Shropshire Council

Committee and Date	Item
Council 30th September 2010 10.00 am	**10**

ANNUAL TREASURY REPORT 2009/10

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Summary

This report informs members of treasury activities for Shropshire Council for 2009/10, including the investment performance of the internal treasury team to 31 March 2010. The internal treasury team outperformed their investment benchmark by 0.33% in 2009/10, performance for the last three years is 0.51% above benchmark. Treasury activities during the year have been within approved prudential limits set and have complied with the Treasury Strategy.

Members will be aware that Bridgnorth District Council had £1 million invested in the Icelandic Bank, Landsbanki Islands. The latest position in relation to this investment is that Shropshire Council could receive 95% back of the principal sum invested however payments are likely to be delayed until October 2011 with annual payments thereafter and the final payment being made in October 2018.

As reported in the 2010/11 Treasury Strategy, the Council proposes to offer to lend funds to Shropshire Housing Ltd (which incorporates both South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for the provision of affordable housing. It is proposed to offer to lend up to £10 million to each of these Housing Associations in order to finance the provision of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. If Shropshire Rural were to request a similar facility, for a smaller amount given the size of this local Housing Association, this could also be facilitated. Presently South Shropshire Housing and the Council are working together to finalise a legal agreement that can make this work well for all parties.

Recommendation to the Council

a) Approve the lending of up to £10 million to Shropshire Housing Ltd (which incorporates both South Shropshire Housing Association and the Meres & Mosses Housing Association) and up to £10 million for Severnside Housing in order to finance the provision of affordable housing and shared office accommodation in Shropshire.

REPORT

Introduction

1. The revised CIPFA Code of Practice on Treasury Management 2009 was adopted by Council in February 2010 and Shropshire Council fully complies with its requirements. The primary requirements of the Code are as follows:-

   - the creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
   - the creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
   - the receipt by Cabinet / Council and Strategic Overview and Scrutiny of an annual strategy report for the year ahead, a midyear review report and an annual report of the previous year.
   - 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.
   - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Strategic Overview and Scrutiny Committee.

   Treasury management in this context is defined as "The management of the local authority's investments and 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. The Treasury Strategy for 2009/10 was approved by Council in February 2009. This Annual Report sets out our actual treasury performance for the year and shows, in much the same way as we do for the budget, how the actual treasury performance varied from our estimates and planning assumptions.

Borrowing

The Strategy for 2009/10

3. The borrowing strategy for the year continued to be funding the Council's long term borrowing requirement at advantageous rates. Short term finance from internal balances would be used in the interim pending favourable market conditions for long term funding.

4. Short term PWLB rates were expected to be significantly cheaper than longer term borrowing rates during 2009/10 therefore borrowing for periods up to 10 years later on in the financial year when rates were expected to be at their lowest would be considered. An alternative strategy was to defer any new borrowing as long term borrowing rates were expected to be higher than investment rates during the year. This would maximise savings in the short term and also have the added benefit of running down investments which would reduce credit risk. If long term borrowing rates were expected to rise in future years then borrowing in advance would be considered in order to secure future years funding at low levels. Short term money market borrowing was not used during the year.

Outturn for 2009/10

5. Movements in rates during 2009/10 are shown in the graph at Appendix A. Funds were drawn down in the final quarter of 2009/10 as detailed below.

Date	Lender	Amount £m	Period Years	Rate %
26 Feb 2010	RBS	10.000	50 years	4.02
26 Jan 2010	RBS	7.000	50 years	4.05
01 Feb 2010	PWLB	6.000	3 years	2.06
01 Feb 2010	PWLB	4.900	4 years	2.56

6. For budget purposes, it was estimated that all new borrowing would be undertaken at 4.75%. The above table shows that borrowing was secured at rates below this level.

