Attachment 12

BODY:	**CABINET**
DATE:	**9th July 2008**
SUBJECT:	**ANNUAL TREASURY MANAGEMENT REPORT FOR 2007/2008 AND INTERIM REVIEW OF 2008/2009**
REPORT OF:	**ASSISTANT DIRECTOR FINANCIAL MANAGEMENT**

Ward(s):	All
Purpose:	To report on the activities and performance of the Treasury Management service during 2007/2008 and interim review of 2008/2009
Contact:	Lesley Lane Assistant Director Financial Management, Telephone 01323 415149.
Recommendations:	Approve the treasury management stewardship report for 2007/2008 and the actual prudential indicators for the year.

1.0 Introduction

1.1 The annual treasury management report is a requirement of the Council's constitutional reporting procedures. This report covers the treasury management activity for financial year 2007/2008 and includes the actual Prudential Indicators for that year in order to comply with the requirements of the Prudential Code.

1.2 The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance, principally the Local Government Act 2003, including Statutory Instrument 3146 which develops and controls powers within the Act.

1.3 This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above statutory regulations. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken on a prudent, affordable and sustainable basis.

1.4 The Code requires as a minimum the regular reporting of treasury management activities to:

- Forecast the likely activity for the forthcoming year (the Annual Treasury Strategy included in the annual budget setting report); and
- Review actual activity for the preceding year (this report).

1.5 This report sets out:

- A summary of the strategy agreed for 2007/2008;
- The Council's treasury position at 31st March 2008;

- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2007/2008;
- The treasury decisions taken and their revenue effects;
- The associated risks of any of these decisions;
- Performance indicators set for 2007/2008;
- The performance of these decisions;
- Risk and performance;
- An interim review of 2008/2009

2.0 The Strategy Agreed for 2007/2008

2.1 Borrowing

Money Market analysts predicted that long term interest rates would remain relatively stable, moving between 4.25 – 4.75%. As Eastbourne Borough Council was successful in its bid to achieve a two star housing service, which was announced in the autumn, it was then possible for £7.52m of new borrowing to be drawn down in the final quarter of 2007-08.

2.2 Investment

Guidance issued by the former Office of the Deputy Prime Minister on 12th March 2004, later amended by Statutory Instrument 534 2004, required Councils to invest prudently, giving priority to security and liquidity over yield.

The Council maintains a policy which is used to determine the security of investment counterparties, based on credit ratings and asset size. Investments for 2007/2008 were divided into Specified and Non Specified and were closely monitored. To ensure sufficient liquidity in the Council's investments, maximum periods are determined for which funds may be prudently invested. Short term interest rates, (periods of less than 1 year) were predicted to rise. It was agreed that investments should be kept short in anticipation of rising rates, and that investment decisions would be made for periods with fixed investment rates to lock in good value and security of return.

3.00 Treasury Position at 31st March 2008

3.1 The treasury position at 31st March 2008 compared with the previous year was:

Table 1

	31 March 2008		31 March 2007	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£38.7m	6.99%	£31.2m	7.58%
Variable Interest Rate Debt	N/A	N/A	N/A	N/A
Total Debt	£38.7m	6.99%	£31.2m	7.58%
Fixed Interest Investments	£11.0m	5.85%	£6m	5.44%
Variable Interest Investments	£1.97m	5.25%	£1.6m	5.28%
Total Investments	£12.97m	N/A	£7.6m	N/A

4.0 Prudential Indicators and Compliance Issues

The Council is required by the Prudential Code to report the actual annual prudential indicators after the year end. Appendix A provides a schedule of all the mandatory prudential indicators. Certain of these indicators provide either an overview or a limit on treasury activity, and these are shown within the tables set out below:

Table 2

	31 March 2008 Actual	31 March 2008 Original Indicator
Capital Financing Requirement	£42.24m	£36.3m

The original indicator was based on the existing level of borrowing as at February 2007, and did not include any an allowance for any new borrowing in 2007-08. The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is a gauge for the Council's debt position shown in the table below. In order to ensure that over the medium term borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short term, exceed the CFR for 2007/2008. The table above highlights that the Council has complied with this requirement.

