Treasury Management Interim Report **Appendix C**
Six months to 30 September 2009

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. Therefore, this report ensures the Council is embracing Best Practice in accordance with CIPFA's recommendations.

1. The Economy

1.1. Recent economic statistics show:

- The Bank Base Rate remaining unchanged at 0.50%;
- Inflation falling from 1.6% in August to 1.1% in September; its lowest level for five years;
- GDP continuing to contract; and
- Unemployment continuing to rise.

1.2 Despite the statistics above, some sectors of the economy have fared better. Since March 2009 equity prices on the London stock exchange have rallied strongly. House prices have also risen steadily in 2009.

1.3 With the Bank Base Rate at its lowest level since the Bank of England was founded three hundred years ago, the Monetary Policy Committee (MPC) announced in March 2009 that it would resort to injecting money directly into the economy in order to boost demand and meet the CPI inflation target of 2%. The programme, known as quantitative easing, currently stands at £200 billion.

1.4 However, despite the injection of these billions, so far the policy has had only limited success in boosting the supply of credit and the money supply. Most analysts are predicting that economic recovery will be slow with unemployment remaining high, and interest rates low, for a long time to come.

2. The Council's Investments

2.1 Because of the instability in the financial markets, at the beginning of the year the Council's funds were invested either in the UK government's Debt Management Office or in money market funds. Both these investments carry the highest possible long term credit rating (AAA using Fitch's long-term credit ratings). Other financial institutions were excluded on the basis that one or more of the credit rating agencies had placed each and every UK bank and building society on "negative watch" or "negative outlook". Historically it has always been council policy to exclude such institutions from our lending list until the ratings are reviewed and stabilised, at which point we would look to see if they still met our lending criteria. Whilst the Debt Management Office is very secure the rate of interest offered is very low at 0.25%.

2.2 The problem with the continuing uncertainty in the financial markets is that the "negative outlook" or "negative watch" tag assigned to most of the bank and building societies is not being lifted. Three-quarters of the banks remain on negative outlook due to continued concern about the level of future bad debts that institutions may incur and their ability to absorb these losses.

2.3 However, conditions in the financial markets have improved during the last six months. Many of the banks have declared good profits and the fear of bad debts spiralling out of control has abated.

2.4 Therefore on the advice of Sector, the council's treasury advisers, in the last six months the council has cautiously extended its lending list.

2.5 In June 2009 it was considered that the financial markets had stabilised sufficiently for the list of eligible counterparties to be extended to include the nationalised and part nationalised banks (Lloyds Banking Group and the Royal Bank of Scotland Group), as recommended by Sector. Sector advised that, due to the high level of support by the government, resulting in the government owning a large stake in the banks, the banks effectively take on the credit worthiness of the government itself and should be reinstated on our lending list. Therefore in June 2009 we invested in instant access accounts with both National Westminster Bank and the Bank of Scotland (investing £5 million in each). More recently, the £5 million in the instant access account with the Bank of Scotland has been transferred to a three month term deposit to increase the interest rate earned from 0.85% to 1.10%.

2.6 As at 30 September 2009 the investments held by the council were as follows:

Investment	**Rate of interest**	**Amount invested**	
		£m	**£m**
Instant access accounts:			
Bank of Scotland	0.85%	5.00	
National Westminster	1.10%	5.07	10.07
Money Market Funds:			
Standard Life	0.43%	5.00	
Insight	0.59%	5.00	
Blackrock	0.67%	5.00	15.00
Debt Management Office:			
Various short term deposits	0.25%	8.86	8.86
Total	0.60%		33.93

2.7 In October 2009 the council's lending list was extended again to include HSBC, Barclays and Abbey National.

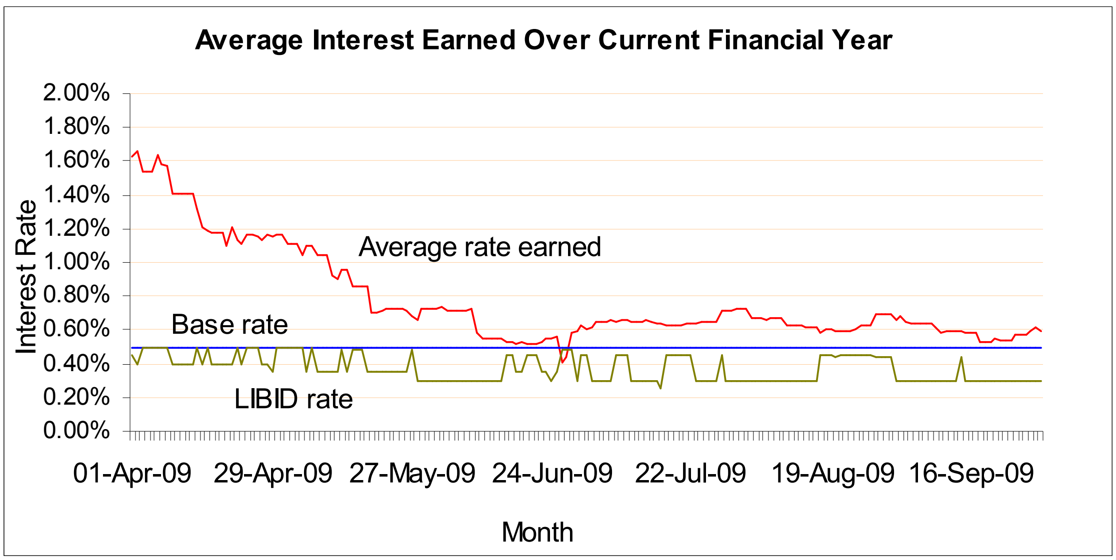
2.8 All three banks participated in the government's recapitalisation scheme which was introduced last autumn. The scheme involved the participants making a commitment to bolster their balance sheets by increasing their reserves, drawing on government support if necessary. In addition, these three banks have all reported good profits during 2009.

