APPENDIX 1

TREASURY MANAGEMENT REPORT 2007/08

PURPOSE

The purpose of this report is to advise Cabinet of the council's treasury management activities for 2007/08.

1. INTRODUCTION AND BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management 2001 was adopted by this council in February 2002 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 Cabinet of an annual 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.

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. "

1.3 The authority's treasury management activities expose it to a variety of financial risks:

a.Credit risk: The possibility that other parties might fail to pay amounts to the council.

b.Liquidity risk: The possibility that the council might not have funds available to meet its commitments to make payments.

c.Market risk: The possibility that financial loss might arise for the council as a result of changes in such measures as interest rates.

The council in adopting the CIPFA Code of Practice on Treasury Management to produce its annual Treasury Management Strategy has operated within a control framework to minimise risks relating to financial instruments.

1.4 An Internal Audit review in March 2008 concluded that the monitoring and control of the treasury management system is **good**.

1.5 This annual treasury report covers:

a. the council's borrowing transactions 2007/08.

b. the council's investment transactions 2007/08.

c. the outturn position 2007/08.

d. the strategy for 2007/08.

e. the economy in 2007/08 (borrowing and investment rates in 2007/08).

f. compliance with treasury limits and Prudential Indicators.

1.6 Effective treasury management can make a useful contribution to helping achieve the council's strategic objectives.

2. THE COUNCIL'S BORROWING TRANSACTIONS 2007/08

2.1 The following summary gives information relating to the council's long-term borrowing transactions in 2007/08.

Long-term Borrowing	£
As at 1st April 2007	93,852,794
New Borrowing (see paragraph 2.3)	12,500,000
Less: Repayments	(464,180)
As at 31st March 2008	**105,888,614**

2.2 The Public Works Loan Board (PWLB) remains the main source of long-term borrowing for the council. In addition to PWLB loans the council has two LOBO (Lender Option, Borrowing Option) loans totalling £12m.

2.3 After careful consideration of interest rate forecasts, expected capital spending, repayment profile and having regard to the existing debt, loans were taken during 2007/08 as follows:

Date	Loan Type	Lender	Amount £	Period (years)	Interest Rate %
27/11/07	Fixed Maturity	PWLB	5,000,000	34	4.48
07/01/08	Fixed Maturity	PWLB	5,000,000	30	4.42
13/03/08	Fixed Maturity	PWLB	2,500,000	4	3.99
			12,500,000		

2.4 As comparative performance indicators, average PWLB maturity loan interest rates for 2007/08 were:

Period (years)	Interest Rate %
1 year	5.18
4 years	5.10
9.5–10 years	5.07
25-30 years	4.74
30-35 years	4.68
49.5–50 years	4.60

2.5 The average rate of interest paid on borrowings during the year was 4.50% compared to 4.48% in 2006/07.

2.6 The longer term debt at 31st March 2008 falls due for repayment as follows:

Long-term Debt Profile **Within**	**£**	**% of total debt**
1 year	12,485,952	12
1 – 5 years	3,581,792	3
5 – 10 years	1,818,994	2
10 – 15 years	7,932,108	7
15 years and over	80,069,768	76
TOTAL	**105,888,614**	**100**

2.7 In addition to the external borrowing identified above, the council has a bank overdraft facility with its bankers, National Westminster Bank plc, of £6,000,000, which was used on a limited basis during the year. This was used in replacement of any short-term borrowing of amounts less than £100,000 where it would not be cost effective to borrow through the money market.

2.8 The council's aim is to maintain a nil cleared balance, as far as possible, in low-interest bearing accounts. In practice this is hard to achieve because some payments are made directly in to the bank. However, such sums are not significant in overall terms. The average daily bank balance for 2007/08, on which debit and credit interest is calculated was £46,642 in credit.

3. THE COUNCIL'S INVESTMENT TRANSACTIONS 2007/08

3.1 **Internally Managed Investments** – The council manages its in-house investments with the institutions listed in the council's approved lending list. The council placed investments for a range of periods from overnight to 364 days. The length depended on factors such as cash flow requirements and if it was viewed that interest rates would change.

3.2 During the year the interest rate earned on internally managed funds varied between 5.25% and 6.8% and the average daily investment managed internally was £53,672,976. The actual daily investments ranged from £30,540,000 to £68,499,566, which illustrates how much the temporary cash flow fluctuates throughout the year. The temporary short-term investment transactions for 2007/08 are summarised as follows:

Internally Managed Investments	**£**	**£**
As at 31st March 2007		33,205,906
Investments made during year (276 transactions)	785,912,456	
Less: Investments recalled during year	777,973,510	7,938,946
As at 31st March 2008		**41,144,852**

3.3 The level of funds that were available for internal investment increased during the year, due to bringing in-house the investments previously managed by Investec Asset Management Limited (paragraph 3.6).

