ENCLOSURE 8.1

CANNOCK CHASE COUNCIL

COUNCIL

30 SEPTEMBER 2009

REPORT OF HEAD OF FINANCIAL MANAGEMENT

ANNUAL TREASURY REPORT 2008-09 AND QUARTER 1 OF 2009-10

1. Purpose of Report

1.1 To advise Members of the Council's Treasury activities during 2008-09 and for the first quarter of 2009-10

2. Recommendation

2.1 That the contents of this report be noted.

2.2 In order to follow proposed best practice that Treasury Management Governance arrangements and quarterly reports are delegated to the Audit and Governance Committee.

3. Conclusions and Reasons for the Recommendations

3.1 The CIPFA Code of Practice on Treasury Management in Local Authorities updated in 1996 and revised in 2001, requires that reports be submitted as follows:-

(a) Annual Strategy and Plan in advance of the year.

(b) Annual Report after the year end close.

3.2 CIPFA issued an interim Treasury Management guidance document in March 2009, highlighting Best Practice recommendations for Local Authorities to follow. The document suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Council is embracing Best Practice in accordance with CIPFA's recommendations

4. Key Issues

4.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by this Council on 4 March 2003 and this Council fully complies with its requirements. The primary requirements of the Code are the:-

(a) creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;

(b) creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

(c) receipt by the Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead and an annual review report of the previous year;

(d) 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.

Treasury management in this context is defined as:

"The management of the local authority's cash flows, its banking, money 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".

4.2 This annual treasury report covers:

- the Council's treasury position as at 31 March 2009;
- performance measurement;
- the strategy for 2008-09
- the economy in 2008-09;
- borrowing and investment rates in 2008-09;
- the borrowing outturn for 2008-09;
- compliance with treasury limits and Prudential Indicators;
- investment outturn for 2008-09;
- debt rescheduling;
- other issues

4.3 During 2008-09 the Council did increase its Long Term Borrowing Portfolio by £3 million

4.4 Although the investment return again exceeded the accepted benchmark of the uncompounded LIBID 7 day rate, investments were of necessity kept in small amounts and on the whole, short term (i.e. 3 months or less). This inevitably decreases the return available, but based upon market conditions in the year actually increases the amount of interest earned by the Council.

4.5 None of the prudential indicators set at the beginning of the year were exceeded and all investments were carried out with institutions listed in the Council's approved lending list.

4.6 The CIPFA Treasury Management Panel Bulletin is attached as Annex 3 it proposes that the Audit Committee should be given explicit responsibility to keep Treasury Management Arrangements under review.

REPORT INDEX

Section 1

Background

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b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c. Receipt by the Cabinet/Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead and an annual review report of the previous year.

d. 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.

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- the Council's treasury position as at 31 March 2009;
- performance measurement;
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- the economy in 2008-09;
- borrowing and investment rates in 2008-09;
- the borrowing outturn for 2008-09;
- compliance with treasury limits and Prudential Indicators;
- investment outturn for 2008-09;
- debt rescheduling;
- other issues.
- First Quarter performance for 2009-10

Section 2

Details of Matters to be Considered

2008- 2009

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

	31 March 2009 Principal		Rate/Return	31 March 2008 Principal		Rate/Return
Fixed Rate Funding:						
- PWLB	£18.7m			£16.1m		
- Market	£- m	£18.7m	6.80%	£- m		7.79%
Variable Rate Funding:						
- PWLB	£- m			£- m		
- Market	£0.0m		0.00%	£0.2m		5.71%
Total Debt		£18.7m	6.80%		£16.3m	7.79%
Investments:						
- In-house	£5.4m		4.65%	£6.0m		5.57%
- With Managers	£- m		-%	£- m		-%
Total Investments		£5.4m	4.65%		£6.0m	5.93%

Performance Measurement

One of the key changes in the revision of the Code in 1996 was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table above).

The Strategy for 2008-09

The Sector recommended treasury strategy for 2008-09, (in January 2008) was based on their view of a declining rate of growth of GDP in the UK economy from the peak of 3.3% in Q3 2007 to 2% in 2008. Bank Rate was expected to continue falling from 5.75% In November 2007 to reach 5.0% in Q2 2008 and then stay there for the rest of the financial year. This was based around the dilemma facing the MPC of balancing the opposing risks of inflationary pressures driven by spikes in oil prices against concerns around the impact of the credit crunch both on the UK housing market and economy and even more so on the US housing market and economy and the knock on impact on world growth rates.

The effect on interest rates for the UK was therefore expected to be as follows:-

Shorter-term interest rates – The "average" City view anticipated that Bank Rate would be stable in 2008-09 at 5.25% based on a balance of risks around rising inflationary pressures on the one hand and falling growth rates and concerns over the impact of the credit crunch on the other hand.

Longer-term interest rates – The view on longer-term fixed interest rates, 50 years, was that they would remain static around the 4.45% for the whole of the year. The 25 year rate would also remain flat around 4.50 – 4.55%.