2.9 In October we recommenced using our Abbey National instant access account (interest rate 0.80%) and we are in the process of opening an instant access account with Barclays (interest rate 0.65%).

2.10 It has been found that the rate paid on instant access accounts is often very competitive when compared to term deposits of between three and six months and so the council is not being penalised for requesting instant access to funds.

2.11 When setting the budget for 2009/2010 an interest rate of 0.75% was used to estimate interest receivable.

2.12 In the six-month period to 30 September 2009 the rate of interest earned has averaged 0.75% but the daily average rate of interest earned has varied from 1.60% at the beginning of the year to a low of 0.40% in June 2009. At the beginning of the year the average rate was increased by term deposits, made in earlier periods when the interest rate was higher, but by mid-June these had all matured. In addition, the average rate earned decreases for high investment balances due to the council's limited lending list and the use of the Debt Management Office. The chart below shows the average rate of interest earned on investments in the first half of 2009/2010.



2.13 The interest rate achieved compares favourably with the generally accepted benchmark of the average 7-Day London Inter-Bank Bid (LIBID) rate which averaged 0.45% for the six month period.

2.14 It is anticipated that the rate of interest earned on the council's investments will average around 0.75% for the remainder of the year but the balances invested may be less than budgeted due to balances being used to finance capital expenditure in preference to external borrowing. Therefore at the end of the year there may well be a budget deficit for interest earned but that this will be more than offset by savings made from reduced borrowing costs.

3. The Council's Borrowing

3.1 To date the council has not taken out any new borrowing in 2009/2010.

3.2 As at 30 September 2009 the council's long term borrowing totalled £115.28m with maturities as follows:

Principal repayable:	£	%
Within the next 10.5 years to 31 March 2020	20,039,379	17.38%
Between 1 April 2020 and 31 March 2030	22,244,137	19.30%
Between 1 April 2030 and 31 March 2040	30,000,000	26.02%
Between 1 April 2040 and 31 March 2050	18,000,000	15.61%
Between 1 April 2050 and 31 March 2060	25,000,000	21.69%
Principal outstanding as at 30 September 2009	115,283,516	100.00%

3.3 All the above borrowing is from the Public Works Loan Board except for two bank loans totalling £12 million, which were taken out in 2004.

3.4 The Treasury Management Strategy outlined various options regarding council borrowing for 2009/2010, however, at the present time the favoured approach is to use internal borrowing as far as possible.

3.5 There are three main reasons for this:

- Financial markets have recovered to a certain degree but the risk of investing is still higher than in the past resulting in a much more limited lending list;
- The rate of interest the council can earn on its investments is at an all time low with a large differential between the rate we can earn on our investments and the rate payable on our loans; and
- In the year to date the rates payable on PWLB loans have not increased significantly.

3.6 The introduction on 1 November 2007 of different PWLB rates for new borrowing, as opposed to early repayment of debt, has meant that PWLB to PWLB debt restructuring is now much less attractive than before. In addition, the relatively low PWLB rates this year make the repayment of debt very expensive for all but our lowest rate loans. Debt rescheduling has been discussed with our treasury advisors but, because of the high cost of repayment coupled with the risk of having to replace loans in the future when rates may well be higher, so far this year this option has not been pursued but will be kept under review.

3.7 Depending upon the timing of payments, particularly with reference to the council's capital programme, further PWLB borrowing of between £5 million and £10 million may be needed before the end of the financial year, even after running down investment balances. Also if PWLB rates were to start an upward trend the policy of using internal borrowing would be reviewed.

3.8 The council may consider taking out short term loans to cover temporary fluctuations in cashflow.

4. Projected Outturn

4.1 The projected outturn is an underspend against budget of £458,000.

4.2 Of this amount approximately £22,000 relates to projected interest received being less than budget and £480,000 relates to an underspend on borrowing.

4.3 The underspend on borrowing is due to slippage on the 2008/2009 capital programme and external borrowing, resulting in a reduced minimum revenue provision (MRP) for debt repayment and less external interest payable in the year.