FINANCE CABINET MEMBER MEETING	Agenda Item 27 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement (incorporating the Annual Investment Strategy) 2007/08 - End of year review.**		
Date of Meeting:		**21 July 2008**		
Report of:		**Director of Finance & Resources**		
Contact Officer:	Name:	**Peter Sargent, Loans & Technical Manager**	**Tel:**	**29-1241**
	E-mail:	peter.sargent@brighton-hove.gov.uk		
Key Decision:	No			
Wards Affected:	All			

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 The Treasury Management Policy Statement (TMPS) and the Treasury Management Practices (including the schedules) for the year 2007/08 were approved by Policy & Resources Committee on 1 March 2007. The TMPS sets out the key role for treasury management, whilst the practices and schedules set out the annual targets for treasury management and the methods by which these targets shall be met.

1.2 The TMPS includes an annual investment strategy, which sets out the key investment parameters for council cash funds. Full Council approved the investment strategy on 8 March 2007.

1.3 The purpose of this report is to advise of the action taken during the second half of the financial year 2007/2008 on the TMPS, including the investment strategy (the action for the first half year was reported to Financial Management Sub Committee on 23 November 2007).

2. RECOMMENDATIONS:

2.1 To endorse the action taken during the second half year to meet the treasury management policy statement and practices (including the annual investment strategy); and

2.2 To note the authorised limit and operational boundary set by the Council have not been exceeded.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

3.1 Overview of markets

The crisis in the financial markets abated marginally during the second half year. Despite Bank of England intervention short-term interest rates remained above official levels.

The action taken by the Director of Finance & Resources in August 2007 to limit investment in all counterparties to a maximum of one month was reassessed during the period. The limits on all but a few counterparties were restated as further information became available but a number of institutions were either suspended or removed altogether.

An overview of the market is set out in Appendix 1 to this report.

3.2 Treasury Management Strategy

A summary of the action taken in the period October 2007 to March 2008 is provided in Appendix 2 to this report.

Treasury management is one of the criteria used in the comprehensive performance assessment to judge use of resources. The criteria require that "the council has a treasury management strategy that reflects the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services." In 2007/08 this criteria was satisfied.

Action taken has reduced the average cost of the debt portfolio from 4.79% per annum to 4.75%pa over the year. In addition investment returns for the year have been higher than included in the 2007/08 Budget as follows:

	In-house – core investments	In-house – cash flow investments	Cash manager investments
Budget 2007/08	5.00%	5.00%	5.00%
Benchmark rate (i.e. average market rate)	5.59%	5.59%	5.78%
Actual rate	5.88%	5.91%	5.24%

The above performance, together with better than expected cash flow balances, has contributed towards an underspend on the financing costs budget of circa £1.4m in 2007/08. The following table summarises the areas of major underspend.

Budget 2007/08		£8,450k
Impact of action taken by in-house treasury team		
• debt rescheduling	- £56k	
• above benchmark performance on investments	- £287k	- £343k
Impact of market factors		
• lower average debt outstanding	-£110k	
• higher average investment balances outstanding (e.g. cash flows)	- £933k	

• higher interest rates	- £548k	- £1,591k
Impact of action taken by cash manager		-£7k
Higher investment income paid on internal funds, etc		£567k
Actual 2007/08		£7,076k

The two borrowing limits approved by full Council in March 2007 – the 'authorised limit' and 'operational boundary' – have not been exceeded during the year.

3.3 Socially responsible investments

The council continues to promote its' ethical investment strategy with institutions within which it deposits money. Investment counterparties are advised of the following statement each and every time a deposit is placed with them:

"Brighton & Hove City Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- *encouraging those institutions to adopt and publicise policies on socially responsible investments;*
- *requesting those institutions to apply council deposits in a socially responsible manner."*

At the request of the Financial Management Sub Committee in March 2008 a survey on how investment counterparties are responding to the statement has been initiated. Responses received suggest a move towards socially responsible investments in a number of the institutions surveyed.

4. CONSULTATION

The council's external treasury advisor has contributed to this report.

5. FINANCIAL & OTHER IMPLICATIONS

5.1 Financial Implications

The financial implications arising from the action taken under the TMPS are included in Financing Costs. Details of the 2007/08 outturn for financing costs are included under Section 3.2 above.

