St Edmundsbury
BOROUGH COUNCIL

Z138

Cabinet
30 July 2008

Treasury Management: Annual Report 2007/2008

1.	**Summary and Reasons for Recommendation**
1.1	The report and appendix summarise the investment activity for the year 2007/2008 and is submitted in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. The recommendation is for noting only.
1.2	Interest earned on the Council's capital investments in 2007/2008 was £3,721,450 compared to the budget of £2,147,000, resulting in an excess of £1,574,450. This amounts to an income of £100.29 per Band D Council Tax equivalent property. It should be noted that this is the total interest earned before apportionment of £535,800 across the range of reserve accounts operated by the Council.
1.3	The reasons for the surplus over budget include achieving a higher average rate of interest than anticipated and slippage in the capital programme. The average rate of return on investments for the year was 5.53% compared to a target rate of 5.00%. The actual level of capital expenditure during the year was £16.06m compared to an original gross budget of £34.601m.
2.	**Recommendation**
2.1	The information on the operation of the Treasury Management function for the year 2007/2008, as set out in the Annual Treasury Report at Appendix 1 to this report, be noted.

3.	**Corporate Objectives**
3.1	The recommendation meets the following, as contained within the Corporate Plan:- (a) Corporate Priority : '*To raise corporate standards and efficiency*'; and (b) Cabinet Commitment : *'Improving Efficiency and Value for Money'*.

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4. Key Issues

4.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, adopted by the Council in March 2002, requires that the Cabinet receive an annual review report after the end of the financial year. The report is attached as Appendix 1.

4.2 Interest earned on the Council's capital investments in 2007/2008 was £3,721,450 compared to the budget of £2,147,000, resulting in an excess of £1,574,450. This amounts to an income of £100.29 per Band D Council Tax equivalent property. It should be noted that this is the total interest earned before apportionment of £535,800 across the range of reserve accounts operated by the Council.

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4.4 Given the significant sums that are invested and the amount of interest earned, fluctuations in interest rates and in levels of planned capital expenditure and receipts have a major impact on the budget. The establishment of the Interest Equalisation Reserve, as agreed by Council in February 2005, assists in the smoothing out of year-on-year impact of variations in planned investment returns.

5. Other Options considered

5.1 Not applicable.

6. Community impact *(including Section 17 of the Crime and Disorder Act 1998 and diversity issues)*

6.1 General

6.1.1 The level of interest earned on investments reduces the demand on the Council Tax payer to fund the cost of service provision.

6.2 Diversity

6.2.1 All Council Taxpayers in the St Edmundsbury area benefit from the interest achieved on investments.

7. Consultation

7.1 Not applicable.

8. Resource implications *(including asset management implications)*

8.1 Investment income of £3,721,450 was achieved during 2007/2008. This level of interest represents an income per Council Tax Band D equivalent property of £100.29. The comparative budget figures were £2,147,000 and £57.86.

9. Risk Assessment *(including Health & Safety, potential hazards or opportunities affecting corporate, service or project objectives)*

9.1 Investment activities are carried out in accordance with the approved Annual Strategy and comply with the CIPFA Code of Practice. The Council has a high level of capital receipts. The interest obtained on these receipts is significant and helps to support the annual level of Council Tax. Whilst fluctuations in interest rates and planned levels of capital expenditure and receipts can impact considerably on the Council's budget the establishment of the Interest Equalisation Reserve helps to minimise the effects of this.

In addition the portfolio of investments includes loans for varying periods of duration of up to five years at fixed rates of interest and these give some certainty of return for a proportion of the investments.

Risk area	**Inherent level of Risk** (before controls)	**Controls**	**Residual Risk** (after controls)
Economic (fluctuations in interest rates)	Medium	Spread of investments for periods of up to five years.	Low
		Interest Equalisation Account	Low

10. Legal or policy implications

10.1 Consideration of the report complies with Council policy and the CIPFA Code of Practice on Treasury Management.

Ward(s) affected	All	**Portfolio Holder**	Resources and Efficiency
Background Papers		**Subject Area** Finance	

APPENDIX 1

Annual Treasury Report 2007/2008

1 Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by the Council on 21st March 2002. One of the requirements of the Code is the receipt by the Cabinet of an annual strategy report for the year ahead and an annual review report of the previous year.

