Appendix 1

Expectations on the Economy and Interest Rate movements

(Courtesy of Butlers)

The outlook for the UK economy has deteriorated and the Bank of England has indicated that monetary policy will err on the side of caution, at least until it is confident that inflation has peaked and is headed substantially lower.

Domestic activity is set to decelerate sharply in the next few quarters and a recession is now a distinct threat. GDP (a measure of national income) for the period July to September 2008 declined for the first time since the early 1990's by 0.5%. A host of reasons have been identified for this downturn. The main causes can be itemised as follows: a substantial fall in personal disposable income as the higher cost of living and debt servicing costs in the wake of the 2007 financial crisis take effect; a slump in housing activity; a collapse in business investment; the weak international backdrop and low public sector spending growth.

The situation is not expected to improve in the near term. Consumer spending is in danger of falling more markedly in the months ahead, especially on the back of the slump in consumer confidence. In addition to this, the parlous state of public sector finances means there is no room for a substantial and meaningful fiscal boost.

Inflation remains for September 2008 hitting 5.2%, over 3% higher than the Government's target rate of 2%. The Bank of England's Monetary Policy Committee (MPC) is warning that CPI will remain above the 2% target range until well into 2009. This could have worrying implications for the future wage demands and corporate pricing behaviour. Ultimately, the impact this might have upon inflation will depend upon company pricing power, which will be determined by the strength of retail spending.

In the mean time, the MPC will remain cautious for the balance of this year. But the combination of weak growth and an easing in inflation pressures should provide scope for some further relaxation of domestic monetary policy. The cut in Base Rate by 50 basis points (0.5%) in October 2008 could be followed by a further cut as early as November.

Concerns about the health of the financial sector evidenced by Bear Stearns, Lehman Brothers, HBOS, Bradford and Bingley etc., will persist for some time, and in addition, the weaker growth outlook on a global as well as domestic basis should lead to a moderating bias to fixed interest rates.

However, two considerations will militate against much of a decline from current levels. In the first place, concerns that the performance of inflation will remain an on-going problem for the industrialised nations over the medium term will deter investors from chasing interest rates to the low levels seen previously.

Second, in the UK, the bond markets face the additional burden of the Government's exceptionally heavy funding programme.

Appendix 2

Summary of action taken in the period April to September 2008

Treasury Management Strategy

New long term borrowing

No new long-term borrowing raised in the first 6 months.

Debt maturity

No debt matured in the first 6 months. Lender options, where the lender has the exclusive option to request an increase in the loan interest rate and the council has the right to reject the higher rate and repay instead, on four loans were due in the 6 month period but no option was exercised.

Debt restructuring

Opportunities to restructure the debt portfolio are severely restricted under changes introduced by the Public Works Loan Board in October 2007. No restructuring was undertaken in the first 6 months.

Weighted average maturity profile

With no new borrowing or maturities the weighted average maturity period of the debt portfolio has reduced naturally by ½ year from 38.3 years to 37.7 years.

Capital financing requirement

The prudential code introduces a number of indicators that compare 'net' borrowing (i.e. after deducting investments) with the capital financing requirement (CFR) – the CFR being amount of capital investment met from borrowing that is outstanding. Table 2 compares the CFR with net borrowing and actual borrowing.

Table 2 – Capital financing requirement compared to debt outstanding

	1 April 2008	30 Sept 2008	Movement in period
Capital financing requirement (CFR)	£235.8m	£245.3m(*)	+£9.5m
Outstanding debt	£239.9m (**)	£239.9m	£0.0m
Investments	£116.7m	£145.6m	-£28.9m
Net debt	£123.2m	£94.3m	-£28.9m
O/s debt to CFR (%)	101.7%	97.8%	-3.9%
Net debt to CFR (%)	52.2%	38.4%	-13.8%

(*) projected 31 March 2009

(**) includes £3m borrowed in 2007/08 to fund capital investment in 2008/09

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) falls in years when long-term interest rates are high. This strategy is being reviewed in light of the problems within the financial markets. Any change to this strategy

will be implemented by the Director of Finance & Resources and reported to the Cabinet Member – Finance.

Cash flow debt / investments

The TMPS stated that "The council will maintain an investment portfolio that is consistent with its long term funding requirements, spending plans and cash flow movements."

An analysis of the cash flows reveals a net surplus for the first six-months of £28.6m (Table 3). A surplus in the first six months is not unusual as the profile of receipts against payments is heavily weighted towards this period. The surplus is used to meet cash shortfalls in the second half year as receipts fall away and payments accelerate.

