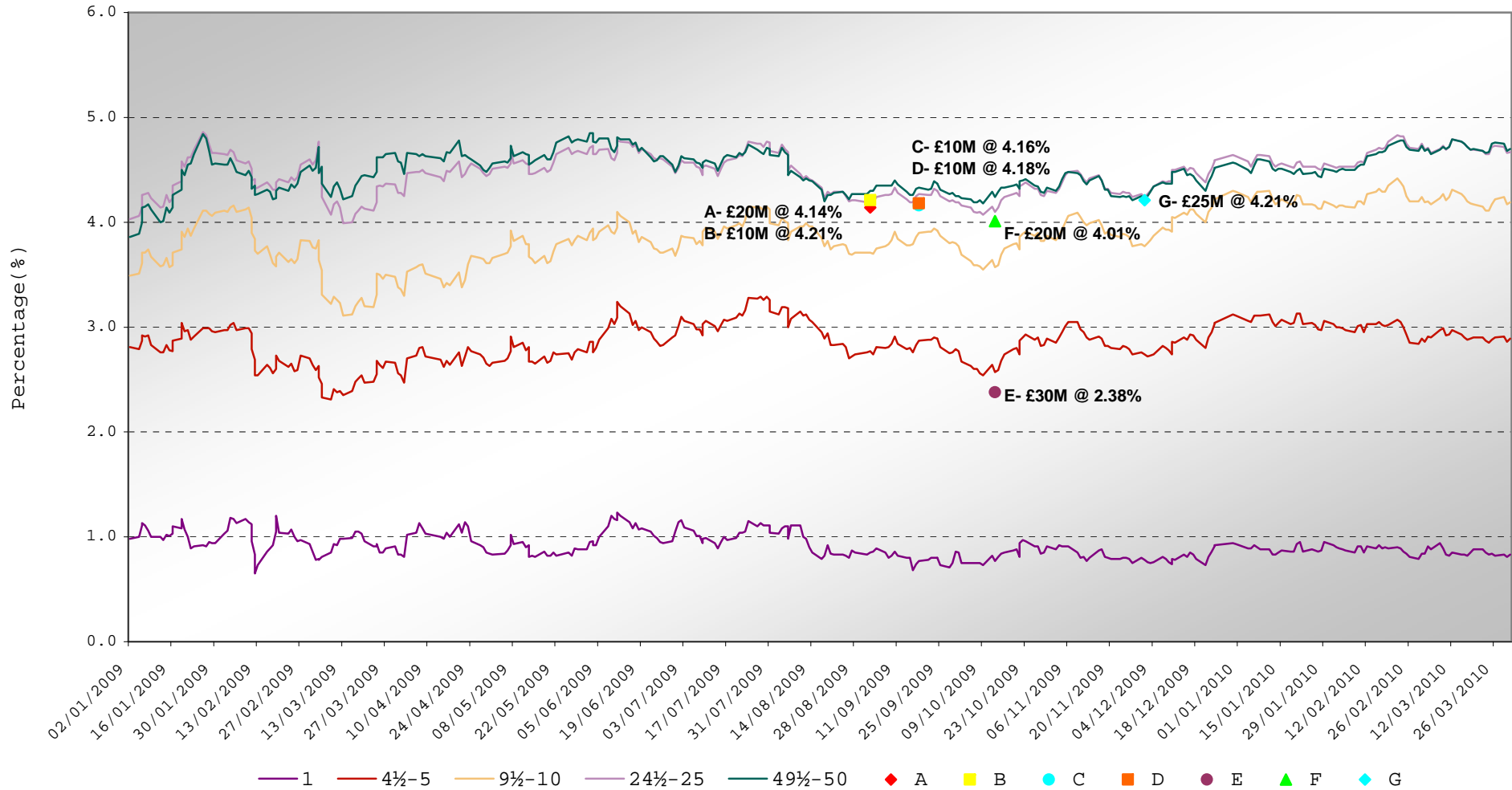
9 Conclusion

- 9.1 The current borrowing position reflects the strong balance sheet of the council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows etc). Although some new borrowing has been taken the policy remains to keep cash as low as possible and, generally, not to borrow in advance of need for capital purposes.

