Appendix A

TREASURY MANAGEMENT

AND

PRUDENTIAL INDICATORS

ANNUAL REPORT

2009/10

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1.0 INTRODUCTION AND BACKGROUND

1.1 This report summarises:

- the capital activity for the year;
- how this activity was financed;
- the impact on the Council's indebtedness for capital purposes;
- the Council's overall treasury position;
- the reporting of the required prudential indicators;
- a summary of interest rate movements in the year;
- debt activity; and
- investment activity.

2.0 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2008/09

2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through capital receipts, capital grants etc.; or
- If insufficient financing is available the expenditure will give rise to a borrowing need.

2.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance. Wider information on the regulatory requirements is shown in Section 12.

2.3 The actual capital expenditure forms one of the required prudential indicators. The table below also shows how this was financed.

	2008/09 Actual £m	**2009/10 Estimate £m**	**2009/10 Actual £m**
Non-HRA capital expenditure	4.729	2.298	2.897
HRA capital expenditure	2.057	1.311	2.359
Total capital expenditure	**£6.786m**	**£3.609**	**£5.256m**
Resourced by:			
Capital receipts	0.314	0.372	0.513
Capital grants	1.101	0.180	0.580
Capital reserves	1.612	1.011	1.186
Revenue/Third Party	3.214	0.061	0.826
Unfinanced capital expenditure (additional need to borrow)	**£0.545m**	**£1.985m**	**£2.151m**

3.0 THE COUNCIL'S OVERALL BORROWING NEED

3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. It represents 2009/10 and prior years net capital expenditure which has not yet been paid for by revenue or other resources.

3.2 The Non-HRA element of the CFR is reduced each year by a statutory revenue charge (called the Minimum Revenue Provision – MRP). The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charge more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP) or depreciation.

3.3 The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR	31 March 2009 Actual £m	31 March 2010 Original Indicator £m	31 March 2010 Actual £m
Opening balance	6.893	7.263	7.258
Plus unfinanced capital expenditure	0.467	1.985	2.150
Prior Year Adjustment	0.000	0.000	0.075
Less MRP/VRP*	-0.180	-0.210	-0.202
*Plus: Deferred Liability – Strategic IT Framework	0.078	0.000	0.000
Closing balance	**£7.258m**	**£9.038m**	**£9.281m**

4.0 **TREASURY POSITION AT 31 MARCH 2010**

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Head of Financial Services and the treasury function can manage the Council's actual borrowing position by either:

- borrowing to the CFR; or
- choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing); or
- borrowing for future increases in the CFR (borrowing in advance of need).

4.2 During 2009/10 the Head of Financial Services managed the debt position by borrowing £1,600,000 from the Public Works Board on 10 March 2010 for a period of one year with the interest rate fixed at 0.7% for the first 6 months. The delay in borrowing during the year coupled with a lower variable interest rate resulted in a saving of £14,000. The Treasury position at 31 March 2010 compared with the previous year was:-

Treasury position	31 March 2009		31 March 2010	
	Principal £m	Average Rate	Principal £m	Average Rate
Fixed Interest Rate Debt	6.988	4.63%	8.588	4.56%
Variable Interest Rate Debt	0.00	-	0.0	-
Total Debt	**£6.988m**	**4.63%**	**£8.588m**	**4.56%**
Fixed Interest Investments	3.354	4.22%	1.000	0.4%
Variable Interest Investments	0.0	-	0.0	-
Total Investments	**£3.354m**	**4.22%**	**£1.000m**	**0.4%**
Net borrowing position	**£3.634m**		**£7.588m**	

5.0 PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

5.1 Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

5.2 **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2009/10 plus the expected changes to the CFR over 2010/11 and 2011/12. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2009 Actual £m	31 March 2010 Original Indicator £m	31 March 2010 Actual £m
Net borrowing position	**3.634**	**5.420**	**7.588**
CFR	**7.258**	**9.038**	**9.281**

5.3 **The Authorised Limit** – The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2009/10 the Council has maintained gross borrowing within its Authorised Limit.

