**Annual Report 2009/10**
**Treasury Management and Actual Prudential Indicators**

## 1. Introduction

**1.1** The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.

**1.2** This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

**1.3** During 2009/10 the minimum reporting requirements were that the Council receive an annual treasury strategy in advance of the year and an annual report following the year describing the activity compared to the strategy (this report). In the future the Council will also receive a mid year treasury report following regulatory changes.

**1.4** This report sets out:
- A summary of the strategy agreed for 2009/10;
- The Council's treasury position at 31 March 2010;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2009/10;
- The Treasury activity during 2009/10;
- Performance indicators set for 2009/10;
- Risk and Performance.

## 2. A Summary of the Strategy Agreed for 2009/10

**2.1** The treasury strategy expected short term interest rates to fall in 2009/10 such that a bank rate below 1% and short-term LIBOR rates of below 2% would not have been a surprise. Long term interest rates were expected to show very little movement at the longer end due. As a result, the Council chose to take a cautious approach to its strategy and take necessary actions on borrowings, investments and debt rescheduling, in conjunction with market conditions at that time.

## 3. The Council's Treasury Position at 31 March 2010

**3.1** During 2009/10, the Executive Director of Corporate Services managed the debt position with the use of internal funds as well as external borrowing, and the treasury position at 31 March 2010 compared with the previous year was:

**Table 1**

| Treasury position | 31 March 2010 | | 31 March 2009 | |
|---|---|---|---|---|
| | Principal | Average Rate | Principal | Average Rate |
| Fixed Interest Rate Debt | £214.960m | 4.96% | £214.955m | 5.38% |
| Variable Interest Rate Debt | £0.461m | 1.01% | £0.485m | 5.09% |
| **Total Debt** | **£215.421m** | **4.95%** | **£215.440m** | **5.38%** |
| **Total Investments** | **£10.713m** | **0.75%** | **£27.731m** | **0.98%** |
| **Net borrowing position** | **£204.708m** | | **£187.709m** | |

**3.2** From the above table, it can be seen that the average interest rate on debt held on 31 March has fallen from 5.38% in 2009 to 4.95% in 2010 due to debt rescheduling carried out during the year. At the same time – in line with market conditions - the average interest rate has reduced on the investments held on 31 March 2009 to 2010 – from 0.98% to 0.75%.

**3.3** There are four treasury prudential indicators which contain the activity of the treasury function within certain limits, thereby reducing the risk of an adverse movement in interest rates impacting negatively on the Council's overall position:

- Upper limits on variable rate exposure.
- Upper limits on fixed rate exposure.
- Maturity structures of borrowing.
- Total principal funds invested for greater than 364 days. During 2009/10 the use of investments greater than 364 days was prohibited in Scotland, so this indicator is set at nil.

**3.4** The indicators within table 2 shows that the upper limits set for debt type and maturity was not breached during the year to 31 March 2010.

**Table 2**

| | 2009/10 Actual | 2009/10 Original Indicator | |
|---|---|---|---|
| **Upper limits on fixed interest rates *(against maximum position)*** | 99.79% | 100% | |
| **Upper limits on variable interest rates *(against maximum position)*** | 0.21% | 30% | |
| **Maturity structure fixed rate borrowing *(%)*** | **Year end Position** | **Max** | **Min** |
| Under 12 months | 9.34% | 15% | 0% |
| 12 months to 2 years | 0.02% | 15% | 0% |
| 2 years to 5 years | 17.21% | 30% | 0% |
| 5 years to 10 years | 13.07% | 50% | 0% |
| 10 years and above | 60.36% | 100% | 0% |
| **Maximum principal funds invested *>364 days*** | Nil | Nil | |

## 4. The Main Prudential Indicators and Compliance with Limits

**4.1** The Council is required by the Prudential Code to report the actual prudential indicators after the year end.

**4.2** **Capital Expenditure and its Financing -** This forms one of the required prudential indicators and shows total capital expenditure for the year and how this was financed. The reduction in total capital expenditure between revised estimate and actual as noted below in Table 3 is due to the following.

- Income and slippage identified to be carried into 2010/11.
- Delayed utilisation of the consent to borrow for equal pay granted by the Scottish Government in February 2010 but not approved by Council until 28 April 2010.

**Table 3**

| | **2009/10 Actual** | **2009/10 Revised Estimate** |
|---|---|---|
| Total capital expenditure | £123.091m | £132.489m |
| Resourced by: | | |
| Capital receipts and grants | £11.687m | £17.776m |
| PPP Contractual Liability | £86.467m | £85.377m |
| Revenue | Nil | Nil |
| **Capital expenditure - additional need to borrow** | **£24.937m** | **£29.336m** |

**4.3** **Net Borrowing and the Capital Financing Requirement (CFR)** - In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be used for capital purposes. Net borrowing should not therefore, except in the short term, exceed the CFR for 2009/10 plus the expected changes to the CFR over 2010/11 and 2011/12.

