Division(s): N/A

CABINET – 20 JULY 2010

TREASURY MANAGEMENT OUTTURN 2009/10

Report by Assistant Chief Executive & Chief Finance Officer

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) 'Code of Practice on Treasury Management 2001' was adopted by this Council on 1 April 2003. One of the primary requirements of the code is the receipt by Cabinet of an annual report on its treasury management activities during the previous year. This report fulfils that requirement for the financial year 2009/10.

2. The following annexes are attached

Annex 1	Lending List Changes
Annex 2	Debt Financing 2009/10
Annex 3	PWLB interest rate graph
Annex 4	PWLB debt Raised and Maturing
Annex 5	Prudential Indicator Outturn.
Annex 6	Benchmarking

Strategy 2009/10

3. The Treasury Management Strategy for 2009/10 was based on an average base rate forecast of 0.50%.

4. The Strategy for Long Term Borrowing was to borrow from internal balances in order to reduce the Council's exposure to credit risk and reduce the cost of carry (difference between borrowing costs and investment returns) whilst debt rates remained higher than investment interest rates.

5. The Strategy included the continued use of the services of external fund managers, Scottish Widows Investment Partnership (SWIP) and Investec.

Market Background

6. After the economic recession and a downturn in growth that extended into early 2009, there were reports of the start of recovery. The Bank of England forecast UK growth to fall by 3.9% in 2009, whilst inflation was forecast to be heading lower and staying lower for longer. The depth of the recession was borne out by the 5.9% year-on-year fall in GDP recorded at the end of the second quarter of 2009, after which negative growth began to contract. The service sector, the dominant element of UK economy, also stalled for much of early 2009 despite a number of optimistic surveys to the contrary.

Beginnings of recovery were evident in the final quarter of 2009 with growth registering 0.4% for the quarter.

7. In order to stimulate growth, the Bank of England maintained the Bank Rate at 0.5% throughout the year. The Bank also took extreme measures to revive the economy through its Quantitative Easing (QE) programme. Financed by the issuance of central bank reserves QE was initially announced at £75bn, and then extended in stages to £200bn.

8. The Bank appears to have successfully staved off the risk of deflation. The increased supply of money in the system due to QE did not however translate into an increase in the movement of money in the system as banks are still unwilling to lend, and consumers are unwilling to borrow at pre-crisis levels.

9. The housing market showed some signs of stability but increases in house prices were modest. Nationwide House prices registered a year on year growth of 9% at the end of March 2010.

10. Consumer Price Inflation, having hit a high of 5.2% in September 2008, began the financial year at 2.3% (April 2009 data), fell to a low of 1.1% in September 2009 as oil, commodity, utility and food prices (the main drivers of high inflation in 2008) fell out of the year-on-year statistical calculations. Thereafter, inflation pushed higher with rising oil and transport costs and VAT reverting to 17.5%. CPI at year end was 3.4% (Mar 2010 data).

11. Companies and households on the whole reduced rather than increased their levels of debt. Credit remained scarce and at a premium (compared to that available two years earlier). Businesses retrenched rather than hired workers and unemployment rose quickly to just under 2.5 million. Against this background, wage growth was minimal.

12. The November 2009 Budget was primarily about public debt. The Chancellor's forecast for net public sector borrowing in 2009/10 was £175bn or 12.4% of GDP. Gross gilt issuance was expected to hit £220bn in 2009/10. As a result of the increasing level of UK Sovereign debt and forecasts for the future, credit rating agency Standard & Poor's changed the UK's rating outlook from stable to negative.

13. The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by high unemployment. The UK fiscal deficit remained high and cuts in public spending and tax increases were becoming inevitable. The potential of a UK sovereign credit rating downgrade escalated with the increasing likelihood of a hung parliament causing a lack of confidence in the markets that a credible plan to reduce the deficit would emerge.

14. LIBOR[1] and LIBID[2] rates which had been high in early 2009, slowly moved lower towards the Bank Rate of 0.5%.

[1] London Interbank Offer Rate is the rate at which banks are willing to lend to another bank.

15. UK Government Gilts were the main beneficiary of the economic downturn (it is an asset class that responds positively to poor economic news); they also formed the significant bulk of the QE purchases and are thought to have pushed gilt yields, and consequently the cost of borrowing, lower by 0.5%.