The high level of interest rates experienced since August 2007 has continued in to the early months of 2008/09. Projecting forward this is likely to have a beneficial impact on the Financing Costs budget in 2008/09. Details of the impact will be reported to Members through the 'targeted budget management' process.

Finance Officer consulted : Peter Sargent (9 June 2008)

5.2 Legal Implications

The TMPS and action under it must be in accordance with Part I of the Local Government Act 2003 and regulations issued thereunder. Relevant guidance also needs to be taken into account.

This report is for information purposes only and as such it is not considered that anyone's rights under the Human Rights Act will be adversely affected by it.

Lawyer consulted : John Heys (9 June 2008)

5.3 Equalities Implications

No equalities impact assessment is required for this report.

5.4 Risk and Opportunity Management Implications

Action taken in the six months to March 2008 is consistent with the risks identified within the TMPS and associated schedules.

5.5 Sustainability / Crime & Disorder / Corporate / Citywide Implications

None arising from this report.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

This report sets out action taken in the six months to March 2008. No alternative options are therefore considered necessary.

7. REASONS FOR REPORT RECOMMENDATIONS

Treasury management is governed by a code that is recognised as 'best and proper practice' under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is a report looking back at the closing year. This report fulfils this requirement.

SUPPORTING DOCUMENTATION

Appendices:

Appendix 1 – Economic background

Appendix 2 – A summary of the action taken in the period October 2007 to March 2008

Appendix 3 – Performance and balances

Appendix 4 – Prudential indicators 2007/08 Actual

Documents In Members' Rooms

None

Background Documents

Part I of the Local Government Act 2003 and associated regulations

The Treasury Management Policy Statement and associated schedules 2007/08 approved by Policy & Resources Committee on 1 March 2007

The Annual Investment Strategy 2007/08 approved by full Council on 8 March 2007

Papers held within Strategic Finance, Finance & Resources

The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2003

Economic Background for 2007/08

The rising trend in UK interest rates continued in the first half of the 2007/08 financial year. The domestic economic backdrop continued to present problems for the Monetary Policy Committee, notably in the early summer. Inflation (as measured by the consumer prices index) breached the 3% upper limit of the Government's target range in April (reported in May), consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices.

Official Bank Rate was raised to 5½% in May and 5¾% in July in response to the deteriorating inflation outlook. In addition, the Bank of England's May and August Inflation Reports hinted that more hikes might be necessary.

The market was plunged into chaos in late August as the tightening of credit conditions, triggered initially by the failure of a selection of US mortgage lending institutions, undermined investor confidence. The London Interbank Offer Rate (that is the rate at which banks lend to each other) rose to well over 6½% as financial organisations' reluctance to lend money to counterparties sparked a severe shortage of funds in the market. In the UK, the crisis came to a head with the failure of the Northern Rock Bank (September) and while the danger of potential meltdown was defused by the Government's decision to guarantee all deposits with this institution, this failed to prevent a prolonged tightening of credit conditions.

Central banks strove to boost market liquidity via the injection of funds to the banking system and there were signs that this might be working in January. But a series of disappointing financial results and a persistent undercurrent of mistrust ensured a wide margin between official and market rates continued to year end.

The credit crisis provoked a significant change in the Bank of England's assessment of UK economic prospects over the medium term. It was clearly concerned that the tightening of liquidity and the consequent rise in borrowing rates across the entire economy could lead to a rapid slowdown in activity. This would help to contain inflation pressures. Bank Rate was cut by ¼% on two occasions, December and February, to end the year at 5¼%.

Long-term rates (gilt yields & Public Works Loan Board rates) charted an erratic course. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into 2007/08 as concerns persisted that international interest would need to rise further to combat mounting inflation pressures.

Gilt yields peaked in late June and started to slip lower in the summer months. The flight to safe investments triggered by the financial crisis placed strong downward pressure upon gilt-edged yields in August/September notably at the short end of the maturity range and the rally in this part of the market gained momentum as the year drew on.

Progress to lower levels was erratic and limited in the early months of 2008, but the general trend in yields was to lower levels. The most notable development was the reversion of the yield curve to a strongly-positive incline.

A summary of the action taken in the period October 2007 to March 2008

Treasury Management Strategy

New long-term borrowing

Long-term borrowing (including a restructure of a market loan) totalled £18m in the 2nd half of the year, as set out in the following table.

