APPENDIX A

Treasury Report 2009/10

1. Background

Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management. This report summarises details of borrowing and investment transactions that took place in 2009/10, and confirms compliance with the Prudential Indicators set out in the Treasury Management Strategy Statement for 2009/10.

2. The economy and events in 2009-10

- After the particularly torrid economic recession and a severe downturn in growth that extended into early 2009, there were reports of nascent recovery. These however did not materialise as evidence gathered that the global economy, including the UK, struggle further before it recovered.
- The Bank of England forecast UK growth to fall by 3.9% in 2009, whilst inflation was forecast to be heading lower and staying lower for longer. The depth of the recession was borne out by the -5.9% year-on-year fall in growth recorded at the end of the second quarter of 2009. The service sector - the dominant element of UK economy - also stalled for much of early 2009 despite a number of optimistic surveys to the contrary. Green shoots of recovery were finally evident in the final quarter of 2009 with growth registering 0.4% for the quarter.
- In order to stimulate growth, the Bank of England maintained the Bank Interest Rate at 0.5% through the year. The Bank also took extreme measures on an extraordinary scale to revive the economy through its Quantitative Easing (QE) programme. Financed by the issuance of central bank reserves, QE was initially announced at £75bn, then extended in stages to £200bn by November.
- The Bank appears to have successfully staved off the very real risk of deflation. The increased supply of money in the system due to QE has not translated into an increase in the movement of money in the system as banks are still unwilling to lend and consumers are unwilling to borrow at pre-crisis levels.
- The housing market showed some signs of stability but increases in house prices were initially modest. Nationwide House prices registered a year on year growth of 9% at the end of March 2010.
- Consumer Price Inflation, having hit a high of 5.2% in September 2008, began the year at 3.2% (Feb 2009 data), fell to a low of 1.1% in September 2009 as the oil, commodity, utility and food prices (the 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 to 17.5%; CPI ended the year at 3.0% (Feb 2010 data) .

- Companies and households on the whole reduced rather than increased their levels of debt during the quarter. Credit remained scarce and at a premium, and certainly as compared to that available two years prior. Businesses retrenched rather than hired workers and unemployment rose rapidly to just under 2.5 million. Against this background, wage growth was muted.

- The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by stubbornly high unemployment.

- The 2009 UK Budget was primarily about public debt. The Chancellor's forecast for net public sector borrowing in 2009/10 is £175bn or 12.4% of GDP. Gross gilt issuance was expected to hit a quite staggering £220bn in 2009/10. Standard & Poor's rating agency responded to the debt that the UK government was building up and a lack of a credible plan to reduce the debt burden. The agency changed the UK's rating outlook from stable to negative.

- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and a credible plan to reduce the deficit is urgently required after the May General Election, the absence of which increases the potential of a sovereign downgrade. The likelihood of a hung parliament has grown and this has and will be disruptive to financial markets.

Gilts and Money Market Rates

- LIBOR and LIBID rates (i.e., the rates at which a banks are willing to borrow from and lend to other banks) which had been stubbornly high in early 2009, slowly moved lower towards the Bank Rate of 0.5%.

- UK government Gilts were the main beneficiary of the economic downturn (it is an asset class that responds positively to poor economic news); they also formed the significant bulk of the QE purchases and are reckoned to have pushed gilt yields, and consequently the cost of borrowing, lower by 0.5% .

3. Debt Management

	Balance on 01/04/09 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance on 31/03/10 £m
Short Term Borrowing	0.007	0.000	0.007	0.007	0.000
Long Term Borrowing	156.259	35.580	0.000	35.580	156.259
Temporary Borrowing	0.000	10.040	0.000	5.040	5.000
TOTAL BORROWING	156.266	45.620	0.007	40.627	161.259

Short Term Borrowing

The Council's short term borrowing was made up of naturally maturing loans held with the PWLB, these were paid off as they matured in the period.

Long Term Borrowing

The Council inherited a debt portfolio which was made up of 100% Fixed Rate Debt, and with the Bank of England rate being at a historical low, and with PWLB Variable Rate falling below 1% the Council made a decision to convert some of its Fixed Rated Debt to Variable Rated Debt, reducing overall debt costs as well as allowing the Council to close the gap between the rate the Council was borrowing at and the rate it was lending at.

Savings of approximately £180K was made this year and a saving of over £1.2m is expected next year. This exercise also gave the Council the opportunity to smooth out its maturity portfolio.

Temporary Borrowing

Temporary borrowing was taken out at the end of the financial year for cashflow purposes, as debt collection was not aligned with payments profiles..

4. Investment Activity

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Investments

	Balance on 01/04/09 £m	Balance on 31/03/10 £m	Movement £m
Short Term Investments	85.719	59.350	(26.369)
Long Term Investments Lime Property Fund	4.301	4.530	0.229
Funds Managed Externally on segregated basis:	5.675	5.749	0.074
TOTAL INVESTMENTS	95.695	69.629	26.066

Short Term Investments:

As the leading authority the Council held balances of £13.7m on the behalf of Bedford Borough at the beginning of the year, this figure has been taken out of the table above.

Cash Balances have moved by £26m this is mainly due to capital expenditure that is due to be financed through borrowing and capital receipts.

Internally the Council has been able to obtain a return well above its set bench mark of the 3 month LIBID average for the year (which was 0.6954%), the Council's average rate of return on investments being 1.74% (which was received overall on internal investments and monies in call accounts).