Treasury Management Activity

Debt Financing

16. The Council's debt financing for 2009/10 is analysed in Annex 2.

17. The table at Annex 2 shows that the Council's cumulative total external debt increased during the year from £402.38m on 1 April 2009 to £412.09 on 31 March 2010, a net increase of £9.71m. The purpose of the increase in borrowing was to finance capital expenditure and Prudential Schemes. Gross 'new' borrowing amounted to £21.71m all of which was borrowed from PWLB[3]. No new money market debt was arranged in 2009/10.

18. At 31 March 2010, the authority had 74 PWLB loans totalling £360.92m and 10 LOBO[4] loans totalling £50m. The average rate of interest paid on PWLB debt was 4.96% and the average cost of LOBO debt in 2009/10 was 3.76%. The combined weighted average for interest paid on long-term debt was 4.81%. Details of new loans arranged during 2009/10 are shown in Annex 3.

19. The 2009/10 borrowing strategy was to use temporary internal balances to reduce the level of investment with banks and therefore counterparty risk, and to reduce the cost of carry (the difference between debt costs and investment returns).

20. In December 2009, with the possibility of a hung parliament seeming increasingly likely and with that the prospect for gilt yields (and therefore PWLB borrowing rates) to rise, the Treasury Management Strategy Team (TMST) agreed that it would be prudent to retain the ability to borrow internally in future years up to a total of £50m. Therefore, it was decided to fund £20m of debt (excluding Prudential Borrowing) externally, with the remaining balance funded internally.

21. During 2009/10 3 short-term loans were arranged to finance temporary cash flow shortages. The gross short-term borrowing for the year was £15.47m with a weighted average maturity of 3.29 days and a weighted average interest rate of 0.41%

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[2] London Interbank Bid Rate is the rate at which banks are willing to borrow from another bank.

[3] The Public Works Loan Board is a Government agency operating within the United Kingdom Debt Management Office and is responsible for lending money to Local Authorities.

[4] LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

Maturing Debt

22. The Council repaid £12 million of maturing PWLB loans during the year. The weighted average interest rate payable on the matured loans was 5.01%. The details are set out in Annex 4.

Debt Restructuring

23. The Treasury Management Strategy Report approved by Council in Feb 2009 set out the circumstances in which the council would consider restructuring existing long-term debt. It was not considered advantageous to restructure long-term debt during 2009/10 due to unfavourable interest rates.

Investment Strategy

24. Security and liquidity of cash was prioritised above the requirement to maximise returns. The council adopted a cautious approach to lending to financial institutions and continuously monitored credit quality information regarding the institutions on the Lending List.

25. The majority of deposits were limited to 3 months in duration throughout the financial year. In the latter part of the year, longer term deposits were entered into with banks of extremely high credit quality, and whose operations are systemically vital to the UK economy. Two long term loans (maturity in excess of 364 days) were arranged during 2009/10 with a combined value of £15m. The weighted average maturity of all deposits during 2009/10 was 94 days.

26. The council used fixed and structured deposits, as well as call accounts to deposit its in-house temporary cash surpluses during 2009/10.

27. In compliance with latest CIPFA guidance on deposits held with Icelandic banks, the year-end final accounts include an amount which represents the potential lost deposit and associated interest on amounts placed with Landsbanki. Local Authority creditors of Landsbanki are currently considered to be Preferential Creditors. However there is currently a process of litigation in motion by the other creditors of Landsbanki in the Icelandic courts to overturn this position. If it is held that Local Authorities should retain Preferential status, then the guidance sets out that 5.15% of the deposit should be impaired to reflect the sum at risk of not being returned (i.e. £0.0515 in each £1.00). If however the courts find in favour of the plaintiff, then the amount at risk is estimated to be 61.79% (i.e. £0.6179 in each £1.00). CIPFA guidance states that as Local Authorities currently enjoy Preferential Creditor status, then the impairment should be based upon 5.15% at risk. A further accounting adjustment transfers the impairment to the Financial Instrument Adjustment Account so that there is no impact on the County Fund in 2009/10.