1.2 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. "

2 Background

2.1 The Council became debt free in 1992 and since then has refrained from any borrowing apart from the temporary use of overdraft facilities. This was continued in 2007/08 with the result that the Council had no Prudential Code indicators so far as borrowing is concerned in the year. During the financial year all the Council's investments were managed by in house staff.

3 Investment Strategy for 2007/2008

3.1 The investment objective for 2007/2008 was for investments to be made prudently with priority being given to security and liquidity as well as yield.

3.2 The target rate of return for investments for 2007/2008, was 5.00%. Based upon the anticipated funds available for investment in the year this gave a target investment income of £2,147,000, equivalent to £57.86 for each Council Tax Band D property. This figure was used in the preparation of the Council's budget for 2007/2008.

3.3 The Treasury Strategy including the target interest rate for investments was based upon advice received from the Council's Treasury Management advisors, Sector Treasury Services. At the time when the strategy was set the prediction was for the base rate to remain stable at 5.00% until the final quarter of the year when it was projected to fall to 4.75%. In view of this outlook for interest rates, investments were to be made with reference to cash flow requirements and also to take advantage of opportunities to invest for longer periods in order to provide certainty of investment income from a proportion of the Council's investments and maintain overall returns at the target level.

4 The Economy and Interest Rates in 2007/2008

4.1 Sector Treasury Services has provided the following commentary on the performance of the economy and interest rate in 2007/2008.

4.2 Shorter-term interest rates – Bank Rate started 2007/08 at 5.25% with expectations that there would be further increases in rates. This was reflected in a positive interbank money market curve. A further increase in rates to 5.5% duly occurred on 10th May 2007 but not before the Governor of the Bank of England had written a letter to the Chancellor in April explaining why the Consumer Price Index (CPI) had risen to 1% or more above the official CPI inflation target of 2%. The Bank of England's Inflation Report issued in May showed inflation would be above target at the two year horizon. Another rise was delivered on 5th July when Bank Rate rose to 5.75% and the markets, including Sector, fully expected Bank Rate to increase again. One year interbank was priced at over 6%, Gross Domestic Product (GDP) growth was continuing to strengthen and the housing market was still robust. The August Inflation Report showed the Bank Rate needed to rise to 6% to keep inflation at target in two years time.

4.3. August, as it turned out, was the peak of interest rates as what has become known as 'the credit crunch' hit the markets and the global economy. The crunch originated in the US through the sub-prime housing market. Although originating in the US, world wide investors, particularly banks, had invested in packages of sub-prime loans, attracted by the higher yields offered. Fears arose that a large number of these investments would turn out to be worthless and this in turn would lead to bankruptcies amongst the banking sector. As a result of these fears, and the ensuing reluctance of banks to lend to each other, the Federal Reserve Bank injected $38bn of liquidity into the markets on 9th August. The European Central Bank (ECB) followed suite but the Bank of England stood on the sidelines only making cash available at a penal rate of 1% above Bank Rate. On 17th August the Federal Reserve cut interest rates by 50 bp to 5.25%. On 20th August Sector revised its interest rate view to reflect a downside risk to its forecast. The dislocation in the markets continued throughout the summer until on 14th September it was announced that the Bank of England had provided billions of pounds of financial support to Northern Rock. Northern Rock had been affected by the drying up of the wholesale money markets which provided 80% of its funding. On 17th September the Chancellor announced a Government guarantee for all deposits held at the stricken bank. A day later the Federal Reserve cut US rates by a further 50bp although oil rose to $80 a barrel and continued to climb reaching a peak, briefly, of $100pb in November. On 24th September Sector revised its interest rate forecast with 5.75% now the peak in rates. At its October meeting the Bank of England's Monetary Policy Committee (MPC) declined to cut Bank Rate, being concerned about the inflation outlook. UK data continued to be robust during the autumn although CPI dropped to 1.8% in September. 3 month London Inter Bank Bid Rate (LIBID) still remained well above Bank Rate. On 31st October the Federal Reserve cut rates yet again to 4.50% and the following day they added $41bn of reserves in an attempt to free up the markets. The MPC eventually cut Bank Rate on 6th December to 5.50% as concerns about the economy and the credit crunch mounted. A day after the Federal Reserve cut rates again, this time by 25bp.