The Adopted Treasury Strategy – The agreed strategy put to the Council/Cabinet, based upon the above forecast, was that:-

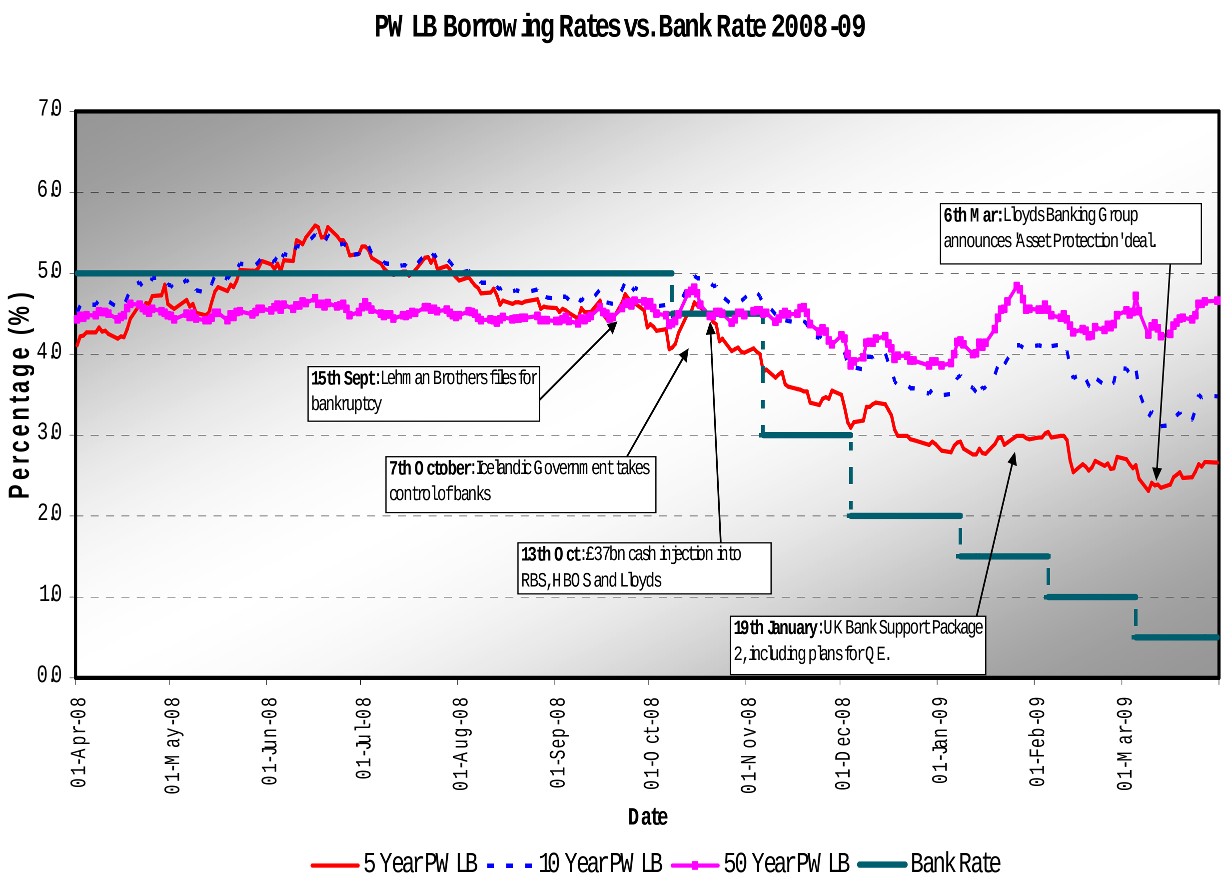
a. That the expectation for falling Bank Rate in the future was so strong that the drawing of cheaper, shorter term funding later in the year for some of the financial year 2008-09 borrowing requirement would assist in lowering debt servicing costs. The risk was that leaving longer term borrowing to later years could eventually entail higher longer-term interest costs.

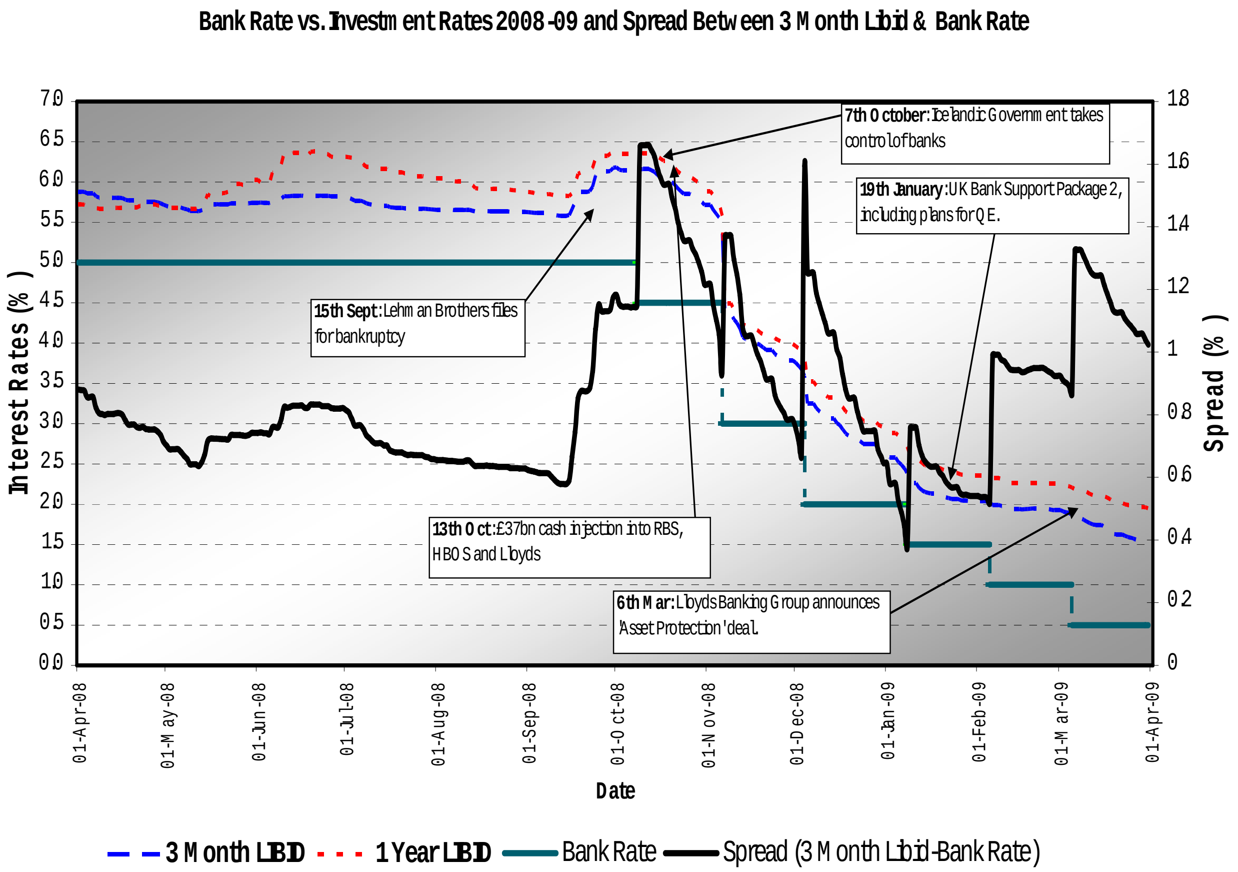
b. That the risks intrinsic to shorter term variable interest rates are such, when compared to historically low long term funding costs, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding.