The Council's Lending List

28. The Council's in-house cash balances are deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List is regularly updated during the year to reflect changes in bank and building society credit ratings. Changes are reported to Cabinet each month. The approved lending list may also be further restricted by officers, in response to changing conditions and perceived risk. Annex 1 shows the amendments incorporated into the Lending List during 2009/10, in accordance with the approved credit rating criteria and additional temporary restrictions.

29. There were no breaches of the approved lending limits in 2009/10.

Investment Outturn

30. The average daily balance of temporary surplus cash invested in-house was £196m in 2009/10. The Council achieved an average in-house return for the year of 1.21%, producing gross interest receivable of £2.362million (excluding interest accrued on Landsbanki deposits). Temporary surplus cash includes: pension fund cash (approximately £33.99m at year-end); developer contributions; council reserves and balances; trust fund balances; and various other funds to which the Council pays interest at each financial year end, based on the average earned on all balances.

31. The Council uses the seven-day inter-bank sterling rate as its benchmark to measure its own in-house investment performance. During 2009/10 the average seven-day interbank sterling rate was 0.42%. The Council's average in-house return (1.21%) thus exceeded the benchmark by 0.79%. This was achieved in part by higher earning long term deposits entered into prior to October 2008. The Council operates a number of call accounts to deposit short-term cash surpluses. During 2009/10 the average balance held on call was £21.36million.

External Fund Managers

32. During the year, the Council continued to use the services of two external fund managers: Investec Asset Management Limited and Scottish Widows Investment Partnership Limited (SWIP). Each fund manager manages £10m of the Council's cash, plus their accumulated returns. Investec began managing the fund on 13 April 2006 and SWIP on 13 July 2006. The fund managers were given slightly different investment criteria and, accordingly, their performance is measured against different benchmarks.

33. SWIP's annualised return for the year was 3.62% (net of management charges) compared to their annualised benchmark return of 0.45%. Investec's return for the year (net of management charges) was 1.20%, compared with a benchmark of 1.56%.

Treasury Management Advisors

34. In the autumn of 2009 the contract with Sector Treasury Services Ltd to provide treasury management advice was due for renewal. After a formal tendering process, the Council appointed Arlingclose Ltd as its Treasury Management Advisors on a three year contract.

Prudential Indicators for Treasury Management

35. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Report. The outturn for the Prudential Indicators is shown in Annex 5.

External Performance Indicators and Statistics

36. The County Council is a member of the CIPFA Treasury and Debt Management Benchmarking Club and completed returns for the financial year 2009/10. The results of this exercise are not yet available.

37. Arlingclose have also benchmarked our investment performance against its other clients. Oxfordshire County Council appears in the lower quartile for both investment return and risk taken. These benchmarking results can be found in Annex 6. The county council has clearly been more risk averse than the average authority, which has resulted in a lower return on deposits.

Audit Commission Recommendations

38. Following recommendations by the Audit Commission, the Council has started to take its annual reports to the Audit Committee for further scrutiny. The first report (the Annual Treasury Management Strategy Report and Annual Investment Strategy 2010/11) was presented to Audit Committee in January 2010. A training session for Audit Committee Members was held in November 2009.

Business Continuity Plan

39. During the heavy snow fall of January 2010 the Treasury Management team was required to implement its business continuity plan in order for the daily money market dealing and cash-flow management activities to be undertaken. The plan was successfully implemented and the dealing was completed on time with no adverse implications. Some minor improvements to the plan were identified during the implementation and have subsequently been adopted into the plan.

Financial and Legal Implications

40. The combined activities of debt and investment management contribute to the strategic measures element of the Council's budget. In the Medium Term Financial Plan, the budget for Interest Payable in 2009/10 was £19.349m

compared with the outturn of £19.368m giving a net overspend of £0.019m. This was mainly attributable to the change in strategy regarding external borrowing in year.

41. The 2009/10 budget for interest receivable was £2.744m, compared with the outturn of £3.051m giving a net underspend of £0.307m. The increase is mainly due to higher cash balances due in part to slippage on the capital programme.

42. The expected return for Interest Payable in 2010/11 is £19.973m. The expected return for Interest Receivable in 2010/11 is £2.135m. These positions will be reviewed during the year.