Table 3 – Cash flow April to September 2008

	Payments	Receipts	Net cash
Total for period	£367.9m	£396.5m	+£28.6m

After adjusting for the net movement in the cleared balance held on the council's bank accounts (-£0.4m) and the increase in the value of the funds invested by the cash manager (+£0.7m) the net movement is increased to £28.9m. This surplus has been used to increase short-term investments (Chart 2 of Appendix 3).

There has been no short-term borrowing during the half-year. Cash flow receipts, together with accumulated investments, have exceeded cash flow requirements throughout the period, thereby negating the need to raise funds temporarily.

Prudential indicators

Full Council approved a series of prudential indicators for 2008/09 at its meeting in February 2008. Taken together the indicators demonstrate that the council's capital investment plans are affordable, prudent and sustainable.

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 4 compares both indicators with the maximum debt outstanding in the first half year.

Table 4 – Comparison of outstanding debt with Authorised Limit and Operational Boundary 2008/09

	Authorised limit	Operational boundary
Indicator set	£276.0m	£254.0m
Maximum amount o/s in first half of year	£239.9m	£239.9m
Variance	£36.1m(*)	£14.1m

(*) 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 has been maintained during the half-year at 4.75% against a background of an increase in the cost of long-term borrowing;
- Chart 2 shows that the level of investment managed by the cash managers and the in-house treasury team. The sum invested via the cash manager increases as investment income is reinvested, whereas investment by the in-house team includes cash flow investments and therefore fluctuates throughout each month.
- Chart 3 compares the returns achieved on external investments with the benchmark rate of 7-day LIBID (London Inter-bank Bid Rate) rate for the in-house treasury team and 7-day LIBID rate (compounded) for the cash manager. The chart confirms that during the six months to September 2008:
  - the investment performance of the in-house treasury team has exceeded the target rate (which is 105% of the benchmark rate), and
  - the investment performance of the cash manager has exceeded the target rate (which is 115% of the benchmark rate).

Approved organisations – investments

No new organisations have been added to the list approved in the AIS 2008/09.

No changes were made to the investment parameters set out in the AIS 2008/09. However a number of institutions were 'suspended' following concerns about future performance or proposed mergers with other institutions.

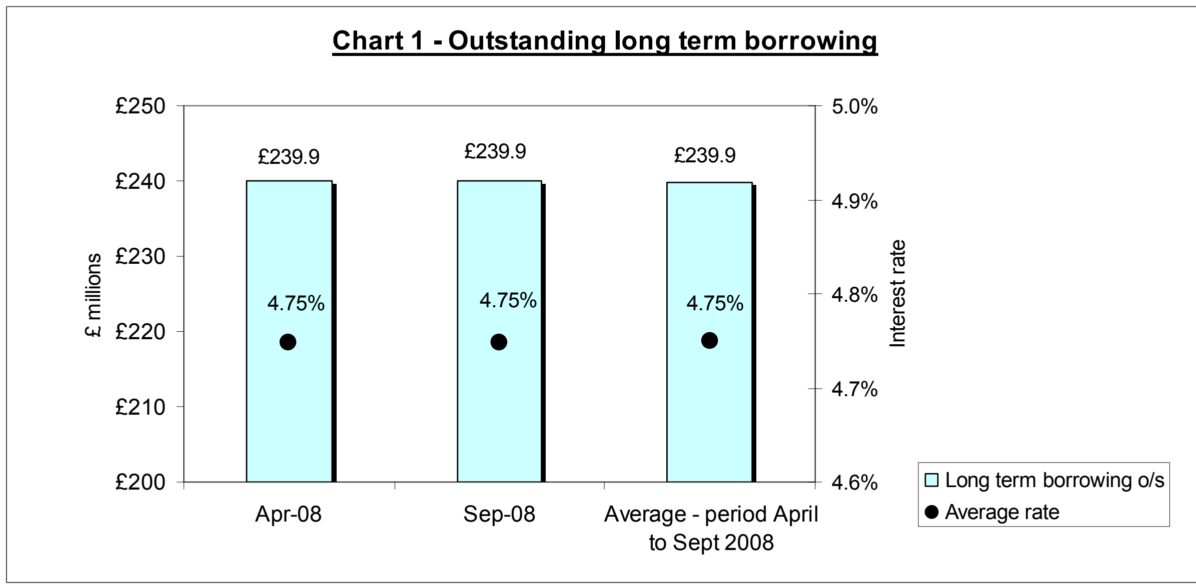
In early October, following considerable turmoil within the financial markets the investment parameters have been temporarily reduced pending a review of the action taken by central banks. For all new and maturing investments the maximum investment period has been reduced to one month.