Table 3

	2007/2008
Original Indicator - Authorised Limit	£40m
Original Indicator - Operational Boundary	£35m
Maximum gross borrowing position during the year	£38.7m
Minimum gross borrowing position during the year	£31.2m
Net borrowing position at 31st March 2008	£25.73m

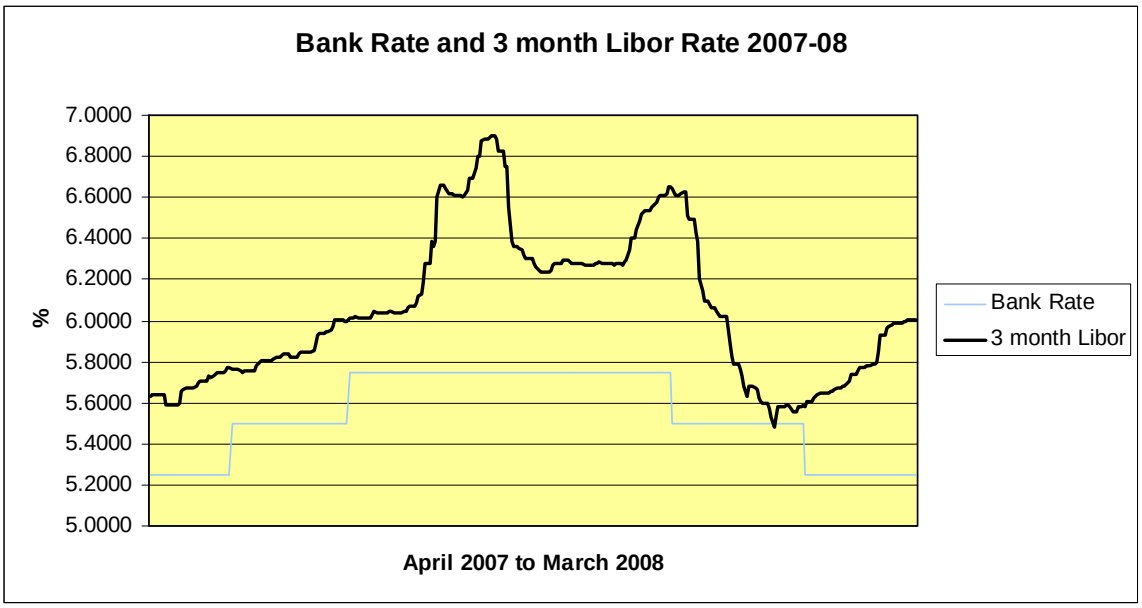
The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The table above demonstrates that during 2007/2008 the Council has maintained gross borrowing within its Authorised Limit.

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.

5.0 Economic Background for 2007/2008

5.1 **Shorter-term interest rates** – Bank Rate started 2007/08 at 5.25%, with a further increase to 5.5% in May. The Bank of England Inflation Report of May 2007 predicted that inflation would be above target at the 2 year horizon. The Bank Rate rose to its peak of 5.75% in July. In August the crisis known as the "Credit Crunch" hit the markets. Fears of possible bankruptcies in the banking sector, resulting from sub prime

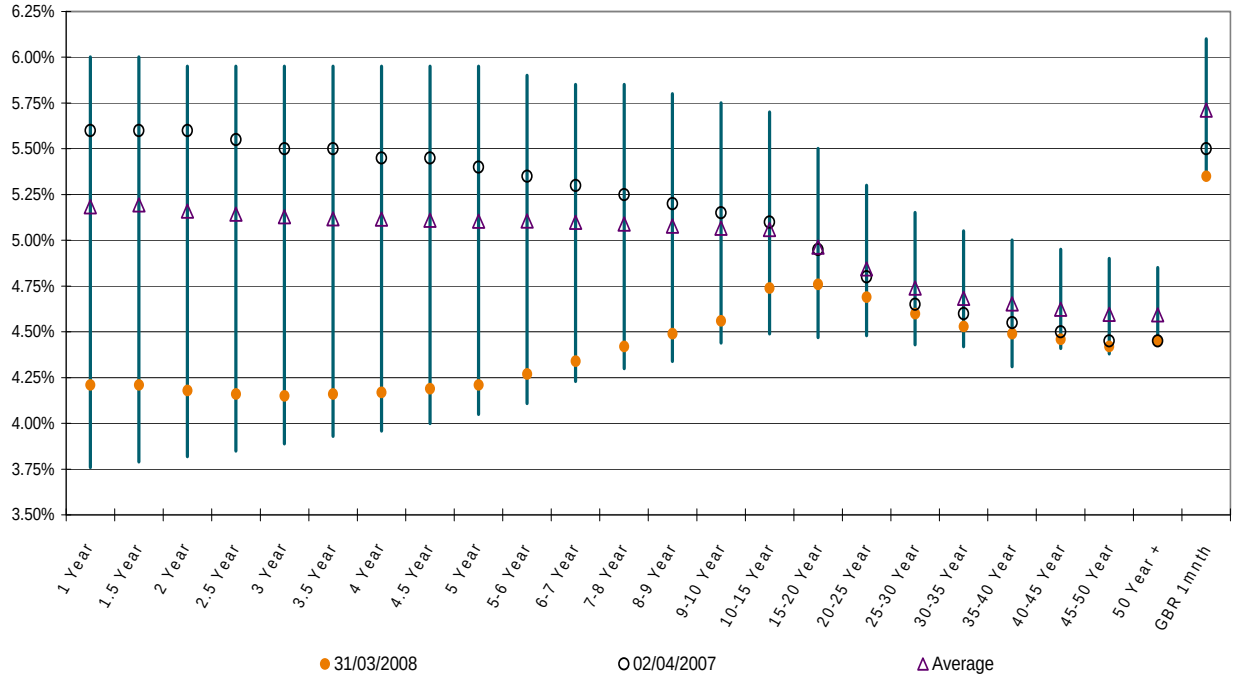
lending in the US, created reluctance between banks to lend to each other. The shortage of money in the markets, lead to 3 month money being dealt above the bank rate. Northern Rock was particularly hard hit by the subsequent shortage of money in the wholesale money markets, which had provided 80% of its funding. This lead to the Government guaranteeing all deposits held at the bank in September 2007 and its eventual nationalisation in February 2008. At its October meeting the Monetary Policy Committee, concerned about the inflation outlook, declined to cut the Bank Rate. It eventually began to cut interest rates as concerns about the economy and credit crunch mounted. The Bank Rate ended the year at 5.25% with 3 month Libor (London Interbank Offered Rate), being dealt at 75 basis points above this rate. The graph below highlights the gap between the bank rate and 3 month Libor during the year.