5.4 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

5.5 Actual financing costs as a proportion of net revenue stream - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2009/10 £m
Original Indicator - Authorised Limit	**16.50**
Maximum gross borrowing position	**8.588**
Original Indicator - Operational Boundary	**8.263**
Average gross borrowing position	**7.084**
Minimum gross borrowing position	**6.988**
Financing costs as a proportion of net revenue stream	**3.95%**

6.0 ECONOMIC BACKGROUND FOR 2009/10

6.1 Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, UK GDP (Gross Domestic Product) data for the first half of 2009 registered its sharpest fall for over 20 years.

6.2 It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more ‘normal’ behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor US banks continued to fail and the troubles of a number of building societies continued to make the headlines.

6.3 The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle was passed during the third quarter of the year but the return to positive growth proved stubborn; for the UK this would not materialise until the fourth quarter of 2009.

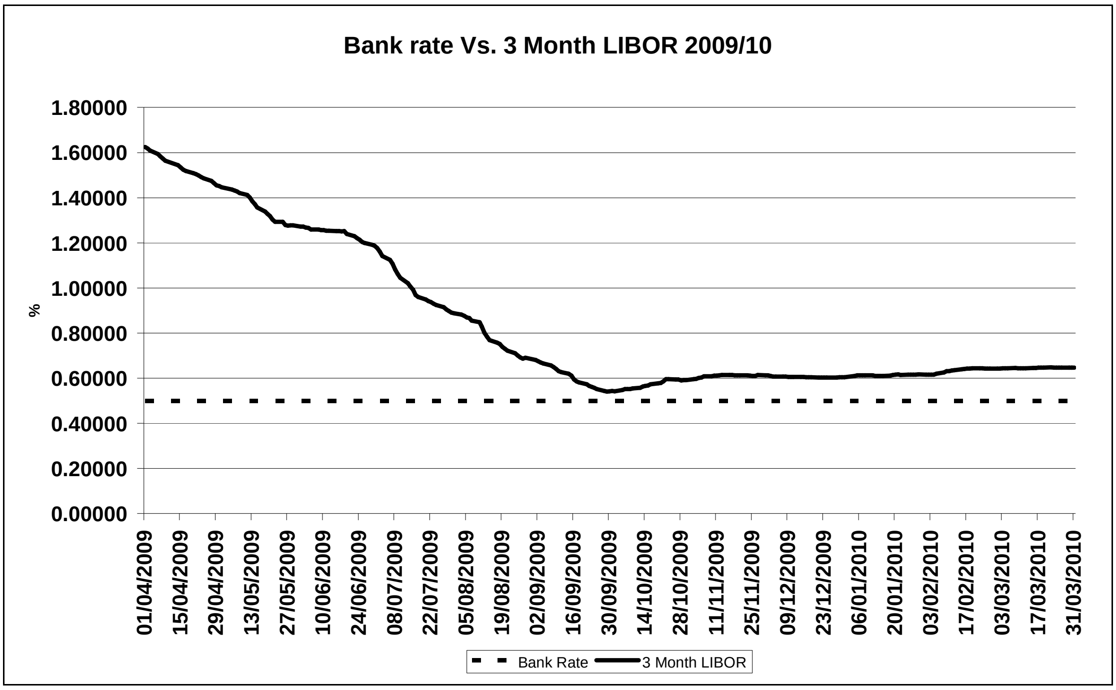
6.4 Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector’s striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