7. The Treasury Team take advice from its external treasury advisors, Sector Treasury Services, on the most opportune time to borrow. A cautious approach is taken and when rates fall to new lows the opportunity is taken to secure borrowing at these levels. PWLB borrowing rates change on a daily basis and it is considered prudent to borrow as soon as a low rate becomes available rather than wait for lower rates which may not materialise.

8. The PWLB 50 year rate started the year at 4.57% and then peaked at 4.85% in June before falling back to its lowest point of 4.18% in October. The 25 year rate started the year at 4.28% and then reached its highest point of 4.83% in February 2010. The lowest point of 4.07% was in October 2009. During the last quarter of 2009/10 £27.9 million was borrowed. Although funds were not advanced from RBS until the final quarter of the financial year the rate was fixed in November 2009. It can be seen from the graph at Appendix A that when the rate on these loans were fixed the yields on 50 year PWLB loans were at their lowest point during the year. As funds were not advanced until the final quarter of the financial year this also had the added benefit of maximising savings in the short term as long term borrowing rates were above investment rates during the year. As long term interest rates were expected to rise in 2010/11 a decision was taken to secure funds at low levels rather than defer funding further.

9. The Council's debt portfolio at 31 March 2010 is set out below:-

Type of Debt	Balance £m	Average Borrowing Rate 2009/2010
Fixed rate – PWLB	230.3	5.56%
Fixed rate – Market	49.2	4.10%
Variable rate	0.9	0.80%

10. The average borrowing rate for the total portfolio (PWLB and Market) has reduced from 5.81% in 2008/09 to 5.44% in 2009/10 due to borrowing at low levels in 2009/10. The maturity profile is evenly spread to avoid large repayments in any one financial year. The average debt period for PWLB loans is 21 years, market loans have an average debt period of 60 years. The total debt portfolio has a maturity range from 1 year to 68 years.

11. The Treasury Strategy allows up to 15% of the total outstanding debt to mature in any one year. It is prudent to have Council's debt maturing over many years so as to minimise the risk of having to re-finance when interest rates may be high. The actual debt maturity profile is within these limits (Appendix B).

12. The average rate for 50 year PWLB loans during 2009/2010 was 4.51%. The two market loans which were drawn down during the year in this period were at rates of 4.02% and 4.05%. The average rate for 3 year PWLB loans was 2.08%, again the loan secured by the Council at 2.06% for this period was below the average rate for the year.

Debt rescheduling

13. No debt restructuring was undertaken during 2009/10. This was due to the PWLB radically changing the structure of their rates in November 2007. The PWLB imposed two rates for each period, one for new borrowing and a new, significantly lower rate for early repayment of debt. The differential in rates ranged from 26 basis points in the shorter dated maturities to over 40 basis points in the longer ones. They also introduced daily movements of 1 basis point instead of 5 basis points and rates in half yearly periods instead of mainly 5 yearly bands. These changes effectively prevented the Council from achieving savings through restructuring the portfolio into new PWLB borrowing.

14. Although these changes have restricted PWLB debt restructuring, opportunities still exist by switching from PWLB loans into market loans. Therefore the current debt portfolio is continually monitored in conjunction with external advisers in the light of changing economic and market conditions in order to identify opportunities for debt rescheduling. Debt rescheduling will only be undertaken:-

- To generate cash savings at minimum risk.
- To help fulfil the Treasury Strategy.
- To enhance the balance of the long term portfolio by amending the maturity profile and/or volatility of the portfolio.

Investments

The Strategy for 2009/10

15. Our treasury advisor felt that the bank rate would remain at 0.50% throughout 2009/10. In 2009/10 investment of surplus cash was managed by the internal treasury team. The strategy for the in-house team was influenced by the need to keep funds relatively short term for cash flow purposes.

16. Lending continued to be restricted to UK banks with a minimum long term rating of AA-, Nationalised and part Nationalised Banks, UK Government and other Local Authorities. The Director of Resources continues to have delegated authority to revert back to previously agreed limits when it is considered money markets are more stable.