Longer-term interest rates – The Public Works Loans Board (PWLB) 45-50 year rate started the year at 4.45% then fell back to a year low of 4.38% in March 2008, before finishing the year at 4.42%. The volatility in yields was a direct reflection of the massive turnaround in interest sentiment brought about by the sub-prime crisis in the US. A radical change to PWLB rate structure was introduced by the Debt Management Office (DMO) on 1st November 2007. Movements of single basis points were introduced together with separate repayment rates at a level significantly below the rate at which they would lend new money.

PWLB rates 2007/2008

The graph below shows the range (high and low points) in rates for each maturity period during the year, and individual rates at the start and end of the financial year:



6.0 Treasury decisions taken during 2007/2008

6.1 **Borrowing** - As highlighted Table 1 the average debt portfolio interest rate has moved over the course of the year from 7.58% to 6.99% This is a result of £7.520m of new borrowing drawn down from the PWLB at lower interest rates than the existing debt, following a successful bid to achieve a two star housing service, which was announced in the autumn.

Table 4

Lender	Principal	Type	Interest Rate	Maturity	Average for 2007/08
PWLB	£2m	Fixed interest rate	4.65%	29.5 years	4.74%
PWLB	£2m	Fixed interest rate	4.63%	34.5 years	4.68%
PWLB	£2m	Fixed interest rate	4.43%	29.5 years	4.74%
PWLB	£1.52m	Fixed interest rate	4.43%	33.5 years	4.68%

A graph showing the new maturity profile is shown in appendix B.

6.2 **Debt Rescheduling** – On 1st November the PWLB imposed two rates for each period, one for new borrowing and a new, significantly lower rate for early repayment of debt. The differential between the two rates ranged from 26bp (basis points) in the shorter dated maturities to over 40bp in the longer ones.

They also introduced daily movements of 1bp instead of 5 bp and rates in half year periods throughout the maturity range (previously had been mainly in 5 year bands). These changes effectively prevented the Council from restructuring the portfolio into new PWLB borrowing.

6.3 **Debt Repayment** - Maturing PWLB debt of £33,333 was repaid during 2007/2008.

6.4 **Summary of Debt Transactions**

The overall position of the debt activity resulted in a fall in the average interest rate by 0.59%.

6.5 Investment Position

6.5.1 Investment Policy – The Council's investment policy is governed by Department of Communities and Local Government (DCLG) Guidance. This was implemented in the annual investment strategy approved by Council on 7th February 2007. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

6.5.2 Investments - The Council manages a small portfolio of investments. It does not have the expertise or resources to actively use a wide range of investment products. Therefore performance tends to be more stable, and this is in accordance with the Council's risk management ethos. The Council is a member of the Institute of Public Finance Treasury Management Benchmarking Club and its performance is measured against other local authorities nationally.

The Council maintained an average investment balance of £17.6m for 2007/2008 and received an average return of 5.88%. The comparable performance indicator is the average 7-day London Interbank Bid rate (LIBID) which was 5.58%. The increased margin of actual return over indicator is partly the result of higher wholesale money market rates from August 2007, for deposits of one month and longer.