c. The Council operated both borrowing and investment portfolios and as a consequence was at lower risk from being impacted by a sharp, unexpected rise in short-term variable interest rates. The strategy for the year was therefore to maintain a balance of funding at short-term rates to match short-term investments thus maintaining balanced treasury risk.

The Economy and Interest Rates

In a year that can only be described as unparalleled and extraordinary the Annual Treasury Report for 2008-09 is summarised in the graphs overleaf. These graphs show the major events of the financial year and the impact they had on both PWLB and investment rates. The financial crisis, commonly known as the 'credit crunch', had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England.


PWLB Borrowing Rates vs. Bank Rate 2008-09
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Percentage (%)
6th Mar: Lloyds Banking Group announces 'Asset Protection' deal.
15th Sept: Lehman Brothers files for bankruptcy
7th October: Icelandic Government takes control of banks
13th Oct: £37bn cash injection into RBS, HBOS and Lloyds
19th January: UK Bank Support Package 2, including plans for QE.
01-Apr-08
01-May-08
01-Jun-08
01-Jul-08
01-Aug-08
01-Sep-08
01-Oct-08
01-Nov-08
01-Dec-08
01-Jan-09
01-Feb-09
01-Mar-09
Date
5 Year PWLB
10 Year PWLB
50 Year PWLB
Bank Rate


Bank Rate vs. Investment Rates 2008-09 and Spread Between 3 Month Libid & Bank Rate
7.0
6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Interest Rates (%)
1.8
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
Spread (%)
7th October: Icelandic Government takes control of banks
19th January: UK Bank Support Package 2, including plans for QE.
15th Sept: Lehman Brothers files for bankruptcy
13th Oct: £37bn cash injection into RBS, HBOS and Lloyds
6th Mar: Lloyds Banking Group announces 'Asset Protection' deal.
01-Apr-08
01-May-08
01-Jun-08
01-Jul-08
01-Aug-08
01-Sep-08
01-Oct-08
01-Nov-08
01-Dec-08
01-Jan-09
01-Feb-09
01-Mar-09
01-Apr-09
Date
3 Month LIBID
1 Year LIBID
Bank Rate
Spread (3 Month Libid-Bank Rate)

On 1st April 2008 Bank Rate was 5% and the Bank of England was focused on fighting inflation. Market fears were that rates were going to be raised as CPI, the Government's preferred inflation target, was well above the 2% target (two years ahead). The money market yield curve reflected these concerns with one year deposits trading well above the 6% level. PWLB rates in both 5 and 10 years edged above Bank Rate during the summer as markets maintained the belief that inflation was the major concern of the monetary authorities. The money markets were reflecting some concerns about liquidity at this time and, as shown in the graph, the spread between Bank Rate and 3 month LIBOR was greater than had historically been the case.

This phase continued throughout the summer until the 15th September when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. As can be seen from the charts this also led to an immediate spike up in investment rates as markets grappled with the implications this might have on other financial institutions, their credit standing and indeed their viability. On 7th October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping a massive £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. The Monetary Policy Committee meantime had reduced interest rates by 50bp on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out. On the other hand the short end of the PWLB fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower.

Market focus now shifted from inflation concerns to concerns about recession, depression and deflation. Although CPI was still well above target it was seen as no barrier to interest rates being cut further. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities across the curve, at the front end because of credit concerns and the longer end because of the economic consequences reducing inflation, driving yields in 10 year PWLB temporarily below 4% and 5 years to around 3.5%. In December as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates to 2%-a drop this time of 1%. The whole interbank yield curve shifted downwards but the 'disconnect' at the short end remained very wide, negating to some degree the impact of the cuts in Bank Rate. 50 year PWLB rates dropped below 4% at the turn of the year, marking the low point, as it turned out, in this maturity.

The New Year of 2009 brought little relief to the prevailing sense of crisis and on 8th January the MPC reduced rates by 0.5% to 1.5%, a record low. More Government support for the banking sector was announced on 19th January 2009. The debt markets had a sharp sell-off at this stage as they took fright at the amount of gilt issuance likely to be needed to finance the help provided to the banks. There was also discussion about further measures that could be introduced to kick start lending and economic activity. These included quantitative easing by the Bank of England, effectively printing money.