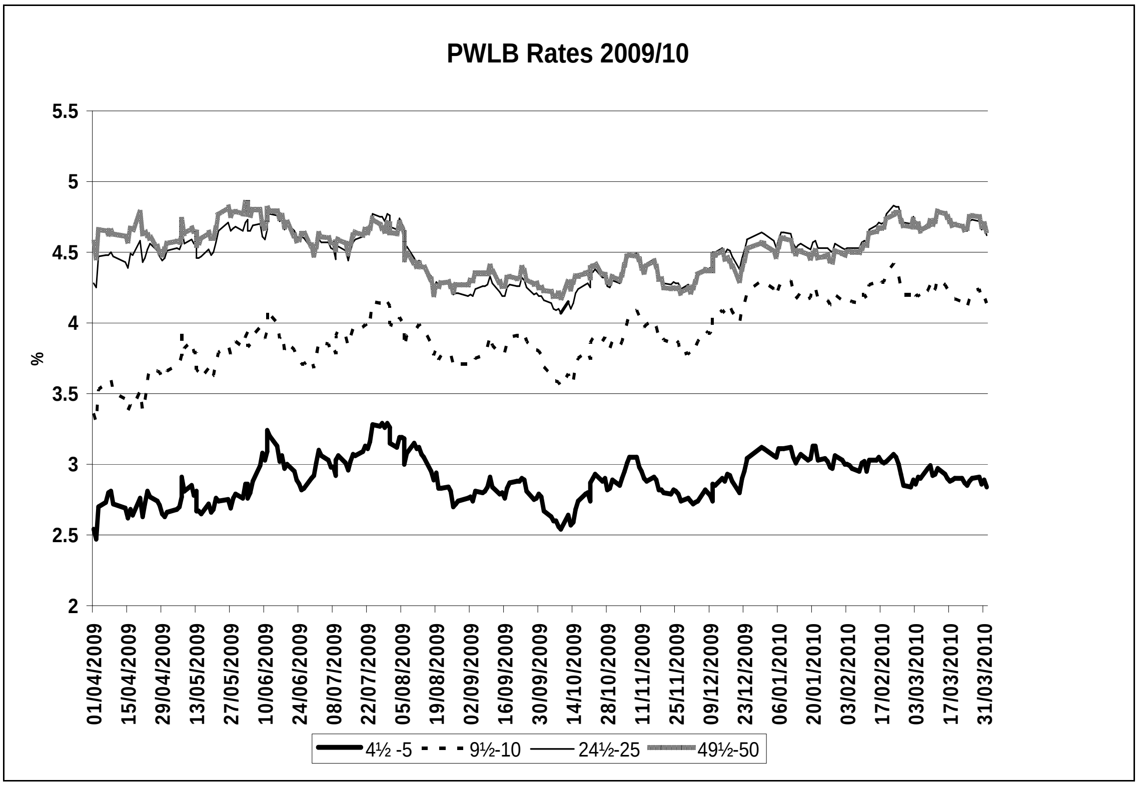
6.5 The bias of MPC (Monetary Policy Committee) decisions remained directed towards policy ease throughout the year. As official interest rates had been reduced to near-zero (0.5% Bank Rate) in March 2009, monetary relaxation took the form of the extension of the Quantitative Easing programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November.

6.6 The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between LIBOR and LIBID rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

6.7 Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The Quantitative Easing programme was the principal source of market support. The large-scale purchasing of stock that this element of monetary policy required meant the Bank of England was to absorb virtually all of the year’s supply.

6.8 Nevertheless, the programme was not sufficient to drive yields below the low point seen immediately after the inauguration of the QE programme in March 2009. Long-term rates remained generally erratic, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end. Indeed, yields returned to a rising trend once QE drew to a close in January 2010.





7.0 THE STRATEGY AGREED FOR 2009/10

7.1 The strategy provided for 2009/10 expected that with continuing growing uncertainty over future interest rates and increases in the risks associated with treasury activity the Council should take a cautious approach on its treasury decisions. It provided that the Head of Financial Services, under delegated powers, should take the most appropriate form of both borrowing and investments depending on the prevailing interest rates at the time and taking into account the risks associated with such actions.

8.0 **ACTUAL DEBT MANAGEMENT ACTIVITY DURING 2009/10**

8.1 **Borrowing** - Loans were drawn to finance the net capital spend and any naturally maturing debt. The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity	Average for 2009/10
PWLB	£1.6m	Variable interest rate	0.7%	1 year – interest rate reviewed after 6 months	0.67%

8.2 This compares with a budget assumption of borrowing at an interest rate of 4.4%. Long-term interest rates moved erratically during the year but the overall trend towards the end of the year was upwards.