4.4 2008 was ushered in with major fears about the global economy. Stock markets fell sharply and government bond yields fell. On 22nd January the Federal Reserve cut rates, this time by a massive 0.75bp to 3.5%, and once more on 30th January to 3%. The MPC followed suit in February cutting Bank Rate by 25bp to 5.25%. On 18th February it was announced that the Government would nationalize Northern Rock. In late February and March the markets seized up again, forcing concerted liquidity intervention by the world's central banks, initially to little avail. The UK budget brought increased debt issuance, but little else, pushing gilt yields up sharply at the front end and driving Public Works Loan Board (PWLB) rates up. On 14th March US investment bank Bear Stearns had to be bailed out by the Federal Reserve, culminating in a takeover by JP Morgan. The year ended with the money markets anxious and nervous and 3 month cash 75bp above bank rate.

4.5 **Longer-term interest rates** –The PWLB 45-50 year rate started the year at 4.45% and fell to a low of 4.38% in March 2008. The high point, of which there were several, for 45-50 year loans was 4.90% before finishing the year at 4.42%. The volatility in yields was a direct reflection of the massive turnaround in interest rate sentiment brought about by the sub-prime crisis in the US. A radical change to the PWLB rate structure was introduced by the Treasury's Debt Management Ofice (DMO) on 1st November when they moved to single basis point moves in their rates and introduced a separate repayment at the same time, at a level significantly below the rate at which they would lend new money.

5 Compliance with Treasury Limits

5.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. In addition no institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

6 Investment Outturn 2008/2009

6.1 Investments are made with counterparties that meet the agreed lending criteria and investment periods range from overnight to five years, dependent on the Council's cash flows, the view on interest rates and the actual interest rates on offer.

Activity in 2007/2008

6.2 Market investments in the year are summarised as follows:

	Number	Value (£)
Opening balance 1st April 2008	25	64,750,000
Investments made during the year	127*	149,700,000
	152	214,450,000
Investments realised during the year	121**	158,250,000
Balance at 31st March 2008	31	56,200,000

* *Includes 33 investments into Business Reserve Accounts*
** *Includes 34 withdrawals from Business Reserve Accounts*

6.3 Investments have been made in a number of longer dated deposits, callable deposits and forward investments. These arrangements have been made in order to lock in to interest rates which exceed the Council's budgeted rate and to provide some certainty of return for a proportion of the Council's investments. In this respect as at 31st March 2008:

- A one year investment of £1m was made in March 2008 (i.e. maturity in March 2009) at 6.02%.
- Callable deposits amount to £17m the longest of which could run to March 2011 with interest rates varying from 4.42% to 5.25%.

6.4 During the year, for cash flow generated balances, greater use was made of the instant access and 7 day notice business reserve accounts with Abbey National Plc and the Bank of Scotland. At 31st March 2008, in order to maintain liquidity whilst at the same time achieving earnings in excess of base rate, £12.7m was held in these accounts.

6.5 At the financial year end the balance of the portfolio, £23.5m, was held in 12 separate investments maturing before December 2008.

Balance Invested

6.6 The average daily investment for the year was £67.3m and ranged from a high of £70.4m in July 2007 to a low of £57.8m in March 2008.

Interest Earned

6.7

	Interest Rate	Interest Earned
	%	£
2007/2008 Budget	5.00	2.147m
2007/2008 Outturn	5.53	3.721m

6.8 The total interest earned in 2007/2008 from the Council's investments amounted to £3,721,450 against a budget of £2,147,000 i.e. an excess of £1,574,450. Overall this is a return in the period of 5.53% compared to the original target of 5.00%. This level of interest represents an income per Council Tax Band D equivalent property of £100.29 in 2007/2008 compared to a budgeted income of £57.86.