**4.4** A key accounting change for 2009/10 was the inclusion of the West Dunbartonshire Schools PPP project on the balance sheet which increases the Council's borrowing need, the CFR. This represents a long term liability on the balance sheet, as opposed to traditional borrowing, and is therefore not included in the net borrowing figure as reported within Table 1.

**4.5** The Executive Director of Corporate Services reports that the Council has complied with the requirement to keep adjusted net borrowing below the CFR in 2009/10 as noted below in Table 4.

**Table 4**

| | **2009/10 Actual** | **2009/10 Original Indicator** |
|---|---|---|
| Net borrowing position per Table1 | £204.708m | £208.972m |
| PPP long term liability | £85.470m | £0.000m |
| **Adjusted net borrowing position** | **£290.178m** | **£208.972m** |
| **Capital Financing Requirement** | **£303.140m** | **£209.459m** |

**4.6** **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by s35 of the Local Government in Scotland Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2009/10 the Council has maintained gross borrowing within its Authorised Limit.

**4.7** **The Operational Boundary** – The Operational Boundary is the borrowing position that the Council expects to work around during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

**4.8** **Incremental Impact of capital investment decisions** - This indicator identifies the trend of the proposed changes in the capital programmes compared to existing commitments and current plans, measured against Band D council tax and weekly housing rents.

**4.9** **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs, net of investment income) against the net revenue stream.

**Table 5**

| | **2009/10** | |
|---|---|---|
| **Original Indicator - Authorised Limit** | **£263.105m** | |
| **Original Indicator - Operational Boundary** | **£241.179m** | |
| **Maximum gross borrowing position during 2009/10** | **£233.883m** | |
| **Minimum gross borrowing position during 2009/10** | **£208.883m** | |
| | **Estimated** | **Actual** |
| **Incremental Impact of capital investment decisions:** | | |
| Council Tax (excluding year-end flexibility) | £2.31 | £1.89 |
| Rent | £2.10 | £1.74 |
| **Financing costs as a proportion of net revenue stream:** | | |
| Housing | 40.55% | 40.72% |
| Non housing | 6.44% | 5.35% |

## 5. Summary of the Economic Factors affecting the Strategy over 2009/10

### 5.1 Economic Background for 2009/10

**5.1.1** Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, UK GDP data for the first half of 2009 registered its sharpest fall for over 20 years.

**5.1.2** It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more 'normal' behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor US banks continued to fail and the troubles of a number of building societies continued to make the headlines.

**5.1.3** The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled as the return to positive growth proved stubborn and did not materialise until the fourth quarter of 2009.

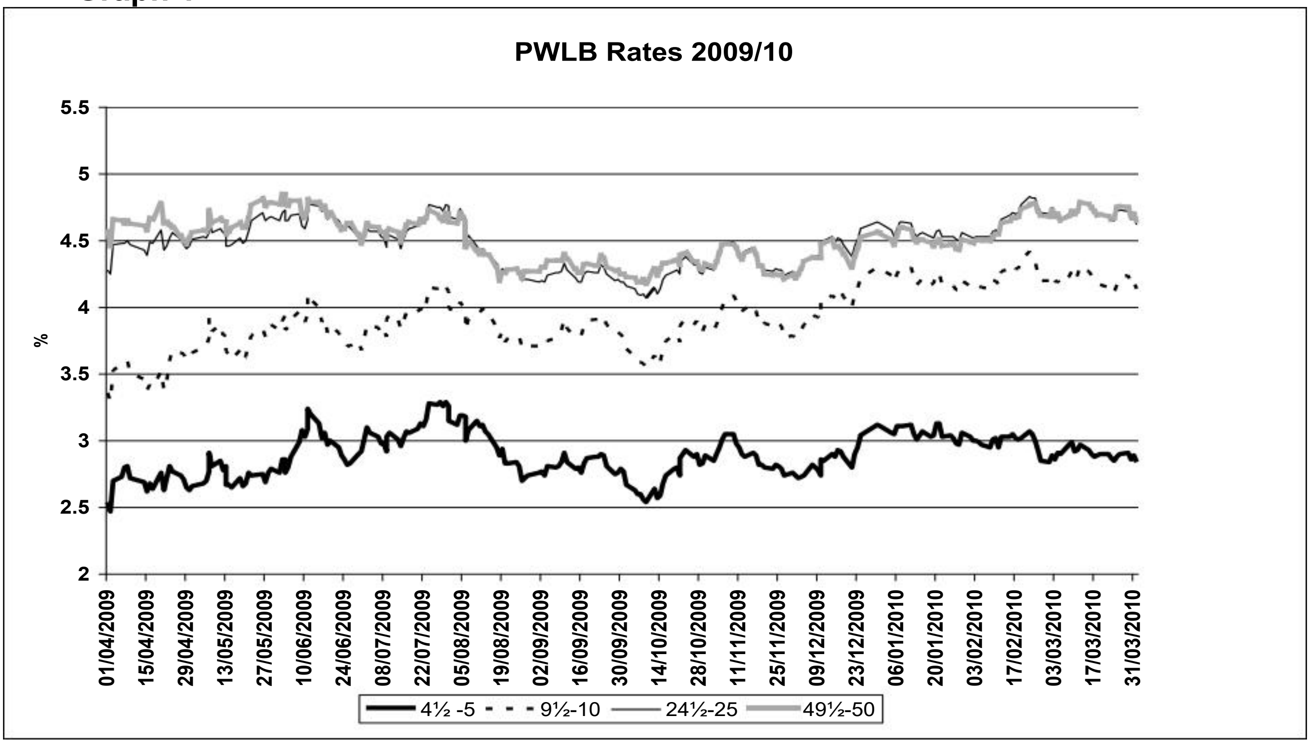
**5.1.4** Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector's striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