RECOMMENDATION

43. **The Cabinet is RECOMMENDED to note the report, and to RECOMMEND Council to note the Council's Treasury Management Activity in 2009/10.**

SUE SCANE
Assistant Chief Executive & Chief Finance Officer

Background Papers: Nil

Contact officer: Tim Chapple Tel: 01865 323980

July 2010

ANNEX 1

Lending List Changes during 2009/10

Counterparties added/reinstated

Abbey plc
Alliance and Leicester plc
Barclays Bank Plc
Clydesdale bank Plc
Commonwealth Bank of Australia
HSBC Plc
Oversea-Chinese Banking Corp
Svenska Handelsbanken AB

Counterparties removed/suspended

Banco Bilbao Vizcaya Argentaria, S.A.
Banco Popular Espanol S.A.
Bank of Montreal
Bradford & Bingley plc
Coventry Building Society
Danske Bank
DBS Bank (Development Bank of Singapore)
DBS Bank LTD
EFG Bank SA (ex-EFG Private Bank)
Friesland Bank
Landesbank Baden- Wuerttemberg
Leeds Building Society
Mizuho Corporate Bank
Nationwide Building Society
Nordea Bank AB
Northern Rock Plc
Overseas Chinese Banking Corp
Skandinaviska Enskilda Banken AB
Standard Chartered Bank
Sumitomo Mitsui Banking Corporation Europe Ltd
Sumitomo Trust & Banking Co Ltd
United Overseas Bank

Lending limits & Maturity limits increased

	New Lending limit	**Maximum Maturity**
Abbey plc	£22m	3 Years
Barclays Bank plc	£22m (+ £5m o/n)	2 Years
Credit Industriel et Commercial	£15m	364 days
National Australia Bank	£22m	3 years

Lending limits & Maturity limits decreased

	New Lending limit	Maximum Maturity
Svenska Handelsbanken AB	£10m	3 months

Name Changes

Old Name	New Name
Abbey plc	Santander UK plc

ANNEX 2

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2009/10

Debt Profile		£m
1. PWLB	87%	352.38
2. Money Market LOBO loans	12%	50.00
3. Sub-total External Debt		402.38
4. Internal Balances	1%	2.02
5. Actual Debt at 31 March 2009	**100%**	**404.40**
6. Government Supported Borrowing		29.74
7. Unsupported Borrowing		8.70
8. Borrowing in Advance		0.00
9. Minimum Revenue Provision		-**17.77**
10. Actual Debt at 31 March 2010		**425.07**
Maturing Debt		
11. PWLB loans maturing during the year		12.00
12. PWLB loans repaid prematurely in the course of debt restructuring		0.00
13. Total Maturing Debt		**12.00**
New External Borrowing		
14. PWLB Normal		21.71
15. PWLB loans raised in the course of debt restructuring		0.00
16. Money Market LOBO loans		0.00
17. Total New External Borrowing		**21.71**
Debt Profile Year End		
18. PWLB	85%	362.09
19. Money Market LOBO loans	12%	50.00
20. Sub-total External Debt		412.09
21. Internal Balances	3%	12.98
22. Actual Debt at 31 March 2010	100%	425.07

Line

1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2009). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.

6 'Government Supported Borrowing' is the amount that the Council can borrow in any one year to finance the capital programme. This is determined by Central Government, and in theory supported through the Revenue Support Grant (RSG) system.

7 'Unsupported Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.

8 'Borrowing in Advance' is the amount the Council borrowed in advance during 2009/10 to fund future capital finance costs.

9 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.

10 The Council's total debt by the end of the financial year at 31 March 2010, after taking into account new borrowing, debt repayment and movement in funding by internal balances.