8.3 This has resulted in the following maturity profile:

Amount £000	Maturity	%
1,600	10/11	18.63
1,450	11/12	16.89
98	24/25	1.14
2,000	25/26	23.29
2,000	26/27	23.29
300	29/30	3.49
300	30/31	3.49
340	52/53	3.96
500	55/56	5.82
£8,588		**100**

The maximum loan maturing in any one financial year as set out in the Treasury Management Policy Statement is 15% or £2,000m.

8.4 Schedule of Borrowings at 31 March 2010:

Lender	Amount £000	Interest Rate %	Repayment Date
PWLB	1600	0.700	10.03.11
PWLB	1000	4.170	28.10.11
PWLB	98	5.000	28.10.24
PWLB	2,000	4.875	28.10.25
PWLB	2,000	4.875	28.10.26
PWLB	300	5.000	28.04.29
PWLB	300	4.550	28.04.30
PWLB	340	4.250	28.04.52
PWLB	500	3.700	28.10.55
PWLB	450	4.290	28.10.11
Total	**£8,588**		

8.5 **Summary of Debt Transactions** – The overall position of the debt activity resulted in a fall in the average interest rate by 0.07%.

9.0 **INVESTMENT POSITION**

9.1 **Investment Policy –** The Council's investment policy is governed by ODPM (now DCLG) Guidance, which has been implemented in the annual investment strategy approved by Council on 4 February 2009 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

9.2 **Resources –** The Council's longer-term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, which meet the expectations of the budget.

Balance Sheet Resources (£m)	**31 March 2009 £m**	**31 March 2010 £m**
Balances	**0.634**	**0.686**
Earmarked reserves	**1.420**	**1.290**
Usable capital receipts	**0.753**	**0.981**
Total	**£2.807m**	**£2.957m**

10.0 INVESTMENTS IN-HOUSE

10.1 The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds (whose performance may fluctuate more). The Council maintained an average balance of over £3.66m and received an average return of 0.4%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.34%. This compares with a budget assumption of 4.25%.

10.2 The total investments at the beginning of the financial year were £3.354m. These reduced by over £2.3m during the year and at 31 March 2010 stood at £1.000m. This was due to the lower level of balances due to funding of the capital programme throughout the year and the use of internal borrowing in order to save borrowing until the final month of the year. Details of the investments outstanding at the 31st March 2010 are set out below:

Borrower (Building Society)	**£000**	**Date Period Invested**	**Interest Rate %**
Debt Management Office	250	24/3/10 to 07/4/10	0.25
Debt Management Office	300	25/3/10 to 12/4/10	0.25
Debt Management Office	450	29/3/10 to 21/4/10	0.25

Total Short Term Investments £1,000

The maturity of the investments was:-

	%
1 to 3 months	0
Less than 1 month	100
	100

10.3 The investment rate of return for 2009/10 was 0.4% compared with an estimate of 4.25%. As a result of lower interest rates and reduced level of balances for the majority of the financial year investment income was £180,000 lower when compared to the original estimate. The return achieved in 2008/09 was 4.22%.

11.0 PERFORMANCE MONITORING 2008/09

11.1 The compliance of the Treasury Management function against Performance was as follows:

(a)

INDICATOR	Performance 2008/09	Performance 2009/10
To achieve a return on external investments in excess of 7 day rate	4.22% gain of 0.5% or £33,740	0.4% gain of 0.06% or £1,510

(b) Interest rate on the new borrowing of £1,600,000 (0.7%) was below the average rate on a one year loan (1.29%).

12.0 REGULATORY FRAMEWORK, RISK AND PERFORMANCE

12.1 The Council's Treasury Management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.

12.2 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its Treasury Management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

12.3 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the majority of the interest rates are fixed by utilising long-term loans.

12.4 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.