6.6 **Performance Indicators set for 2007/2008**

The Council set specific performance indicators for 2007/2008. Performance against these indicators is shown below:

- Average rate of borrowing in the year compared to the average available: New borrowing was taken at or below average rates for the year, as advised by our treasury advisors
- Average overall rate movement year on year: There was a reduction of 0.59%
- Investment Returns compared favourably against the 7 day LIBID rate: 5.88% achieved against an average 7 day LIBID rate of 5.58% (see 6.5.2 above)
- Limit on fixed interest rate exposures of 100% and variable rate exposure of 25%: neither limit was breached
- Upper limits for the maturity structure of the Council's debt. Limits set and actual performance is shown below:

	Upper Limit	Actual at 31st March 2008
Under 12 months	20%	0%
12 months to 2 years	20%	0%
2 years to 5 years	50%	0%
5 years to 10 years	75%	31.5%
10 years and above	95%	68.5%

7.0 Risk and Performance

The Council complied with all of the 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 that its treasury practices demonstrate a low risk approach.

The Council is aware of the risks of passive management of the treasury portfolio and with the support of Sector, the Council's advisers, proactively managed its debt and investments over the 2007/2008 financial year. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is no risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile as has been demonstrated during 2007-08, and accurately forecasting future returns can be difficult. The risk of loss of principal is minimised through the annual investment strategy, and the monthly counterparty credit worthiness reports received from the Council's Treasury Advisors. Eastbourne Borough Council had £2m invested with Northern Rock Bank at September 2007, when the Bank of England guaranteed all investments with the bank. These deposits were subsequently repaid in October 2007 and February 2008. A reduction in credit ratings in September 2007 has lead to the bank failing to meet the Council's minimum credit rating criteria.

8.0 Interim Review of Annual Strategy 2008/2009

8.1 **Investments** – The Council started the year with £12.975m in investments and currently has £23.75m invested in banks and building societies. The authorised list of specified investment counterparties contains only counterparties which are adequately credit rated. This list is regularly reviewed during the year.

The Bank Rate started the year at 5.25% and was cut to 5.0% in April 2008. It is uncertain whether the Bank Rates will rise further this year, most analysts expect them to remain at 5%. Investments have been made in all periods up to one year.

The monitoring of Treasury Management activities is reported quarterly to Cabinet in Finance Matters and the Members Newsletter.

8.2 **Borrowing** – Following the Council's success in achieving a 2 star housing service, further long term borrowing of £11.974m will be drawn down in 2008-09. On 16th May 2008 a £4m 50 year loan was drawn down from the PWLB at a rate of 4.45%. The remainder is expected to be taken shortly.

8.3 **Treasury Advisors** – Sector Treasury Management Ltd continue to provide advice on both investment and borrowing.

9.0 Implications

9.1 None other than those set out in the body of this report

Lesley Lane
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Background papers:
Treasury management strategy, investment strategy and prudential indicators set within the 2008/2009 Budget report approved by Council in February 2008

Appendix A

Estimated and Actual Treasury Position and Prudential Indicators

	Figures are for the financial year unless otherwise titled in italics	2007/2008 Actual	2007/2008 Original Indicator
1	Capital Expenditure	£17.968m	£7.853m
2	Capital Financing Requirement (CFR) at 31st March : Housing Revenue Account General Fund	£42.24m £33.318m £8.919m	£36.3m £25.8m £10.5m
3	Treasury Position at 31 March: Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £38.7m NIL £38.7m £12.98m £25.72m	 £31.2m NIL £31.2m £7m £27.2m
4	Authorised Limit (against maximum position)	£40m	£40m
5	Operational Boundary	£35m	£35m
6	Ratio of financing costs to net revenue stream, see Note (1)	*To follow*	*16.66*
7	Incremental impact of capital investment decisions on the Band D council tax	*0*	*0*
8	Incremental impact of capital investment decisions on the housing rent levels	£0.00p	£0.00p
9	Upper limits on fixed interest rates (against maximum position)	99%	100%
10	Upper limits on variable interest rates (against maximum position)	1%	25%
11	Maturity structure of fixed rate borrowing (against maximum position):		
	Under 12 months	0%	0%
	12 months to 2 years	0%	0%
	2 years to 5 years	0%	0%
	5 years to 10 years	31.5%	39%
	10 years and above	68.5%	61%

12	Maximum principal funds invested (against maximum position)	N/A	N/A

Note (1) Ratio of financing costs to net revenue stream: Total of outstanding premium (£2m) written off to Income and Expenditure account in year.

In addition to the above the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice.
- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR).

Compliance with these indicators is highlighted within the body of the report.