Long Term Investments:

The Council inherited one long term investment which consists of unit bought in an Investment Property Fund. The nominal value of these units is £5m, however after the housing market decline in 2008-09, these units were valued at £4.3m at the start of the year. Despite the fall in capital value the Lime Fund has constantly given us a steady rate of return

In 2009-10 the capital value of the Fund has grown by £229k and the actual rate of return* this year was 5.66% before fees and realised capital gains /losses and 4.51% after fees. (no capital gains /losses were realised)

*Qtr 4 Return estimated

Funds Managed Externally

The council also has funds held with an External Fund Manager called Investec which primarily trades in certificates of deposits and commercial papers. Although these have a fixed rate of return attached to them they are bought and sold on the open market and are exposed to capital gains and losses.

Unlike the Lime Fund all monies made on the fund are reinvested within the fund, despite the analysis showing the fund grew by £74k the fund made a capital loss of £59k of which £49k was realised.

In 2009 the actual rate of return was 2.01% before fees and realised capital gains and losses and 1.19% after fees and realised capital gains and losses.

Security of capital remained the Council's main investment objective. This was maintained by continuing with the revised counterparty policy which the Council introduced in response to the emerging banking crisis. This restricted new investments to the following:

- the Debt Management Office
- Other Local Authorities
- AAA-rated Stable Net Asset Value Money Market Funds
- Deposits with Banks and Building Societies with access to the UK Government's Credit Guarantee Scheme (CGS)* and which have long-term ratings in the 'double-A' category
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank

**The CGS was announced in October 2008 to stabilise the UK banking system and provide solvency support for the "systemically critical" banking institutions in the UK. The government's CGS is not an explicit guarantee for deposits but is main platform to maintain the solvency of institutions critical to the UK's financial stability.*

The Council's maturing deposits have been reinvested at much lower prevailing rates of interest, though the possibility of lower rates has been built into the budget 2009/10, available returns where lower than expected.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2009/10, which were set as part of the Council's Treasury Management Strategy Statement which are summarised in Appendix A.

6. Outlook for 2010-11

The Bank Rate is expected to remain at 0.5% through to the final quarter of 2010 when it is expected to rise to 0.75%, with a further increase to 1% in the first quarter of 2011. This expectation reflects the fragile state of the recovering economy and the severe fiscal correction that will be required post the General Election which will dampen aggregate demand and cut household cashflow.

UK Bank Rate	Jun 2010	Sep 2010	Dec 2010	Mar 2011	Jun 2011	Sep 2011	Dec 2011	Mar 2012	Jun 2012
Upside Risks		+0.25	+0.25	+0.50	+0.50	+0.50	+0.05	+0.05	+0.05
Central case	0.50	0.50	0.75	1.00	1.50	2.00	2.75	3.00	3.00
Downside Risks			-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

7. Revisions to CIPFA Codes, CLG Consultation on Local Authority Investments

CIPFA revised the Code of Practice for Treasury Management, Guidance Notes and the Prudential Code in late November 2009. There are no significant changes, but there is a re-emphasis of treasury risk management, especially credit risk (which needs to be wider than the sole reliance on credit ratings) and the importance of preservation of capital; the requirement to carefully consider borrowing in advance of need; a requirement to review the risk of options within the Council's loans and investments; and that performance benchmarking should consider risk as well as return.

With credit rated counterparties, the minimum criteria will be the highest short term and a long term rating (equivalent to A+ or higher) assigned by Moody's Investor Services, Standards & Poor's, Fitch ratings and either have access to the UK Government's Credit Guarantee Scheme or are systemically important to the sovereign state's economy.

The requirement for staff and member training, and scrutiny of the treasury management strategy and treasury activity are also addressed in detail in the recent Treasury Management Code. Formal reporting on treasury activity is to also include, as a minimum, a half-yearly treasury report.

Appendices

Appendix A

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

	2009/10 Approved £m	2010/11 Approved £m
Authorised Limit for External Debt	360	221
Operational Boundary for External Debt	350	211

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, also know as the Authorised Limit irrespective of their indebted status. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, (prudent but not worst case) scenario without the additional headroom included within the Authorised Limit.

The Council can confirm that there were no breaches to the Authorised Limit and the Operational Boundary during the period.

In 2009-10 when the Authorised and Operational Boundary limits were set it was unknown whether or not the County Council's debt portfolio would be split for 1 April 2009, if at all. Therefore the limits were set assuming worst case scenario and that Central Bedfordshire Council would take on all the debt being the caretaker authority.

For 2010-11 these have been revised downwards to reflect a more realistic amount.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2009/10 %	Limits for 2009/10 %	Actual % as at 31/3/2010

Upper Limit for Fixed Rate Exposure	100	100	77.94
Compliance with Limits:	Yes		
Upper Limit for Variable Rate Exposure	50	35	22.06
Compliance with Limits:	Yes		

In 2009-10 these limits were set to allow maximum flexibility. These limits have been revised in 2010-11 to allow us the necessary flexibility to take advantage of the low variable rate but safeguard us from unexpected changes in interest rates.

(c) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	**Upper Limit %**	**Lower Limit %**	**Compliance with Set Limits throughout year**
under 12 months	0	100	Yes
12 months and within 24 months	0	100	Yes
24 months and within 5 years	0	100	Yes
5 years and within 10 years	0	100	Yes
10 years and above	0	100	Yes

In 2009-10 these limits were set to allow maximum flexibility. In 2010-11 these limits have been revised downwards in the Treasury Management Strategy and no more than 20% of debt maturity will fall in any one year.

(d) **Total principal sums invested for periods longer than 364 days**

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

The limit for 2009/10 was set at £20m. This has been maintained for 2010-11.

The Council's policy response since the onset of the credit crunch in 2007 was to keep investment maturities to a maximum of 12 months. No investments were made for a period greater than 12 months during this period.