Table 1 – New long-term borrowing October 2007 to March 2008

Date raised	Amount	Rate	Period
Fund capital			
PWLB – 13 March 2008	£3,000,000	3.99%	4 yrs
Replace maturing debt			
Dexia Credit Local – 25 January 2008	£5,000,000	3.98%	70 yrs
Restructure			
Barclays Bank – 25 March 2008	£10,000,000	4.65%	70 yrs
	£18,000,000		

The loan raised on 13 March 2008 forms part of the 2008/09 funding requirement.

Debt maturity

There was no debt maturing during the 2nd half-year.

Weighted average maturity of debt portfolio

The weighted average maturity period of the debt portfolio has increased marginally during the 2nd half-year (Table 2).

Table 2 – Weighted average maturity profile – debt portfolio

Date raised	Sept 2007	Sept 2007 balance as at Mar 2008 (*)	Mar 2008 (**)
Weighted average maturity period	36.56 yrs	36.05 yrs	38.27 yrs
(*) the *'Sept 2007 balance as at Mar 2008'* figure reflects the natural 'time elapse' reduction in the average period of the debt portfolio (**) the weighted average maturity period as at 1 April 2007 was 32.79 years			

Debt rescheduling

An opportunity to restructure a market loan was taken during the 2nd half-year. The full year saving in interest charges is estimated at £30k after costs.

Capital financing requirement

The prudential code introduces a number of indicators that compare 'net' borrowing – borrowing less investment – with the capital financing requirement (the capital financing requirement being amount of capital investment met from borrowing). Table 3 compares the capital financing requirement with net borrowing but equally as important to actual borrowing.

Table 3 – Capital financing requirement compared to debt outstanding

	31 Mar 2007	31 Mar 2008	Movement in year
Capital financing requirement (CFR)	£232.4m	£235.8m	+£3.4m
Outstanding debt	£233.9m	£239.9m(*)	+£6.0m
Investments	£96.9m	£116.6m	-£19.7m
Net debt	£137.0m	£123.3m	-£13.7m
O/s debt to CFR	100.6%	101.7%	+1.1%
Net debt to CFR	59.0%	52.3%	-6.7%
(*) includes £3m borrowed in advance of 2008/09 CFR requirements. 'O/s debt to CFR' reduces to 100.5% if this sum excluded.			

Advice received from the council's external advisors suggests that borrowing should be at or near the maximum permitted in order to reduce the risk that demand for capital investment (and hence resources) will fall in years of high interest rates. The above table shows that borrowing is consistent with this advice.

Cash flow debt / investments

The TMPS states the profile of any short-term cash flow investments will be determined by the need to balance daily cash flow surpluses with cash flow shortages. An analysis of the cash flows reveals a net shortfall for the 2nd half-year of £19.7m (Table 4).

Table 4 – Cash flow October 2007 to March 2008

	Payments	Receipts	Net cash
Total for period	£353.0m	£333.3m	-£19.7m
Increase in long-term borrowing			+£8.0m
Net movement in short term position			***-£11.7m***

Taking into account the increase in net long-term borrowing the total cash shortfall amounted to £11.7m for the 2nd half-year. After adjusting for the increase in the funds invested by the cash manager of £0.6m the net shortfall is reduced to £11.1m. The shortfall has been funded by reducing the level of investments (Chart 2, Appendix 3). This has negated the need to use short-term borrowing during the period.

Overall the cash position for the year is a net surplus of £12.3m.

Prudential indicators

Full Council approved a series of prudential indicators for 2007/08 at its meeting in March 2007. Taken together the indicators demonstrate that the council's capital investment plans are affordable, prudent and sustainable. Full details are set out in appendix 4.

In terms of treasury management the main indicators are the 'authorised limit' and 'operational boundary'. The authorised limit is the maximum level of borrowing that can be outstanding at any one time. The limit is a statutory requirement as set out in the

Local Government Act 2003. The limit includes 'headroom' for unexpected borrowing resulting from adverse cash flow.

The operational boundary represents the level of borrowing needed to meet the capital investment plans approved by the council. Effectively it is the authorised limit minus the headroom and is used as an in-year monitoring indicator to measure actual borrowing requirements against budgeted forecasts.