3.4 The average interest rate achieved on internally managed funds was 5.96%, which compares favourably with the generally accepted benchmark of the average 7-Day London Inter-Bank Bid (LIBID) rate of 5.6%. The Bank of England Bank Rate increased from 5.25% at the start of the year to 5.75% in July to combat the threat of inflation. However, in August the U.S. sub-prime mortgae disaster exploded, which stopped any further increase. This crisis generated volatility and fear that gave rise to a credit squeeze resulting in market rates rising significantly above the Bank Rate. The council was therefore able to make investments at very good rates during the year.

3.5 **Externally Managed Investments** – At 31st March 2007 council funds of £7,778,736 were managed externally by Investec Asset Management Ltd (Investec). Due to Investec's poor performance the council withdrew the fund from Investec in June 2007 in order to manage the investments in-house.

3.6 The following table summarises the investment income received in 2007/08:

Summary of Investment Income	£	£
Internally Managed Funds		3,180,843
Externally Managed Funds (net)		89,965
		3,270,808
Less: transfers to Schools	(142,838)	
Interest payments to trusts etc.	(243,601)	
		(386,439)
Interest Received 2007/08		**2,884,369**

4 TREASURY MANAGEMENT OUTTURN 2007/08

4.1 The outturn position for treasury management activities was an underspend against budget of £803,534. The main reasons for this were:

a. Investment interest rates above the target rates were achieved.

b. Cash flow advantages in delays in spending, and in particular slippage on the capital programme.

5 THE STRATEGY FOR 2007/08

5.1 The treasury management strategy for 2007/08 was based on a view of a steady rate of growth in the UK. It took into account advice and trends evident in the previous year.

5.2 The Monetary Policy Committee (MPC) had raised the Bank Rate in November 2006 and January 2007 to 5.25% due to concerns over inflation. One more increase in the Bank Rate was forecast before an anticipated switch to a falling trend as inflation came back under control, bringing the Bank Rate to a level of 5% by the end of 2007. This was predicted on the Consumer Price Index (CPI) being at target on the two year horizon, that wage growth was below the MPC's threshold of 4.5%,

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

Shorter-term interest rates - The view was that weak growth in the UK, US and EU would eventually lead to a decrease in the UK Bank Rate to 5% by the end of March 2008 after peaking at 5.5% at the start of the 2007/08 financial year .
Longer-term interest rates - The view on longer-term fixed interest rates (50 years) was that they would remain static around 4.25% for the whole of the year. The 25 year rate would also remain "flat" around 4.50%.

5.4 After taking into account the above the strategy was:

a. Very long dated borrowing could be taken at any time in the financial year.

b. Variable rate borrowing and short term borrowing were expected to be more expensive than long term borrowing and therefore unattractive throughout the year compared to long term borrowing.

c. The Director of Resources would carefully monitor interest rates available and adopt a pragmatic approach to any changing circumstances.

6 THE ECONOMY IN 2007/08

6.1 **Shorter-term interest rates:** The Base Rate started 2007/08 at 5.25% with expectations that there would be further increases in rates. A further increase in rates to 5.50% 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 CPI had risen to 1% or more above the official CPI inflation target of 2%. Another rise was delivered on 5th July when the Bank Rate rose to 5.75% and the markets fully expected Bank Rate to increase again.

6.2 August saw what has become known as the ‘credit crunch’ that affected the markets and the global economy. The crunch originated in the US through the sub-prime housing market. World wide investors, particularly banks, had invested in packages of sub-prime loans, attracted by the higher yields offered. The problems in the markets continued throughout the summer until on the 14th September it was announced that the Bank of England had provided significant financial support to Northern Rock. The MPC eventually cut Bank Rate on 6th December to 5.50% as concerns about the economy and the credit crunch mounted.

6.3 The start of 2008 saw 2008 major fears about the global economy. Stock markets fell sharply and government bond yields fell. The MPC cut interest rates in February to 5.25%. On the 18th February it was announced that the Government would nationalize Northern Rock. In late February and March the markets became difficult again giving rise to intervention by the world’s central banks.

6.4 **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 was 4.90% before finishing the year at 4.42%. The volatility in yields was a direct reflection of the interest rate issues brought about by the sub-prime crisis in the US. A radical change to the PWLB rate structure was introduced by the Debt Management Office on 1st November when they moved to single basis point moves in their interest rates. At the same time they introduced a separate repayment rate at a level significantly below the rate at which they would lend new money.

7. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

7.1 During the financial year the council operated within the treasury limits and Prudential Indicators set out in the council’s Treasury Management Policy Statement and annual Treasury Management Strategy. The outturn for the Prudential Indicators is shown in **Annex A**. The Prudential Indicators set out are recommended by the CIPFA Prudential Code for Capital Finance.