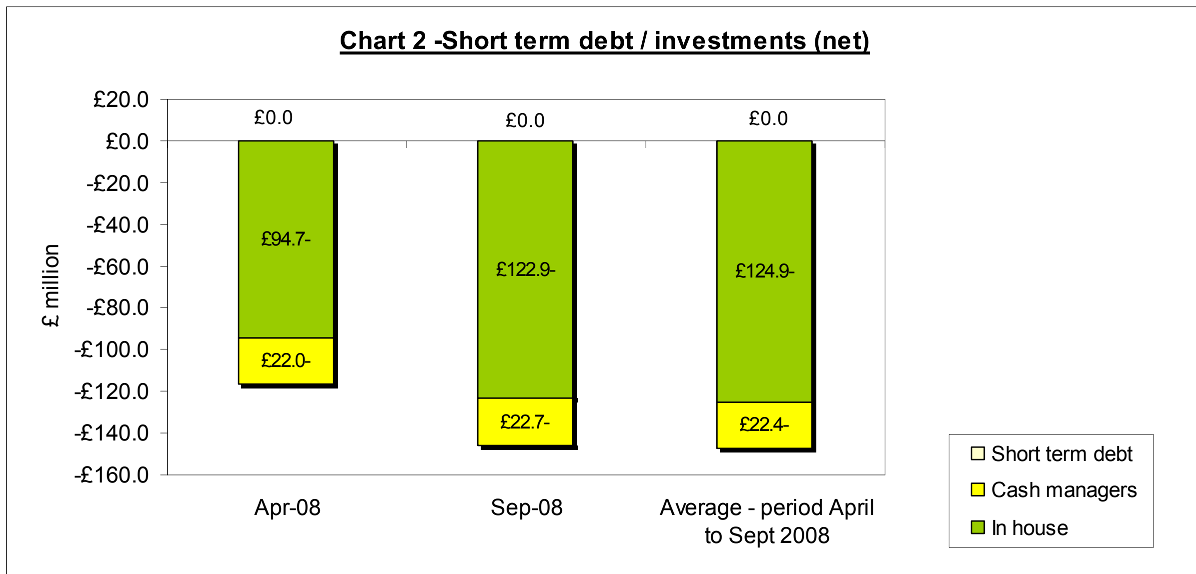
Appendix 3

Treasury Management Policy Statement 2008 /2009

Mid year review

Charts





The performance for the cash manager includes increases / decreases in the capital value of investments purchased.

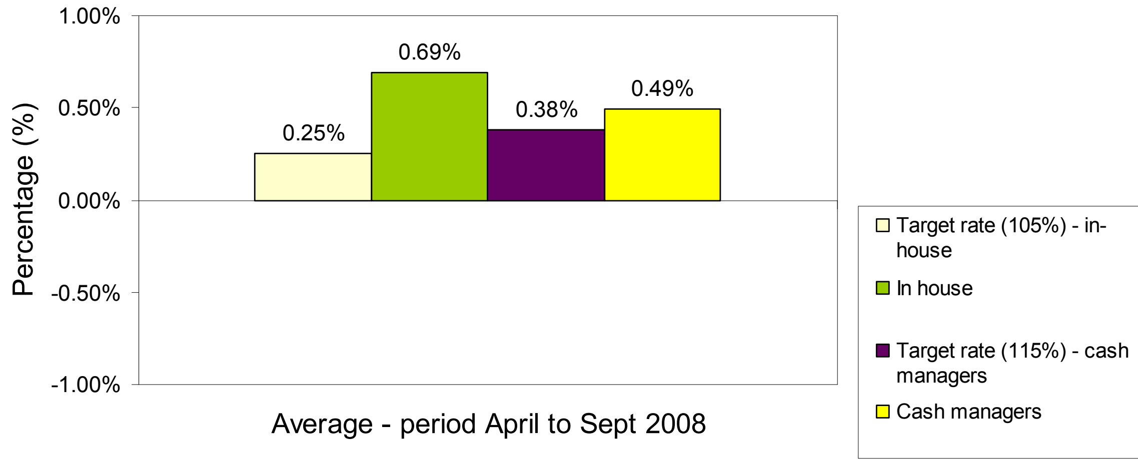


Chart 3 - Performance indicators (annualised) : variation from benchmark (x axis) and target rate (105% / 115% times benchmark)
1.00%
0.50%
0.00%
-0.50%
-1.00%
Percentage (%)
0.25%
0.69%
0.38%
0.49%
Average - period April to Sept 2008
Target rate (105%) - in-house
In house
Target rate (115%) - cash managers
Cash managers