11 The Council's normal maturing PWLB debt.

12 PWLB debt repaid early during the year.

13 Total debt repaid during the year.

14 The normal PWLB borrowing undertaken by the Council during 2009/10.

15 New PWLB loans to replace debt repaid early.

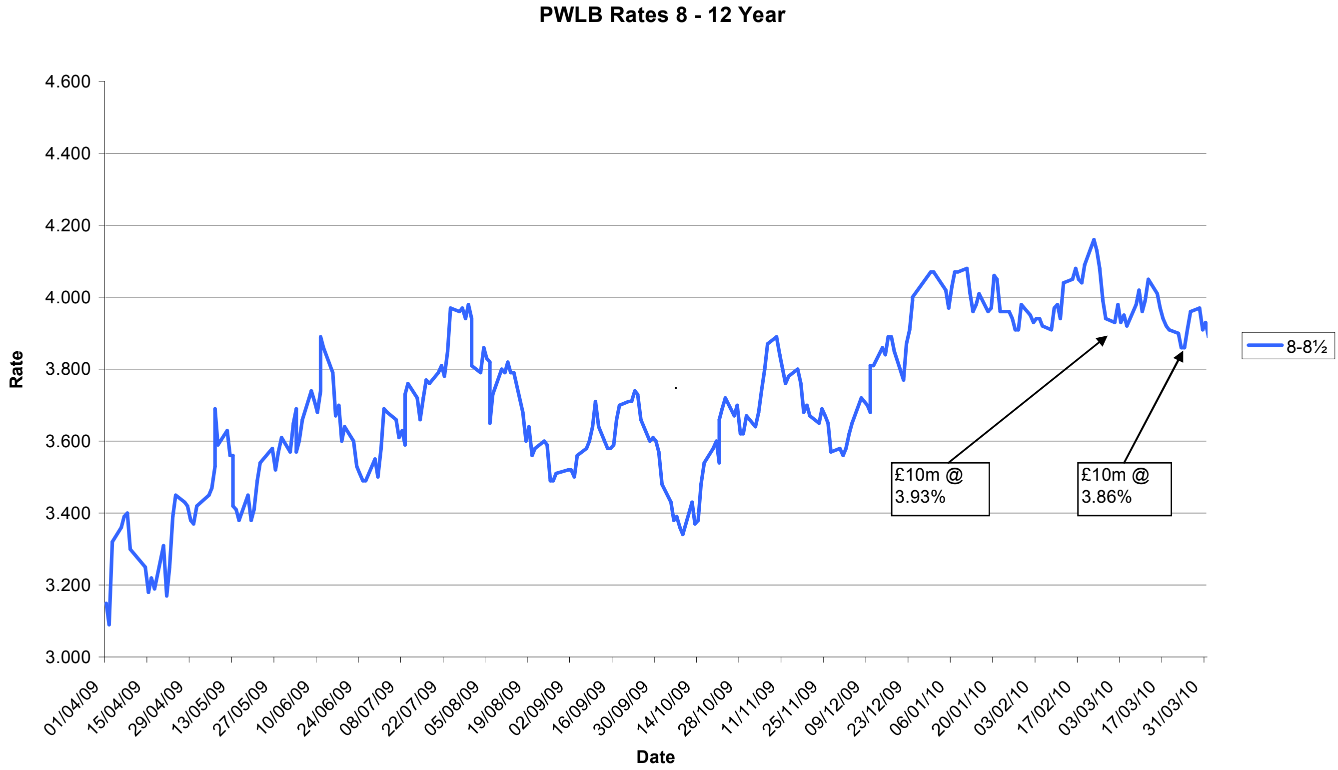
16 The Money Market borrowing undertaken by the Council during 2009/10.

17 The total external borrowing undertaken.

18-22.1 The Council's debt profile at the end of the year.

ANNEX 3

PWLB Interest Rates 2009/10 for 8 to 8.5 year loans



New borrowing undertaken during 2009/10 (not inc Prudential borrowing).]

ANNEX 4

Long-term debt Raised and Maturing 2009/10

Normal Debt Financing PWLB: Loans Raised

Date	Amount £m	Interest Rate%	Termination Date
03/03/2010	10.00	3.93	14/06/2018
26/03/2010	10.00	3.86	31/08/2018
31/03/2010	1.71	1.12	31/08/2012
Total	**21.71**		

Public Works Loan Board: Loans Maturing in 2009/10

Date	Amount £m	Rate %
14/12/2009	4	4.800
31/01/2010	6	4.800
26/03/2010	1	6.125
26/03/2010	1	6.000
Total	**12**	

ANNEX 5

Prudential Indicators Outturn 31 March 2010

Authorised and Operational Limit for External Debt

Authorised Limit for External Debt	£504,000,000
Operational Limit for External Debt	£494,000,000
Actual External Debt at 31 March 2010	£449,718,590

External debt includes Pension Fund cash invested in-house and long-term liabilities.