In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Interbank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The MPC cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. This scheme would focus on buying up to £75bn of gilts in the 5-25 year maturity periods and £10 -15bn of corporate bonds. This led to a substantial rally in the gilt market, particularly in the 5 and 10 year parts of the curve, and PWLB rates fell accordingly. Finally at the end of March it was announced that the Dunfermline Building Society had run into difficulties and its depositors and good mortgages were taken over by Nationwide whilst the Treasury took on its doubtful loans.

The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place. Investment income returns have been badly hit but lower borrowing rates in short to medium periods had allowed indebted local authorities to benefit.

Borrowing and Investment Rates in 2008-09

12-month bid rates: One year LIBID fluctuated between around 5.7% to 6.4% with two peaks driven by credit crunch fears in June and September. Bank Rate had been held at 5.0% until October 9 when the first of a series of major cuts caused 12 month LIBID in 2008-09 to be on a rapidly falling trend to the end of the financial year, reaching 1.85% at the end.

Longer-term interest rates – The PWLB 45-50 year rate started the year at 4.43% (25 year at 4.62%) and was then generally within a band of 4.3 - 4.6% (4.6% - 5.0%) until mid October when there was a spike up to 4.84% (5.08%) followed by a plunge down to 3.86% (4.03% late December) in early December. Further spikes of 4.84% (4.86%) and 4.72% (4.69%) occurred in late January and early February with the year closing out at 4.58% (4.28%). It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year.

Borrowing Outturn for 2008-09

New Borrowing was taken out in March 2009 for £3,000,000 for a period of 3 years at 1.89%.

As comparative performance indicators, average PWLB maturity loan interest rates for 2008-09 were:-

1 year	3.264%
9.5 - 10 year	4.477%
25 - 30 year	4.570%
49.5 - 50 year	4.438%
1 month GBR variable	3.682%

Debt Performance – As highlighted above, the average debt portfolio interest rate has moved over the course of the year from 7.79% to 6.8%. The approach during the year was to fund borrowing from surplus cash except at the end of the year when this seemed to be becoming unfeasible due to fall off in Capital Receipts. The borrowing was taken out at short term fixed rates, as they were generally lower than longer term rates.

Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Annex 1.

Investment Outturn for 2008-09

Internally Managed Investments – The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

Investment Strategy – The expected short-term investment strategy for in-house managed funds was that the Council viewed the market's expectation for base rates as too low, and that short term rates would rise during the year. Investments were, accordingly, kept short, with a view to enabling returns to be compounded more frequently.

Throughout the last financial year the characteristic of market interest rates was set by the continuing lack of liquidity in the market place with banks remaining uneasy about lending. Continuing fears around the credit crunch, and so heightened credit spreads, forced the level of all market rates higher than in normal times. Whilst this was a desperate time for borrowers the flip side of the ensuing problems was that investors were the benefactors of these conditions, with deposit rates remaining inflated by high credit spreads and thus enabling an element of core funds to be lent in the longer term to secure good returns over the course of the next 12-24 months.

The collapse of Lehman's and the Icelandic banking system in September/October 2008 created an environment of fear, and the nationalisation and part nationalisation of many financial institutions was necessary to secure the global financial system in the face of hundreds of billions of pounds worth of toxic asset related losses. Governments commenced a series of stimulus packages aimed at kick starting the global economy and central banks, helped by a downturn in inflation and inflation expectations, and so began an aggressive policy of interest rate cuts which has seen interest rates, though maintaining elevated credit spreads, crashing to record low levels.

Investment Outturn for 2008-09 – Detailed below is the result of the investment strategy undertaken by the Council.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return
Internally Managed	£9.583m	4.65%	N/A	3.69%
Externally Managed	-	-	-	-

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

Debt Rescheduling

No opportunity for debt rescheduling presented itself during the year and none was therefore undertaken.

Other Issues

There were no other issues of note for Treasury to deal with in 2008-09

2009-10

Economic Background

The first quarter of the financial year of 2009 saw:

- The 'green shoots' of recovery emerge;
- GDP contracted by 2.4% during last quarter, the largest fall for over 50 years, an improvement in the output-related data was to be somewhat expected.
- Monetary policy loosened further via the extension of the Bank of England's quantitative easing programme, but lending growth is still slow;
- Unemployment rise and earnings growth fall;
- Inflation fall further, but oil prices rise;
- Bond yields and equity prices rise in response to the improved economic outlook;
- Sterling appreciate, but only to a level well below its 2007 peak;
- Activity strengthen to a similar extent in the US, but a much weaker extent in Europe.

The first quarter saw some encouraging signs that the rate of contraction in the economy had eased considerably. Retail sales grew by 1.0% in April, and while they fell back in May, they remained above March's level. Consumer confidence continued to pick up. Industrial production rose by 0.2% m/m in April, the first rise since November 2007, and the Nationwide house price index rose in May and June, leading to the first quarterly rise since Q4 2007.

April's Budget announced an injection of £5.2bn in 2009/10, but a tightening of £5.2bn in 2011/12. The Chancellor forecast that public sector net borrowing would increase to 12.5% of GDP in 2009/10 and that net debt as a percentage of GDP will leap from 41.2% in 2008/09 to 62.9% in 2009/10, before peaking at 94.2% in 2015/16. This may have a significant impact on the UK economy.