Outturn for 2009/10

17. During 2009/10 the Monetary Policy Committee (MPC) was focused on helping the economy to turn around from plunging into the deepest and longest recession the UK economy had experienced for many years. Despite keeping the bank rate at an unprecedented historical low of 0.5% all year as expected, the MPC also had to resort to extreme measures in terms of pumping liquidity into the economy through quantitative easing by purchasing £200 billion gilts and corporate bonds. This had the effect of boosting prices for gilts and corporate bonds and therefore bringing down yields, so also reducing borrowing costs for both the corporate and public sector.

18. The dominant focus in 2009/10 was on quarterly GDP growth figures. There was major disappointment that the end of the recession failed to materialise in quarter 3

2009 but the fourth quarter did then see economic growth return. Inflation was not a concern of the MPC as it fell back below the 2% target level from June to November. However, it did rise to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as it was expected to fall out of the inflation index and inflation was forecast by the Bank of England to fall back under target by the end of 2010.

19. In light of continuing stresses on the world banking system, enhanced priority was given to security and liquidity in order to reduce counterparty risk. In order to counter the downturn in investment rates, and following advice from Sector, use was made of direct deals with main UK banks which were part nationalised for various periods from three months to one year. Direct deals offered substantially enhanced rates over the equivalent rates available through brokers. This provided opportunities to lock into higher, long term rates at times when it was thought that they offered substantial enhancement over short term benchmark rates. Due to the enhanced market rates over base rate this resulted in the total portfolio outperforming the benchmark**.** In addition, an instant access account was set up with the Council own bankers, Natwest. This account offered both instant access to funds and paid a rate which was higher than placing short term deposits through brokers.

20. Movements in short term rates through the year are shown in the graph at Appendix A.

21. Throughout the year the level of interest rates were lower than budgeted in 2009/10 as the bank rate was at 3% when the budget was set in November 2008 and interest rates were not expected to fall to historically low levels at that time. This resulted in the internal treasury team achieving a lower level of interest on revenue balances than budgeted. The majority of this shortfall was met by using capital receipts voluntarily set aside during 2009/10 to reduce the Minimum Revenue Provision (MRP) charges in the same year. The remaining shortfall was met by a re-direction of existing resources as reported in the Quarter 4 Budget Monitoring report 2009/10.

22. At 31 March 2010 the allocation of the cash portfolio was as follows:-

	£m
• In-house short dated deposits for cash flow management	42.2
• In-house long dated deposits (up to 364 days)	10.0
• Other Local Authorities	44.4
• DMO Account	3.2
	99.8

23. The following table shows the average return on cash investments for the internal treasury team during the year and for the last 3 years to 31 March 2010. Recognising the need to manage short term cash flow requirements, the target for the internal team is the Local Authority 7 day deposit rate.

	Return 2009/10	**Return 3 years to 31 March 2010**
	%	**% p.a**
Internal Treasury Team	0.67	3.71
Benchmark (Local Authority 7 Day LIBID rate)	0.34	3.20

24. The conclusions to be drawn from the table are:-

- During 2009/10 the internal treasury team outperformed their benchmark by 0.33%.
- Over the 3 year period the internal team's performance has been 0.51% above the benchmark.

This means that our internal treasury team has done better than the external providers who would also have charged the Council fees.

Landsbanki Deposit Update

25. The claim for the £1 million deposit placed by Bridgnorth District Council with the Icelandic Bank, Landsbanki has been accepted as a priority claim by the Landsbanki Winding up Board. It has previously been reported that the Council expected 88% of the deposit to be repaid in four equal instalments of 22% starting in March 2011, with the final payment being made in December 2013. Latest information now suggests that 95% of the deposit may be repaid but the profile of repayments has been amended. The first payment of 22% is now not expected until October 2011, with annual payments of 9% in October each year until 2017, with the final payment of 19% being made in October 2018.