Fixed Interest Rate Exposure

Fixed Interest Net Borrowing limit	150%
Actual at 31 March 2010	89.11%

Variable Interest Rate Exposure

Variable Interest Net Borrowing limit	25%
Actual at 31 March 2010	10.89%

Sums Invested over 365 days

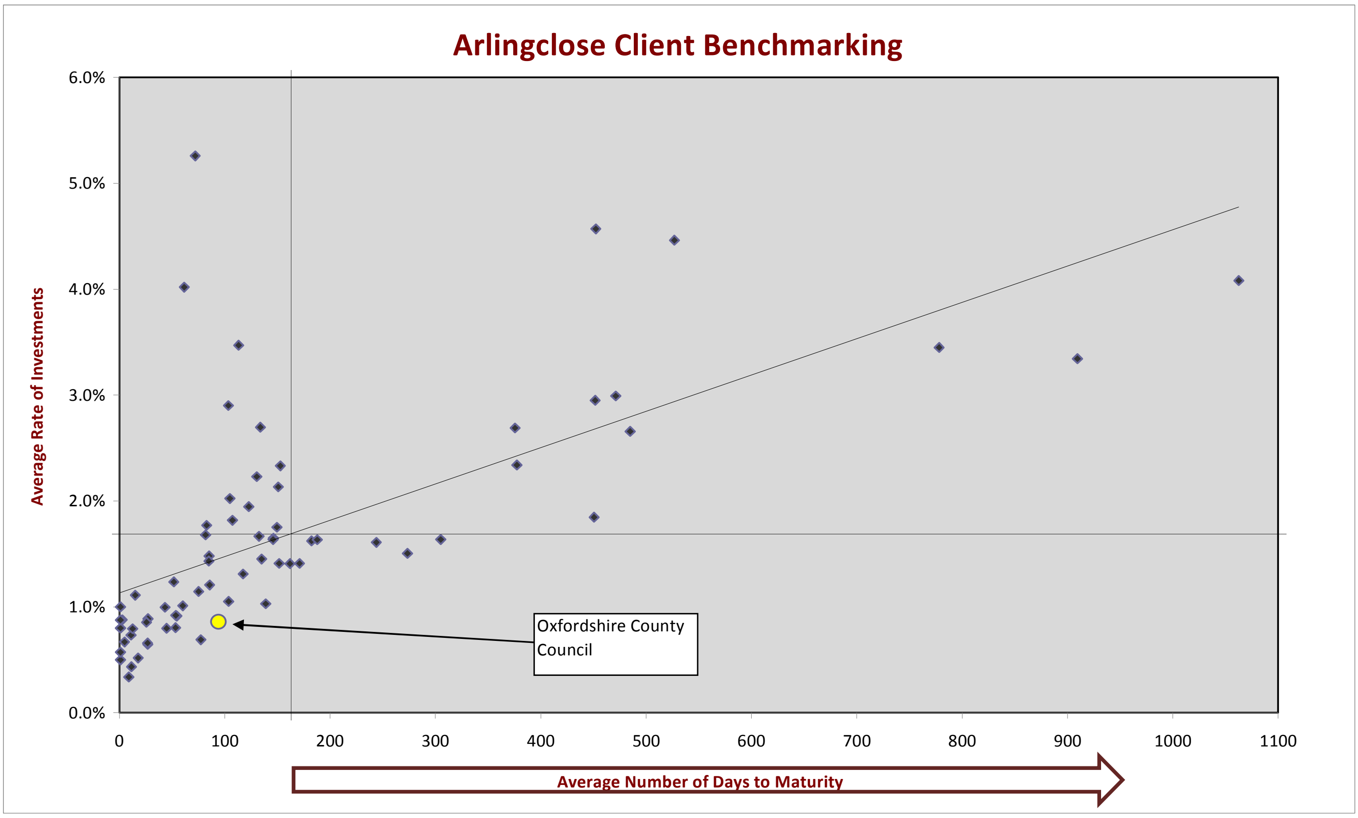
Total sums invested for more than 364 days limit	£100,000,000
Actual sums invested for more than 364 days	£ 15,000,000