After rapidly cutting official interest rates to a record low of 0.5%, the MPC increased the amount of asset purchases under the Bank's quantitative easing (QE) programme from £75bn to £125bn in May. The MPC still retains the option to extend these purchases by a further £25bn before having to ask the Chancellor for further authorisation. However, while QE does at least seem to have been successful in improving liquidity in financial markets, its impact on the real economy remains limited.

Inflationary pressures within the economy continued to reduce in the quarter, although at a slower rate than had been expected. The key factors in this trend are tax rises and increasing oil prices. While the headline rate of CPI inflation fell to 2.2% in May, the reduction was smaller than the consensus expected. RPI inflation fell to -1.1% in May.

Economic Forecast

The Council's Treasury Advisers, Sector, provides the following forecast:

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Bank rate	0.50%	0.50%	0.50%	1.00%	1.50%	2.00%	2.50%	3.00%	3.75%	4.25%	4.50%	4.75%
5yr PWLB rate	2.70%	2.75%	2.85%	3.10%	3.30%	3.45%	3.75%	4.00%	4.40%	4.70%	4.85%	5.00%
10yr PWLB rate	3.65%	3.70%	3.70%	3.80%	3.95%	4.15%	4.40%	4.65%	4.85%	5.00%	5.05%	5.20%
25yr PWLB rate	4.40%	4.40%	4.50%	4.50%	4.55%	4.70%	4.80%	4.95%	4.95%	5.10%	5.20%	5.30%
50yr PWLB rate	4.55%	4.55%	4.60%	4.65%	4.75%	4.85%	4.95%	5.05%	5.10%	5.25%	5.25%	5.35%

This indicates that the Bank Rate will remain at an historical low level until mid-way through 2010, by which time the economy is expected to have improved. For the same reason, PWLB rates are expected to increase over time.

Treasury Management Strategy Statement:

Annual Investment Strategy:

The Treasury Management Strategy Statement (TMSS) for 2009/10 was approved by Cabinet on 12th February 2009. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the first quarter of 2009/10.

As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the first quarter of 2009/10 was £2m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

The Council's budgeted investment return for 2009/10 is £165,670, and performance for the year to date is £28,560 below the profiled budget for the first quarter.

Borrowing:

Prudential Indicators:

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS. Officers can confirm that the Prudential Indicators were not breached during the first quarter of 2009/10.

As outlined below, interest rates have gradually increased during the quarter across all bands, with the low points in early April and the high points in early to mid June. It is anticipated that further borrowing will not be undertaken during this financial year.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.81	2.47	3.3	4.25	4.46
Date	02/04/2009	02/04/2009	02/04/2009	02/04/2009	02/04/2009
High	1.2	3.2	4.06	4.77	4.85
Date	09/06/2009	12/06/2009	12/06/2009	12/06/2009	02/06/2009
Average	0.970819672	2.797540984	3.708852459	4.562295082	4.656557377

Section 3

Contribution to CHASE

As a major contributor to attaining the Budget requirements Treasury Management enables the Council to fulfil all aspects of CHASE.

Section 4

Financial Implications

There are no direct financial implications arising from this report.

Section 5

Human Resource Implications

There are no Human Resource Implications arising from this report.

Section 6

Legal Implications

The legal implications are set out throughout the report..

Section 7

Section 17 (Crime Prevention) Implications

There are no Section 17 implications arising from this report.

Section 8

Human Rights Act Implications

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

Section 9

Data Protection Act Implications

There are no implications arising from this report.

Section 10

Risk Management Implications

Treasury Management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces all risks to a minimum.

Section 11

Equality and Diversity Implications

There are no identified implications arising from this report.

Section 12

Other Options Considered

There are no other options to be considered.

Section 13

List of Background Papers

Statement by the Leader of the Council 2008-09 & 2009-10

Report Author Details

Bob Kean, Head of Financial Management Ext 4334

Prudential Indicators

	2007-08 Actual	2008-09 Projected	2009-10 Estimated	2010-11 Estimated	2011-12 Estimated
Affordability					
Ratio Financing Costs to Net Revenue Stream					
General Fund	-5.74%	-2.32%	-0.89%	-0.97%	-2.00%
HRA	10.47%	9.40%	9.84%	10.66%	
Incremental impact of capital investment decisions on Council Tax	0	0	0	0	0
Incremental impact of capital investment decisions on average weekly housing rents	0	0	0	0	0
Capital Expenditure	**£m**	**£m**	**£m**	**£m**	**£m**
Total Capital Expenditure (including external funding)					
General Fund	3.990	3.025	4.199	2.090	2.094
HRA	8.435	7.974	5.775	5.500	
Capital Financing Requirement as at 31March					
General Fund	7.558	8.425	7.107	6.856	6.605
HRA	18.579	18.942	19.305	19.668	20.031
External Debt					
Authorised Limit	21.351	22.182	22.602	23.022	23.022
Operational Boundary	19.627	20.458	20.878	21.298	21.298
External Debt as at 31 March if no new borrowing undertaken	16.287	18.739	18.455	18.287	18.101
Net Borrowing (ie less Investments) as at 31 March	10.279	13.273	18.115	18.287	18.101

Prudence

Net Borrowing and the Capital Finance Requirement: Net Borrowing is not expected to exceed the total of the Capital Financing Requirement (except in the short term)

	2007-08 Actual	2008-09 Projected	2009-10 Estimated	2010-11 Estimated	2011-12 Estimated
Interest Rate Exposure					
Upper Limit Fixed					
Borrowing		100%	100%	100%	100%
Investment		50%	50%	50%	50%
Upper Limit Variable					
Borrowing		10%	10%	10%	10%
Investment		100%	100%	100%	100%