26. However, an objection has been filed in respect of the decision by non-priority creditors such as bond holders and banks. Challenges to the decision will follow Icelandic legal processes. First of all the courts require that the parties go through a process of mediation, as no agreement was reached during this stage of the process all cases are now being heard by the Icelandic District Court. If unsuccessful parties wish to appeal the decision of the Icelandic District Court then this appeal is heard in the Icelandic Supreme Court which could delay the timing of any repayments further. It is expected that the decision will be upheld but if the claims are classified as unsecured claims the expected recovery rate is around 38%.

Compliance with Treasury limits and Prudential Indicators

27. All borrowing and lending transactions undertaken through the year have complied with the procedures and limits set out in the Council's Treasury Management Practices and Treasury Strategy. In addition, all investments made have been within the limits set out in the approved counterparty list. No institutions, in which investment were made, showed any difficulty in repaying investments and interest in full during the year.

28. The 2003 Prudential Code for Capital Finance in local authorities introduced new requirements for the setting, monitoring and reporting of Prudential Indicators. Appendix C shows the Prudential Indicators approved by Council as part of the 2009/10 and 2010/11 (revised estimates) Treasury Strategies compared with the actual figures for 2009/10. In summary, during 2009/10 treasury activities have been within the prudential limits set in the Treasury Strategy.

Lending to Housing Associations

29. As reported in the 2010/11 Treasury Strategy, the Council proposes to offer to lend funds to Shropshire Housing Ltd (which incorporates South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for affordable housing and the Council is generating only a small amount of interest on revenue balances.

30. It is proposed that the interest rate charged will depend on the period over which the loan is to be taken and that it will be linked to the applicable PWLB rate. It is

proposed to offer to lend up to £10 million to each of these Housing Associations in order to finance the provision of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. If Shropshire Rural were to request a similar facility, for a smaller amount given the size of this local Housing Association, this could also be facilitated.

31. Officers have sought advice from Wragge & Co who has confirmed that the Council has the power to lend funds to Housing Associations under the Housing Act 1996. A draft loan agreement is attached at Appendix D for information. The Council are asked to approve the lending of up to £10 million to Shropshire Housing Ltd and Severnside Housing.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 25 Feb 2010, Treasury Management Strategy 2010/11 Council, 27 Feb 2009, Treasury Management Strategy 2009/10 Cabinet, 12 May 2010, Budget Monitoring Fourth Quarter of 2009/10 Cabinet, 12 May 2010, Treasury Management Update Quarter 4 2009/10 Council, 24 June 2010, Capital Monitoring Report/Outturn 2009/10 & Revised 2010/11 Budget.
Human Rights Act Appraisal The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998
Environmental Appraisal N/A
Community / Consultations Appraisal N/A
Risk Management Appraisal Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with comprehensive and rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potentials for financial loss.
Cabinet Member: Keith Barrow, Leader of the Council
Local Member N/A
Appendices A. Movements in Interest Rates 2009/10 B. Debt Maturity Profile as at 31/03/2010 C. Prudential Indicators 2009/10 D. Draft Loan Agreement

APPENDIX C

SHROPSHIRE COUNCIL PRUDENTIAL INDICATORS 2009/10

C1. The Prudential Code requires the Council to set Prudential Indicators in the Treasury Strategy and report performance against those indicators in the Annual Treasury Report.

C2. The ratio of financing costs compared to the net revenue stream of the Council was higher than expected during 2009/10 due to a change in accounting policy. Under the International Financial Reporting Standards (IFRS) PFI transactions had to be reclassified in 2009/10 meaning that they now appear on the Council's balance sheet along with the liability for the finance provided by the PFI operator. The impact of this meant that financing costs increased during the year. This is not an additional cost to the authority just a reclassification of existing costs due to a change in accounting policy.