Table 5 compares both indicators with the maximum debt outstanding in the 2nd half-year.

Table 5 – Comparison of outstanding debt with Authorised Limit and Operational Boundary 2007/08

	Authorised limit	Operational boundary
Indicator set	£267m	£246m
Maximum amount o/s during the year	£239.9m	£239.9m
Variance	£27.1m(*)	£6.1m

(*) can not be less than zero

Performance

The series of charts in Appendix 3 provide a summary of the performance for both the debt and investment portfolios.

In summary the key performance is as follows:

- Chart 1 shows the average cost of the long-term debt portfolio reducing to 4.75%, a reduction from the 4.79% at the beginning of the year;
- Chart 2 shows the level of investment managed by the cash manager and the in-house treasury team. The sum invested by the cash manager increases as investment income is reinvested. The amount invested by the in-house treasury team is analysed between cash flow investments (that are invested to meet short-term cash commitments) and core investment (that have a longer investment profile to match the spending profile for both the revenue & capital investment programmes).
- Chart 3 compares the returns achieved on external investments with the benchmark rate of 7-day LIBID rate for the in-house treasury team and 7-day LIBID rate (compounded) for the cash manager. The chart confirms that the investment performance of:
    - the in-house treasury team has matched the target rate on both cash flow and core investments, the target rate being 105% of the benchmark rate. The return for the year was 5.91% (cash flow) and 5.88% (core) against a benchmark rate of 5.59% (target rate 5.87%);
    - the investment performance of the cash manager has fallen below the benchmark rate. The return for the year was 5.24% against a benchmark rate of 5.78%. The below benchmark return is attributable to investments in gilts that underperformed against other markets.

Approved organisations – investments

There were no breaches of the investment criteria during the second half-year.

Changes to PWLB funding

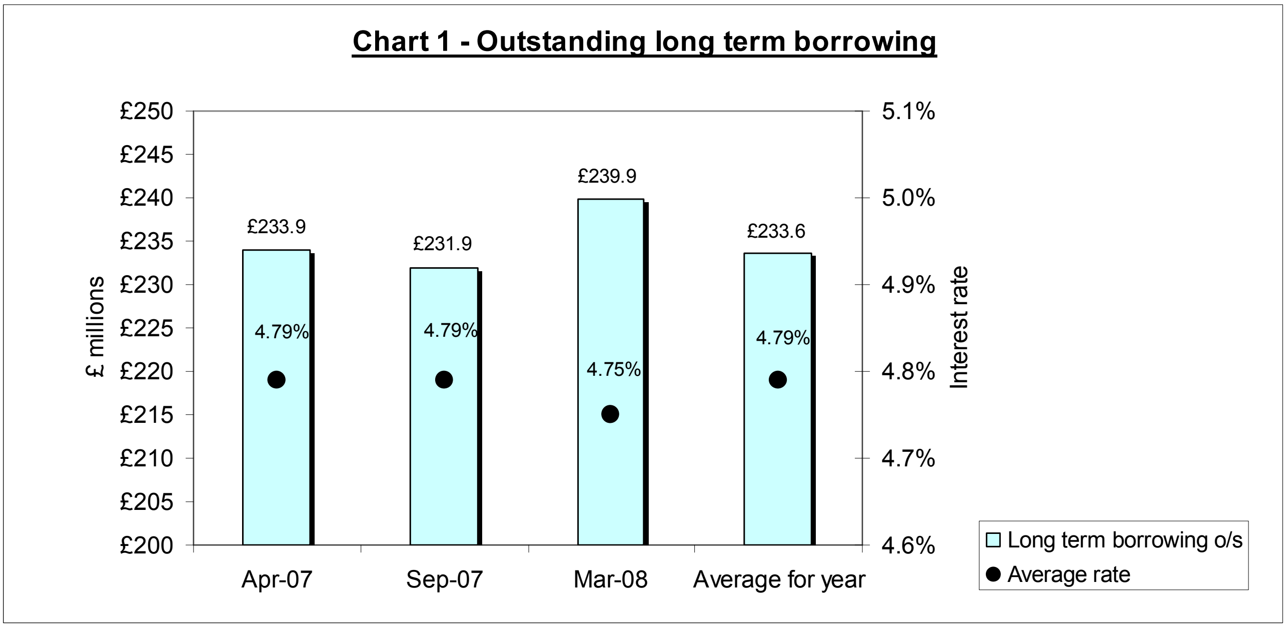
In November 2007 the PWLB introduced three changes to their lending conditions that have an impact on the cost of new borrowing and the cost of restructuring existing debt:

- Interest rates on new borrowing now set at half-yearly brackets rather than periods of one or 5 years;
- Interest rates expressed in increments of one basis point (0.01%) rather than the previous ⅛% age point (0.125%); and
- A separate set of lower rates to calculate the cost of repaying debt early.