Maturity Structure of Borrowing

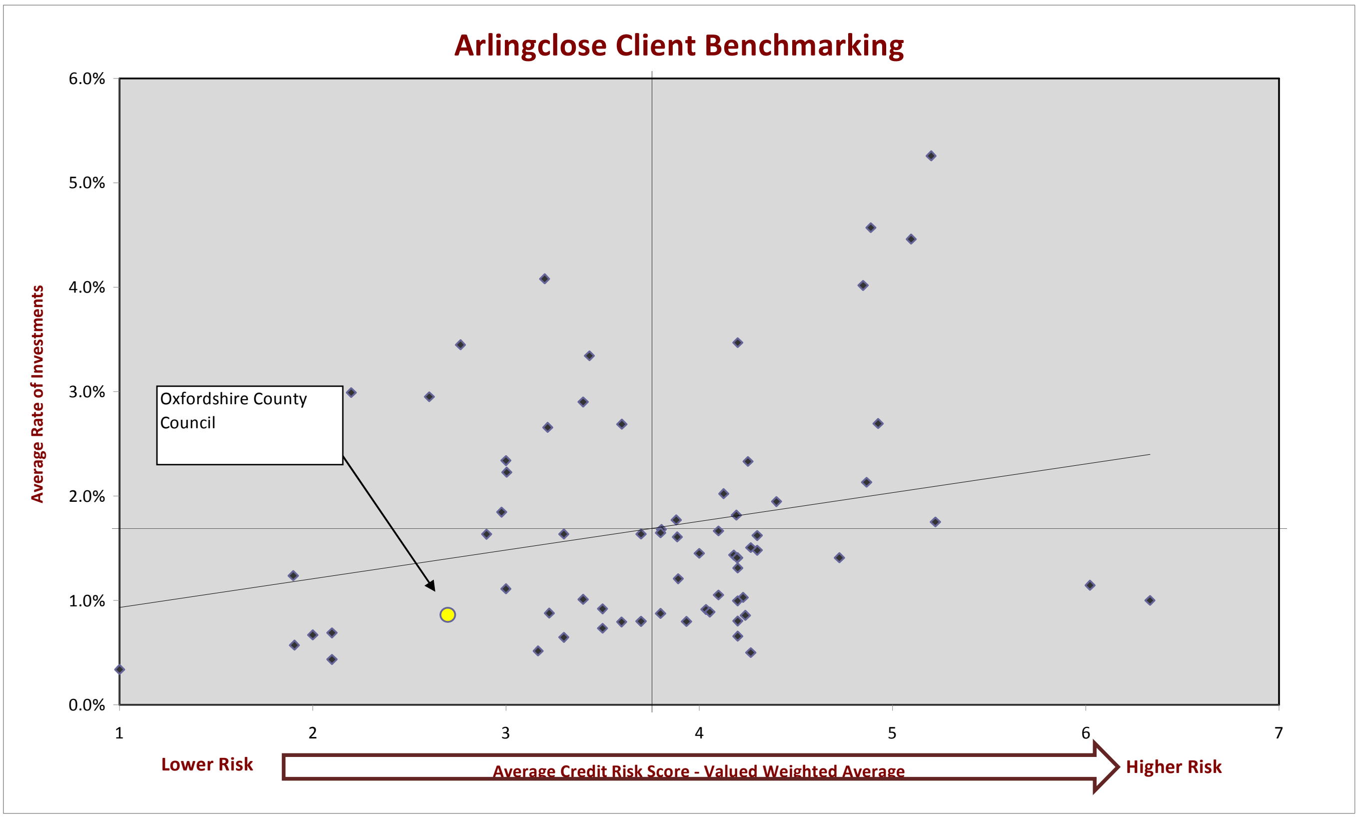
	Limit %	**Actual %**
Under 12 months	0 - 20	0
12 – 24 months	0 - 25	5.10
24 months – 5 years	0 - 35	12.79
5 years to 10 years	5 - 40	12.86
10 years +	50 - 95	69.25