Prudential Indicator	2009/10 Revised Estimate	2009/10 Actual
	%	%
Non HRA Ratio of financing costs to net revenue stream	9.9	10.6

Prudential Indicator	2009/10 Revised Estimate	2009/10 Actual
	%	%
Non HRA Ratio of financing costs (net of investment income) to net revenue stream	9.6	10.2
HRA Ratio of financing costs to HRA net revenue stream	15.4	15.5

C3. In addition to the £2 million Prudential Borrowing utilised in 2008/09 for Tern Valley a further £6.7 million was undertaken during 2009/2010 for the Ptarmigan & Mount Mckinley buildings and a desktop virtualisation scheme which resulted in the figure below being higher than projected. This was partly offset by deferring the Prudential Borrowing for William Brookes previously profiled for 2009/10 to 2010/11. The finance costs in relation to this borrowing are funded from the re-direction of existing resources therefore having no impact on Council Tax.

Prudential Indicator	2009/10 Estimate	2009/10 Actual
Estimates of impact of Capital Investment decisions in the present capital programme	**£ p**	**£ p**
Cost of capital investment decisions funded from re-direction of existing resources (Council Tax Band D, per annum)	8.41	8.75
Cost of capital investment decisions funded from increase in council tax (Council Tax Band D, per annum)	0	0
Total	**8.41**	**8.75**

C4. It can be seen from the tables that the authority was well within the approved authorised limit and the operational boundary for external debt for 2009/10.

Prudential Indicator	2009/10 Estimate	2009/10 Actual
External Debt	**£ m**	**£ m**
Authorised Limit:		
Borrowing	409	280
Other long term liabilities	41	0
Total	450	280

Prudential Indicator	2009/10 Estimate	2009/10 Actual
External Debt	**£ m**	**£ m**
Operational Boundary:		
Borrowing	348	280
Other long term liabilities	17	0
Total	365	280

C5. Gross borrowing was as anticipated in 2009/10. A key indicator of prudence is that net borrowing should not exceed the capital financing requirement. It can be seen from the following figures that the Council continues to meet this prudential indicator. The Capital Financing Requirement was lower than estimated following slippage in the capital programme that resulted in a reduced financing requirement from the capital receipts previously set-aside as at 1 April 2009 as approved by Council.

Prudential Indicator	2009/10 Revised Estimate	2009/10 Actual
Net Borrowing & Capital Financing Requirement:	**£ m**	**£ m**
Gross Borrowing	280	280
Investments	149	92
Net Borrowing	131	188
Capital Financing Requirement	279	257

C6. Capital expenditure during the year was lower than anticipated. Explanations for these under-spends were included in the 2009/2010 final capital outturn report.

Prudential Indicator	2009/10 Revised Estimate	2009/10 Actual
	£ m	£ m
Non HRA Capital expenditure	92	77
HRA Capital expenditure	2	1

C7. The level of fixed rate and variable rate borrowing were within the approved limits for the year.

Prudential Indicator	2009/10 Estimate	2009/10 Actual
Upper Limit For Fixed/Variable Rate Borrowing	**£ m**	**£ m**
Fixed Rate	353	279
Variable Rate	176	0.9

C8. The level of fixed rate and variable rate investments were within the approved limits during 2009/10.

Prudential Indicator	2009/10 Estimate	2009/10 Actual
Upper Limit For Fixed/Variable Rate Investments	**£ m**	**£ m**
Fixed Rate	225	90
Variable Rate	225	10

C9. No investments over 364 days were held by the internal treasury team.

Prudential Indicator	2009/10 Estimate	2009/10 Actual
Upper Limit For Sums Invested over 364 days	**£m**	**£m**
Internal Team	10	0
External Manager	25	0

C10. The maturity profile was within the limits set in the Treasury Strategy.

Prudential Indicator	2009/10 Upper Limit	2009/10 Actual
Maturity Structure of External Borrowing	**%**	**%**
Under 12 months	15	1
12 months & within 24 months	15	0
24 months & within 5 years	45	8
5 years & within 10 years	75	11
10 years & above	100	80