The first two changes have had little impact on new borrowing. However the third change has substantially increased the cost of restructuring debt, thereby reducing the benefits of such actions.

Appendix 3

Performance and balances



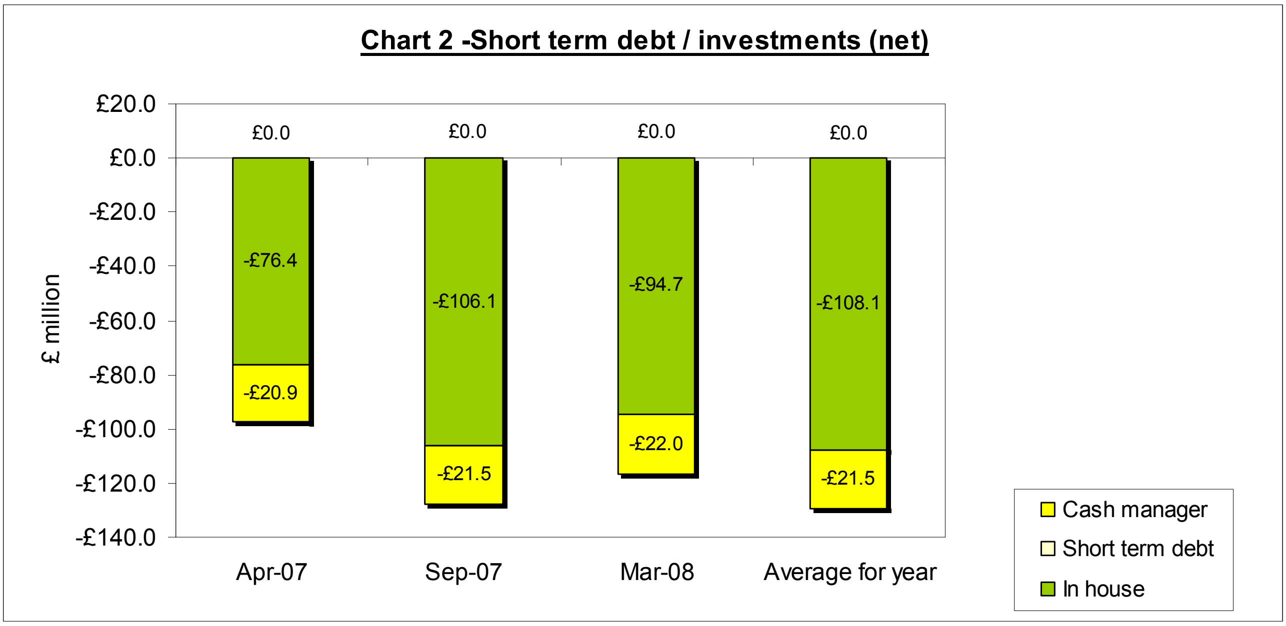


Chart 3 - Performance indicators 2007/08 : variation from benchmark (x axis) and target rate (105% times benchmark)