ANNEX 6

Average number of days to maturity

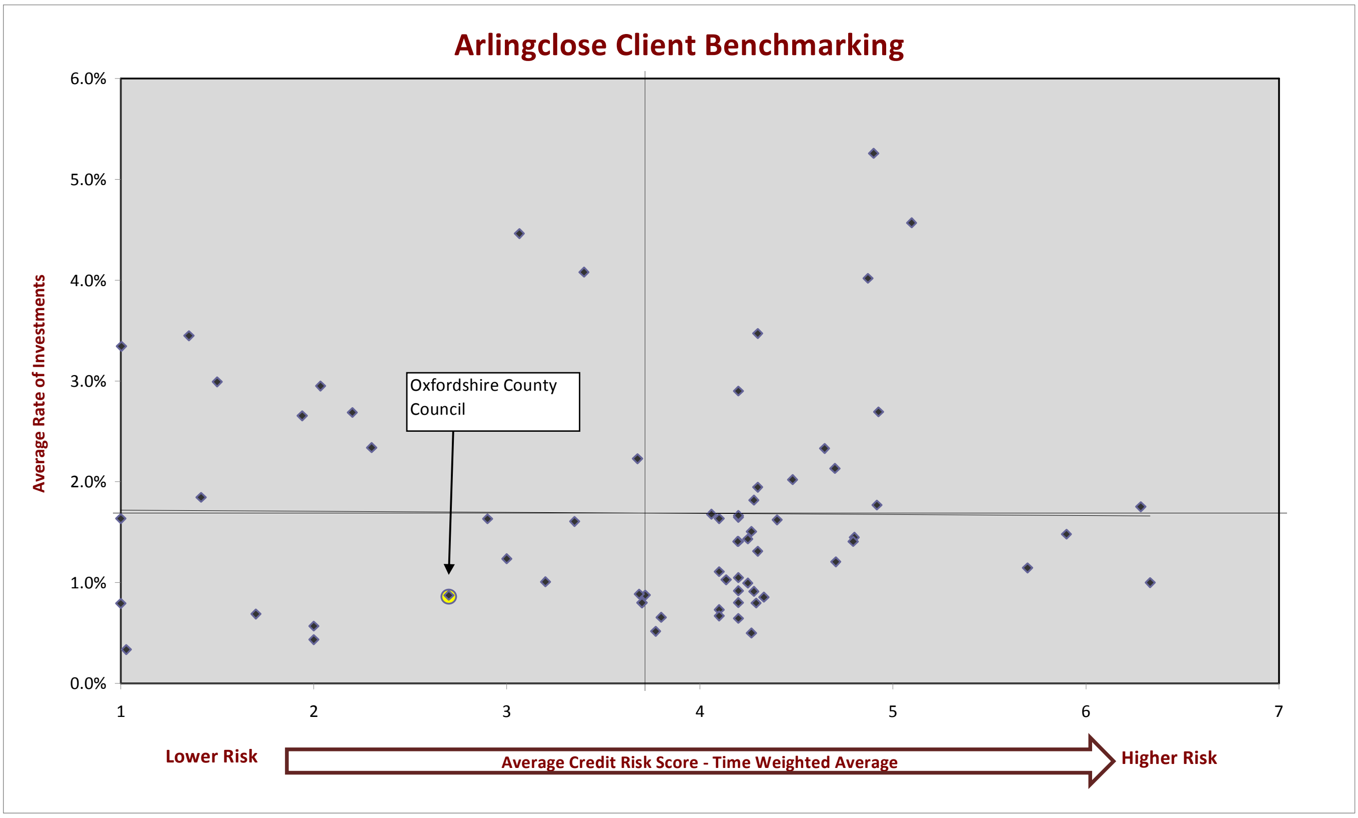


Value weighted average



The graphs above show that Oxfordshire County Council's credit risk was below average and consequently resulted in a lower than average return on deposits during 2009/10.

Time weighted Average



The graph above shows that Oxfordshire County Council's credit risk (taking into consideration both counterparty credit rating and duration of deposit), was below average and consequently resulted in a lower than average return on deposits during 2009/10.