Maturity Structure Of Borrowing	**Lower Limit**
Under 12 months	2%
12 months to 24 months	20%
24 months to 5 years	3%
5 years to 10 years	17%
10 years and above	59%

ANNEX 2: CENTRAL BANK RATE MOVEMENTS

	UK	UK	UK	US	EU	UK	US	ECB
	MPC	MPC Minutes	Inflation Report	FOMC	ECB	Bank Rate	Fed. Rate	Refi Rate
2007								
Jan	10-11	24		30-31	11	**5.25%**	5.25%	3.50%
Feb	7-8	21	14	21 (mins)	8	5.25%	5.25%	3.50%
Mar	7-8	21		20-21	8	5.25%	5.25%	**3.75%**
Apr	4-5	18		11 (mins)	12	5.25%	5.25%	3.75%
May	9-10	23	16	9, 30 (mins)	10	**5.50%**	5.25%	3.75%
Jun	6-7	20		28-29	7	5.50%	5.25%	**4.00%**
Jul	4-5	18		18 (mins)	5	**5.75%**	5.25%	4.00%
Aug	1-2	15	8	7, 29 (mins)	2	5.75%	5.25%	4.00%
Sep	5-6	19		18	6	5.75%	**4.75%**	4.00%
Oct	3-4	17		9 (mins), 30-31	4	5.75%	4.50%	4.00%
Nov	7-8	21	14	21 (mins)	8	5.75%	4.50%	4.00%
Dec	5-6	19		11	6	**5.50%**	**4.25%**	4.00%
2008								
Jan	-	-		22		5.50%	**3.50%**	4.00%
Jan	9-10	23		29-30	10	5.50%	**3.00%**	4.00%
Feb	6-7	20	13	21 (mins)	7	**5.25%**	3.00%	4.00%
Mar	5-6	19		18	6	5.25%	**2.25%**	4.00%
Apr	9-10	23		29-30	10	**5.00%**	**2.00%**	4.00%
May	7-8	21	14		8	5.00%	2.00%	4.00%
Jun	4-5	18		24-25	5	5.00%	2.00%	4.00%
Jul	9-10	23			3	5.00%	2.00%	**4.25%**
Aug	6-7	20	13	5	7	5.00%	2.00%	4.25%
Sep	3-4	17		16	4	5.00%	2.00%	4.25%
Oct	8-9	22		28-29	2	**4.50%**	**1.50%**	**3.75%**
Nov	5-6	19	12		6	**3.00%**	**1.00%**	**3.25%**
Dec	3-4	17		16	4	**2.00%**	**0-0.25%**	**2.50%**
2009								
Jan	7-8	21		27-28 (7 mins)	15	**1.50%**	0-0.25%	**2.00%**
Feb	4-5	18	11		5	**1.00%**	0-0.25%	2.00%
Mar	4-5	18		17	5	**0.50%**	0-0.25%	**1.50%**

Annex 3

The Chartered Institute of Public Finance & Accountancy

Treasury Management Panel Bulletin

Treasury Management In Local Authorities – Post Icelandic Banks Collapse

March 2009

Following the collapse of the Icelandic Banks, Local Authority treasury management has come under the spotlight. The Audit Commission has just published its report “Risk and Return” on local authority treasury management and the Communities and Local Government Select Committee has carried out a review of local authority investments and will report shortly. CIPFA intends to revise both the Treasury Management Code and Guidance Notes in light of the lessons to be learnt. This Treasury Management Bulletin provides some interim advice to local authorities on treasury management practices in the light of the Icelandic Banks collapse and the continuing ‘credit crunch’.

It should be noted that this bulletin constitutes advice only. It does not have the status of formal guidance under legislation. Formal guidance will be published following consultation in the form of a revised Treasury Management Code and Guidance Notes for Local Authorities.

Revised Treasury Management Code and Guidance

The reports from the Communities and Local Government Select Committee and the Audit Commission will help to inform the revised code and guidance. This interim advice covers some of the key areas likely to be covered in the revised guidance. Comments are sought from practitioners on the interim guidance and any additional areas that should be covered. Comments should be emailed to alison.scott@cipfa.org by 29 May 2009. It is intended to issue a revised code and guidance notes in summer 2009.

Treasury Management Objectives

It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy.

Diversification should be a key consideration in setting treasury management objectives. This includes not just diversification between counterparties but also, diversification between countries, sectors and instruments. Authorities should ensure that the instruments they are using are appropriate to their portfolio and skills and understanding.

Treasury Management Governance Arrangements

The introduction of the Treasury Management Code, Prudential Code and Annual Investment Strategy, improved the involvement of elected councillors in treasury management decision making. The Treasury Management Strategy is approved annually by full Council, this is clearly a strength of current arrangements.

Best practice authorities are supporting this decision making with improved information and regular review by councillors in both executive and scrutiny functions. Councillors are not treasury management professionals and the key to councillor involvement is developing their understanding of treasury risks and the need to place risk above reward.

In order to further strengthen councillor involvement, it is suggested that authorities consider how they can best involve Executives and leading Portfolio Holders in determining treasury management strategies and whether Audit Committees should be given an explicit responsibility to keep treasury management arrangements under review. It is clear that councillor involvement should not be at the level of individual transactions but in terms of policies and procedures with special emphasis on risk management. In order to support Audit Committees in this role, CIPFA will be looking to develop training for councillors in this role.