**5.1.5** The bias of MPC decisions remained directed towards policy ease throughout the year. As official interest rates had been reduced to near-zero (0.5% Bank Rate) in March 2009, monetary relaxation took the form of the extension of the Quantitative Easing programme.

**5.1.6** The dwindling fears of financial collapse, created an environment in which money market rates moved to yet lower levels. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

**5.1.7** Interest rates remained generally erratic as noted in Graph 1, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end.

**Graph 1**



## 6. Treasury Activity during 2009/10

6.1 **Borrowing** – The Council raised a new long term loan of £6.500m during the year at an interest rate of 2.42% due to early repayment earlier in the year as part of the debt strategy.

6.2 **Rescheduling** – In early 2009/10, the Council repaid £20.045m at an average interest rate of 4.40% receiving a discount of £0.058m. These loans were replaced with a one year loan of £20.045m at a rate of 0.85%. As a result interest savings of £0.593m were shared between the General Fund and the HRA during 2009/10 with £0.119m to be realised during 2010/11.

6.3 **Repayment** – In early 2009/10 the Council prematurely repaid £6.500m at an average interest rate of 4.25% receiving a discount of £0.157m and generating interest savings of £0.276m that were shared between the General Fund and the HRA. In addition naturally maturing debt was repaid totalling £25.019m, of which £24.962m was replaced with a four and a half year loan at 1.81%.

6.4 **Summary of Debt Transactions** – The overall position of the debt activity, together with the planned movement in some market loans, resulted in a decrease in the average interest rate by 0.43% for loans held at the year end.

6.5 **Investment Policy –** The Scottish Government issued The Local Government Investments (Scotland) Regulations 2010 on 1 April 2010 which gives more freedom to councils than at present.

6.6 The regulations apply from 1 April 2010 and therefore were not applicable during 2009/10, however during this time the Council continued its previous investment policy which was governed by best practice and covered predominantly by the CIPFA Code of Practice on Treasury Management.

6.7 The Council's policy was included in the annual treasury strategy approved by Council on 25 February 2009. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

6.8 The Council's investments decreased from £27.731m at the beginning of the year to £10.713m at the end of the year with an average balance of £23.476m and received an average return of 0.75% over the year.

6.9 The Economic Background for 2009/10 (see 5.1 above) set out the fragility and inconsistency of economic conditions during this period. As a result, interest rates remained low impacting adversely on investment returns.

6.10 Security, liquidity and yield benchmarks have been developed and were introduced for 2010/11. These benchmarks will be reported in the mid year monitoring and the annual stewardship reports in the future.

## 7. Debt and Investment Performance

**7.1** The Executive Director of Corporate Services can report the following performance in relation to debt management and investment returns:

- Debt – Average interest rate at 31 March year on year has decreased from 5.38% to 4.95% due to debt management during the year.
- Investments – Average rate was 0.75%, a year on year decrease of 0.23% with an average external investment period of 53 days.
    - The benchmark average market return for funds invested for a similar maturity period of 53 days lies between 0.47% and 0.75% as can be seen in Table 6 below.
    - The average investment return achieved by the Council of 0.75% compares favourably with this benchmark due to the generation of a maximum investment return of 1.75% on some investments as can be seen in Table 6 below.

**Table 6**

| | **2009/10** |
|---|---|
| **Benchmark Average Short Term Market Interest Rates** | |
| Call | 0.31% |
| Overnight | 0.30% |
| Week | 0.32% |
| 1 Month | 0.47% |
| 3 Month | 0.75% |
| 6 Month | 1.02% |
| 9 Month | 1.21% |
| 1 year | 1.47% |
| **Maximum investment return actually achieved during 2009/10** | 1.75% |
| **Minimum investment return actually achieved during 2009/10** | 0.50% |

## 8. Risk and Performance

**8.1** The Council has complied with all relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

**8.2** The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position within the current economic climate. The Council has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

**8.3** Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.