- 9.2 Proactive treasury management during the year has enabled us to achieve an average net return on our investments of 0.66%, which is significantly better than the Benchmark Average 7-day LIBID rate of 0.42% and an average cost of temporary borrowing of 0.40% which is better than the benchmark of 0.55%. In addition, the average rate of interest on the Council's overall net debt reduced from 5.34% to 4.79%, in the main due to high interest PWLB debt being redeemed by the Government and new PWLB debt being taken on close to the lowest interest rates available so far this year.
- 9.3 A further £20M of PWLB borrowing has been taken out after 31st March 2010, this was taken in advance of need to enable the council to take advantage of historically low long term rates prior to the General Election.
- 9.4 Consideration will be given to further borrowing in 2010-11 depending on the interest rates available and the need to borrow to meet the council's cash needs. Whilst the council has in the past made substantial use of market funds there is less availability in the market since the 'credit crunch' and PWLB loans are seen as providing more certainly and better value. However all alternatives available will continue to be considered.

2009-10 PWLB Rates

APPENDIX 1



TREASURY MANAGEMENT PRUDENTIAL INDICATORS : 2009-10

	Original £000	Minimum In Year £000	Maximum In Year £000
Operational Boundary for External Debt - Borrowing	£1,028,000	£565,099	£696,977
Other Long Term Liabilities	£0	£0	£0
Authorised Limit for External Debt - Borrowing	£1,167,000	£565,099	£696,977
Other Long Term Liabilities	£0	£0	£0
	Original	Actual as at 31 March 2010	
Authority has adopted CIPFA's Code of Practice for Treasury Management in the Public Services	Yes	Yes	
Upper Limit for Fixed Interest Rate Exposure			
Net Borrowing at Fixed Rate as a percentage of Total Net Borrowing	73%	72%	
Upper Limit for Variable Interest Rate exposure			
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	71%	28%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

	<u>Lower Limit</u>	<u>Upper Limit</u>	
Maturity structure of Fixed Rate Borrowing	2009-10 Original	2009-10 Original	Actual as at 31 March 2010
under 12 months	0%	50%	0%
12 months and within 24 months	0%	60%	24%
24 months and within 5 years	20%	70%	46%
5 years and within 10 years	0%	60%	9%
10 years and above	0%	60%	21%

Appendix 3

Glossary of Terms

Authorised Limit - This represents the limit beyond which borrowing is prohibited, and needs to be set and revised by the Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Carrying Amount – the amount of principal and accumulated interest outstanding on loans or investments with a third party (e.g., banks, building societies).

Counterparty – the other party involved in a borrowing or investment transaction.

Credit Rating – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount – Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fair Value - this is defined as the amount that the asset or liability could be exchanged for, assuming that the transaction was negotiated between parties knowledgeable about the market in which they are dealing and willing to buy or sell at an appropriate price.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

LIBOR – (London Interbank Offer Rate). The interest rate at which banks offer to take short-term borrowing from other banks in the London interbank market.

Liquidity – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO – Lender Option Borrower Option. Long-term borrowing deals structured in a such a way that a low rate of interest is usually offered for a short, initial period (anything from 1 year to 7 years), followed by a “step up” to a higher rate of interest (the “back end” interest rate), which is to be charged for the remainder of the loan period. The overall length of LOBOs is usually 50 or 60 years, but can be for shorter or longer periods. After the “step up” date, and at set intervals thereafter, the lender (the bank) has the option of increasing the “back end” interest rate. Whenever this option is exercised, if the proposed new

interest rate is unacceptable, the borrower (the City Council) can redeem the loan without penalty. Vanilla LOBO loans have an interest rate which remains constant throughout the life of the loan, although still potentially subject to change at the lender's option.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

Monetary Policy Committee (MPC) – the independent body which determines Bank Rate.

Operational Boundary – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an early warning indicator to ensure the Authorised Limit is not breached.

Premium – Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. An institution managed by the Government to provide loans to public bodies at rates which reflect the rates at which the government is able to sell Gilts.

SORP - Code of Practice on Local Authority Accounting in the United Kingdom - A Statement of Recommended Practice. This is based on approved accounting standards.

Variable Rate Funding - The rate of interest either continually moves to reflect interest rates of the day, or can be tied to specific dates during the loan period. Rates may change on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt that matures in the year and needs replacing, and the more debt subject to variable interest rates, the greater the volatility.

Weighted Average Interest Rate – There are several ways of weighting an interest rate calculation (e.g. period in years, months or days), but, for the Council's Treasury Management activities, the weighted average interest rate for a number of borrowing or investment loans is derived by taking into account the amount of the principal over a particular period, not just its interest rate.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short term loans compared to long term loans. An inverted Yield Curve is the opposite of this.