The role of the Director of Finance in Treasury Management will be developed as part of the Statement on the Role of the Finance Director for Local Government but it is clear that he or she is ultimately responsible for ensuring that Treasury Management policies and practices are in place and are properly adhered to. The role of internal audit in providing these assurances should be reviewed on a regular basis.

Monitoring

It is recognised that many authorities formally report on treasury management more regularly than the annual report required by the Treasury Management Code. In order to enshrine best practice it is suggested that authorities report formally on treasury management activities at least twice a year and preferably quarterly. Other than the annual report the additional monitoring reports could be taken to executive committees as long as they are public reports available to all councillors and audit and scrutiny committees.

Gross and Net Borrowing

Authorities may have a gross borrowing level that exceeds their capital financing requirement for a number of reasons including historical differences between capital receipts and debt repayment profiles and borrowing in advance of need. Authorities should satisfy themselves that, where gross and net debt levels vary substantially, they have taken account of all the risks associated with this strategy and that the reasons underpinning it are sound.

In the interests of transparency and to improve decision making, it is suggested that both the reasons for any significant difference between gross and net debt and the risks and benefits associated with the strategy are clearly placed before councillors as part of their agreement of the annual strategy.

Local authorities are reminded that borrowing for the explicit purpose of re-investment is ultra vires.

Skills and Training

Local authorities should recognise the importance of their treasury management functions and ensure that they are adequately resourced to manage and safeguard the authority's cash resources. Training of staff should address all of the procedures, practices and processes which are relevant to the authority's treasury management arrangements. It is important that staff are only dealing with treasury management transactions where they fully understand the inherent risks.

CIPFA and the Association of Corporate Treasurers will be launching a joint treasury management qualification aimed at public sector organisations in June 2009.

CIPFA has also launched a risk management consultation paper and will look to develop practical guidance and toolkits for local authorities for management of treasury risk.

Counterparty Lists

There has been much debate about the role of credit ratings and their use by local authorities. Credit ratings remain a key source of information but it is important to recognise that they do have limitations. Authorities are advised to have regard to the ratings issued by all three main agencies, Fitch, Moodys and Standard and Poor, and to make their decisions on the basis of the lowest rating. Ratings should be kept under regular review and 'ratings watch' notices acted upon.

Other sources of information should also be systematically reviewed by authorities. These include the quality financial press, market data and information on government support for banks and the credit ratings of that government support.

Current best practice by authorities includes setting limits on both the principal amounts invested and duration dependant on the financial standing of institutions and applying sector and country limits in line with their financial strength. It is recommended that authorities in addition to applying limits to individual institutions also apply clear country and sector limits.

Use of Treasury Management Advisers

There has also been significant debate about the role and use by authorities of Treasury Management Advisers. One of the key issues appears to have been over-reliance by some authorities on their advisers. Responsibility for investments and borrowing remains with the authority. Authorities should be clear on the status of the service they are receiving from their advisers and satisfy themselves of its appropriateness for their needs.

Authorities should also regularly review their decisions on the use of external investment managers to ensure that these remain appropriate in the light of a changing investment climate.

Benchmarking

Benchmarking has a role in treasury management but benchmarks should not only refer to yield but also reflect the risk inherent in treasury management activities. At a minimum they should include information on security, liquidity and yield.

ANNEX 4: KEY DATES IN 2008-09

8.9.08 Nationwide takes over Cheshire and Derbyshire Building Societies

15.9.08 Lehman Bros went into liquidation

16.9.08 US Government nationalises AIG

17.9.08 LloydsTSB in advanced talks with HBOS to save it by merger after major collapse in HBOS share value.

19.9.08 US Government announces TARP - Troubled Assets Relief programme $700bn

22.9.08 Last two US investment banks Goldman Sachs and Morgan Stanley give up investment bank status

25.9.08 Washington Mutual - fourth biggest US retail bank fails. Biggest bank to fail in US history

29.9.08

- Bradford and Bingley nationalised.
- US: Wachovia sixth largest bank fails .
- Germany: Hypo Real Estate (owner of Depfa Bank of Ireland) bailed out by consortium of German banks.
- Fortis: bailed out by Belgium, Netherlands and Luxembourg governments.
- Iceland: Glitnir - third largest Icelandic bank - 75% nationalisation
- US Congress refuses to approve TARP

30.9.08 Ireland announces guarantee on all Irish bank deposits to 28.9.10. Other EU countries concerned at lack of level playing field for banks across EU.

30.9.08 Landsbanki, Heritable and Kaupthing, Singer and Friedlander downgraded from F1 to F3, and Glitnir from F2 to F3.

3.10.08 FSA increases savings guarantee on all deposits from £35,000 to £50,000

7.10.08 Icelandic Government takes over banks

8.10.08 Coordinated emergency 0.5% rate cuts by UK, ECB, US, Canada, Sweden and Switzerland.

8.10.08 UK £500bn bank bailout package announced in principle. 8 named banks covered by bank recapitalisation scheme - they are to increase their tier 1 capital by £25bn in aggregate. £25bn available in exchange for preference shares or PIBS, £25bn in exchange for ordinary shares, preference shares or PIBS, £250bn to guarantee debt issuance by 8 banks, plus £200bn to be made available under SLS in short lending support. BoE to announce next week a permanent regime to underpin banking system liquidity including a discount window facility.

13.10.08 £37bn cash injection into RBS, HBOS and Lloyds TSB - £28bn as ordinary shares and £9bn as preference shares @ 12%. RBS takes up £15bn as ordinary shares, £5bn as preference shares = 63% nationalisation. HBOS £11.5bn, Lloyds £5.5bn = 43% of combined group. Barclays to raise £6.5bn from investors.