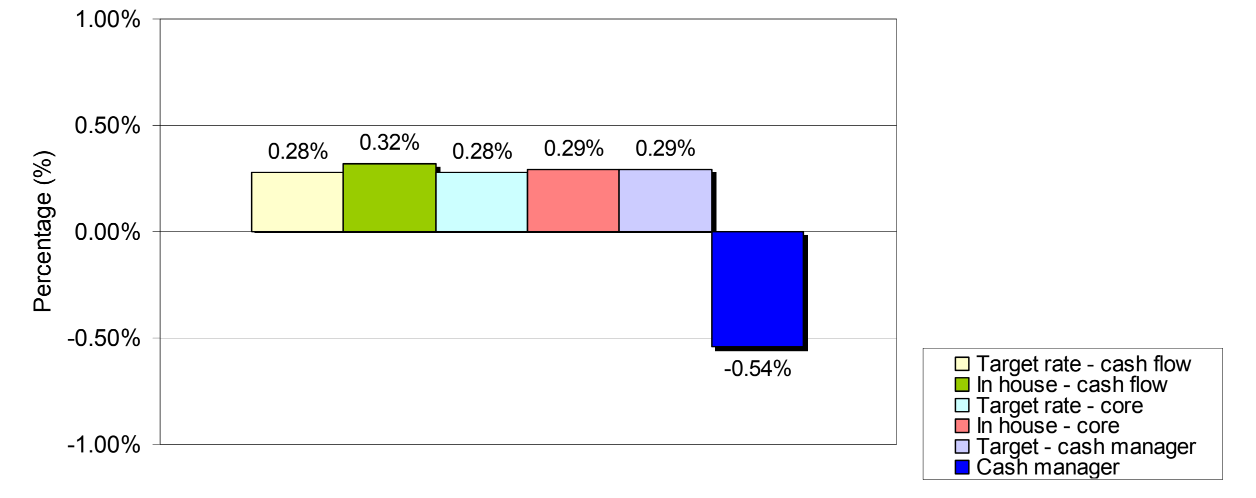
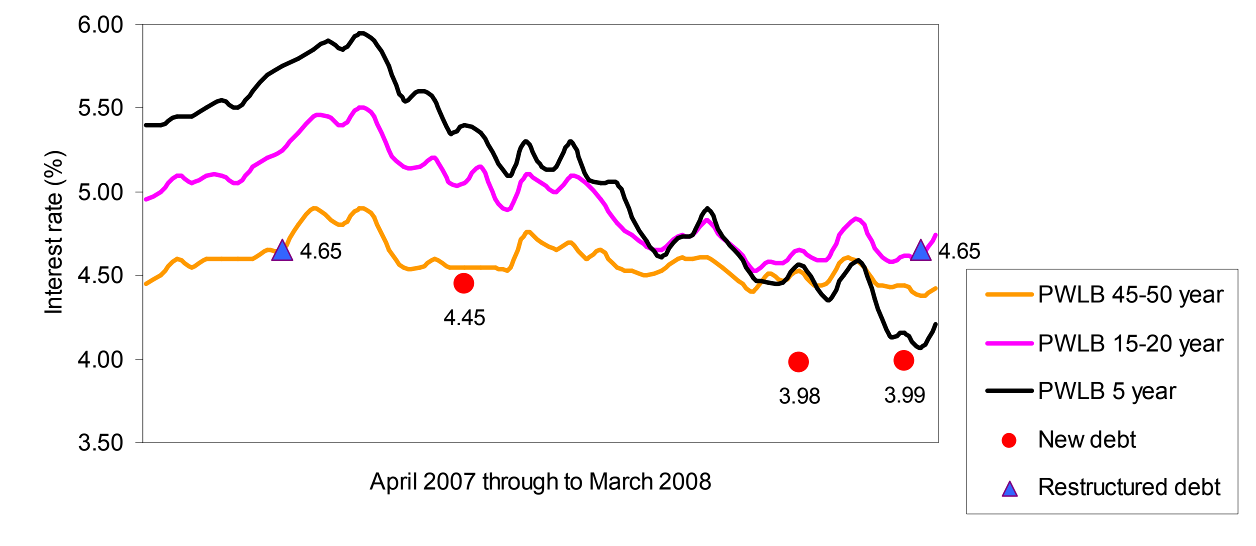


Chart 4 - PWLB interest rates / timing of new borrowing



Appendix 4

Prudential indicators 2007/08 Actual

The following prudential indicators are required to be reported under the Prudential Code for Capital Finance in Local Authorities (published by CIPFA).

Prudential indicator	Actual indicator 2007/08
Actual ratio of financing costs to net revenue stream 2007/08	
- Non HRA	2.6%
- HRA	29.8%
Actual capital financing requirement as at 31 March 2008	
- Non HRA	£145.678m
- HRA	£90.148m
- Total	£235.826m
Actual external debt as at 31 March 2008	
- Actual borrowing	£239.914m
- Actual other long term liabilities	£0.000m
- Total	£239.914m