13.10.08 Germany, France and Spain announce E1 trillion package to support banks through state guarantees and bank recapitalisation.

22.10.08 Barnsley Building Society forced to seek a rescue merger with Yorkshire Building Society after facing up to £10 million in losses on cash it had deposited with Icelandic banks Kaupthing Singer & Friedlander and Heritable.

19.1.09 Bank support package 2

- RBS swaps £5bn preference shares for ordinary shares – now 70% nationalised
- £250bn Government guarantees (insurance scheme) for toxic assets clogging up bank balance sheets; insurance scheme putting a floor on the amount that banks can lose on them (will help to free up capital).
- £100bn Government guarantees for new bonds issued by banks to back fresh loans to consumers, homebuyers and businesses – aim to reopen the asset backed security market
- Extension of £250bn credit guarantee scheme October 2008 extended to end of 2009
- £50bn asset purchase facility to buy corporate bonds, commercial paper and other company debts
- Northern Rock to start lending to customers again and to stop repaying its loan from the Government (subject to EU approval). NR to be split into good bank (with new input of capital from the Government) and bad bank.
- FSA announced that capital buffers built in during the recapitalisations of banks can be allowed to run down during the downturn on the basis that they will strengthen again once the business cycle turns
- Bank of England's Special Liquidity Scheme due to close in January but will be replaced by the Bank of England's discount window to ensure banks have permanent access to long term liquidity
- Bank of England given the go ahead to embark on quantitative easing through purchasing assets from banks whose liquidity is currently impaired

13.2.09 Asset purchase scheme starts buying commercial paper

26.2.09 Asset Protection Scheme published – insurance of toxic assets

26.2.09 RBS – RBS lost £24bn in 2008. Government support increases from £20bn to £45bn. The surprise need for additional capital was necessary to facilitate RBS's participation in the Government's Asset Protection Scheme - under which the Treasury will guarantee the bank against losses on £325 billion of its problem assets. The Government will inject an immediate £13 billion into RBS in return for non-voting B shares. It will then make an additional £6 billion available at the request of the bank.

Finally, it will pay £6.5 billion in fees to take part in the APS in the form of B shares, taking the total to up to £25.5 billion. The need for additional capital was because of RBS's agreement to shoulder the first £19.5 billion of losses on assets put into the APS. Losses larger than that will be shared 90 per cent by the Government and 10 per cent by RBS.

5.3.09 QUANTITATIVE EASING: twice weekly buying to start 11 March.

9.3.09 Lloyds puts £260bn into Asset Protection Scheme = £216bn from HBOS and higher than expected £44bn from LTSB. Following the preference share conversion, LBG will be 65%-owned by the UK government (assuming no take-up by existing shareholders) and this figure would rise to 77% assuming the government exercised an option to convert the GBP15.6bn 'B' shares issued to the UK government as the fee for participation in the APS. Upon completion of the APS transaction LBG's core Tier 1 capital ratio will increase sharply to around 14.5%, leaving it well-equipped to meet the mortgage and small business lending targets agreed with the UK government.

25.3.09 Governor of the Bank of England, King advises against any further fiscal expansion in upcoming budget – no more debt issuance affordable; leave it to BoE to do Quantitative Easing now.

25.3.09 Gilt auction fails; £1.75bn 2049 conventional – first failure since 2002.

30.3.09 Dunfermline Building Society taken over by Nationwide

30.3.09 Irish AAA sovereign rating downgraded by S&P to AA+ as debt to GDP expected to exceed 70% and will be difficult to get down again below that level.

Annex 5

Prudential Indicators – Quarter 1 2009

Prudential Indicator	2009/10 Indicator £'000	Quarter 1 – Actual £'000
Capital Financing Requirement (CFR)	26.412	26.412
Gross borrowing	18.455	18.607
Investments	0.34	10.063
Net borrowing	15.115	8.544
Authorised limit for external debt	22.602	22.602
Operational boundary for external debt	20.878	20.878
Limit of fixed interest rates based on net debt	90%	90%
Limit of variable interest rates based on net debt	10%	10%
Principal sums invested > 364 days	100%	100%
Maturity structure of borrowing limits		
Under 12 months	2%	2%
12 months to 2 years	20%	17%
2 years to 5 years	3%	18%
5 years to 10 years	17%	14%
10 years and above	59%	49%

Glossary of Terms

bp – base points. The Base Rate is the rate used by the Bank of England for its official operations in the Sterling Money Markets.

CPI – Consumer Price Index. A calculated index showing how the average cost of consumer prices changes over time.

DMO – Debt Management Office. An executive agency of HM Treasury, responsible for debt and cash management for the UK government, lending to local authorities and managing certain public sector funds.

ECB – European Central Bank. This bank determines the policy with regard to the euro. The ECB's primary task is to maintain the purchasing power of the euro and thereby the price stability in the euro countries.

GDP – Gross Domestic Product. A measure of the total domestic economic activity. It is the sum of all incomes earned by the production of goods and services on UK economic territory.

MPC – Monetary Policy Committee (of the Bank of England). Meets monthly to discuss and alter interest rates.

LIBID – London Inter Bank Bid Rate. Banks in the City of London tend to lend and borrow money from one another in the wholesale money markets. The rate at which a bank is willing to borrow money is called the London Inter Bank Bid Rate.

PWLB – Public Works Loan Board. A central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the government itself can borrow. Local authorities are able to borrow a proportion of their requirements to finance capital spending from this source.

UBS – Union Bank of Switzerland. World leaders in financial services.