CHESHIRE EAST COUNCIL

REPORT TO: CABINET

Date of Meeting:	16 August 2010
Report of:	Borough Treasurer and Head of Assets
Subject/Title:	Treasury Management Annual Report 2009-10
Portfolio Holder:	Cllr Frank Keegan

1.0 Report Summary

1.1 The Treasury Management Policy requires an annual report on the performance of the Council's treasury management operation. This report contains details of the activities in 2009-10 for Cheshire East Borough Council.

2.0 Decision Requested

2.1 To receive the Treasury Management Annual Report for 2009-10 as detailed in Appendix A.

3.0 Reasons for Recommendations

3.1 To meet the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services and the Prudential Code for Capital Finance in Local Authorities.

4.0 Wards Affected

4.1 Not applicable

5.0 Local Ward Members

5.1 Not applicable

6.0 Policy Implications

6.1 None

7.0 Financial Implications 2010/11 and beyond

7.1 Contained within the report.

8.0 Legal Implications (Authorised by the Borough Solicitor)

8.1 There are no specific legal implications related to the issues raised in this report.

9.0 Risk Management

9.1 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management function will be measured.

10.0 Background and Options

10.1 This annual treasury report, detailed in Appendix A covers:

- the Councils treasury year end position;
- forecast prospects for interest rates for 2009/2010;
- interest rate outturn for 2009/2010:
- compliance with treasury limits;
- investment strategy for 2009/2010;
- borrowing strategy for 2009/2010
- economic events of 2009/2010
- Prudential indicators 2009/2010.

11.0 *Access to Information*

The background papers relating to this report can be inspected by contacting the report writer:

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Appendix A

Treasury Management Annual Report 2009/2010

Introduction and Background

The CIPFA definition of Treasury Management is *"the management of the Council's investments and cash flows, its banking and its capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks"*.

The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and now, as a minimum, formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;

b) presents details of capital financing, borrowing, debt rescheduling and investment transactions;

c) reports on the risk implications of treasury decisions and transactions;

d) gives details of the outturn position on treasury management transactions in 2009/10;

e) confirms compliance with treasury limits and Prudential Indicators.

In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital Finance in Local Authorities. The CLG also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes/Guidance re-emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds. Authorities were also henceforth required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. Authorities are now also required to have a separate body or committee responsible for the scrutiny of the treasury function.

The Council has revised its treasury policy and practices documentation to take account of the requirements and changes in the revised Codes and Guidance.

1. Treasury Year End Position

At the start of 2009/2010 cash was transferred from the former District Councils as investments matured and cash balances became available. Most cash was transferred early in the year with the remainder as it became available prior to closure of the District bank accounts in February/March 2010. However, cash held by Cheshire County Council was not transferred pending final settlement of the disaggregation of the Cheshire County Council balance sheet. Cheshire County Council cash was retained on behalf of Cheshire East and Cheshire West & Chester Councils in instant access accounts and money market funds.

The amount of investments outstanding at 31st March 2010 was £96.0m as follows:

	CEBC	CCC	Total
	£m	£m	£m
BANKS			
Bank of Scotland		7.5	7.5
Barclays Bank	10.9		10.9
Co-operative Bank	4.2	0.7	4.9
Lloyds TSB	15.0		15.0
Royal Bank of Scotland	10.0		10.0
Santander (UK)	16.3	2.7	19.0
Yorkshire Bank (Clydesdale)	10.0		10.0
BUILDING SOCIETIES			
Nationwide Building Society	5.0		5.0
MONEY MARKET FUNDS			
Blackrock		0.2	0.2
Invesco AIM	2.2	5.1	7.3
RBS	1.5	2.0	3.5
Scottish Widows	1.2		1.2
Standard Life	1.5		1.5
TOTAL	**77.8**	**18.2**	**96.0**

The average interest rate gained on all balances during 2009/2010 was 0.90% compared to the benchmark 7 day LIBID return of 0.40%.

In addition to the above investments, Cheshire County Council also had funds invested with a cash fund manager. This fund has been retained and is shared with Cheshire West and Chester Council. This Councils share of the monies managed by the external cash fund manager at 31st March 2010 totalled £13.4 million and comprised:

- Bonds issued by the European Investment Bank £0.7 million
- Certificates of deposit issued by UK banks £6.6 million
- Certificates of deposit issued by French banks £4.8 million
- Certificates of deposit issued by UK building societies £1.3 million

The average interest rate gained on the externally managed cash fund during 2009/2010 was 1.76%.

The overall average rate of interest on all investments in 2009/2010 was 0.99%. The total investment income for 2009/2010 was £1.62m compared to a budget of £0.90m. The investment income includes £160,000 relating to deposits made by the former Cheshire County Council with the Icelandic Heritable Bank.

At the end of the year 2009/10 the Council had £135m long term loans outstanding. Of this £17m represented loans raised from commercial banks whilst £118m represented loans from the PWLB.

The interest payable in 2009/2010 was £6.0m compared to a budget of £7.8m.

2. Icelandic Bank Deposits

On the date Heritable Bank (Heritable) was placed into administration Cheshire County Council had £8.5 million deposited with the bank of which £4.6m is the Cheshire East share. These deposits were immediately frozen. This meant that such monies would not be returned to the Council until such time as the work of the administrator (ie to ascertain the assets and liabilities of Heritable and to make dividend payments to the bank's creditors (of which the Council is one)) has been completed.

During 2009/2010 the administrator has paid out £1.6m which equates to 35% of the claim. The latest report from the administrator contains estimates of the amounts to be repaid and broad indications of the dates on which any such repayments may be made. On the basis of the contents of this report, the Council has assumed that the following amounts will be recovered from the administrators of Heritable Bank on the following dates.

June 2010	5% of the amount due on 6th October 2008
September 2010	5% of the amount due on 6th October 2008
December 2010	5% of the amount due on 6th October 2008
March 2011	5% of the amount due on 6th October 2008
June 2011	5% of the amount due on 6th October 2008
September 2011	5% of the amount due on 6th October 2008
December 2011	5% of the amount due on 6th October 2008
March 2012	5% of the amount due on 6th October 2008
June 2012	5% of the amount due on 6th October 2008
September 2012	5% of the amount due on 6th October 2008

Accounting rules require that the estimated amounts due to be repaid need to be discounted back to a present value, at 31st March 2010, by the interest rates of 5.75% and 6.15% (these being the rates of interest due to be earned on the deposits originally placed with Heritable Bank). Discounting the estimated amounts to be repaid recognises the anticipated loss of interest the council will suffer pending the monies being repaid.

In 2008/09 the impairment charge was calculated as £1.324m. Using the latest information from the administrators, discounting the estimated amounts to be recovered back to their present value at 31st March 2010 gives rise to an impairment charge of £1.034m. As the value of the impairment has reduced then a reversal of £0.29m is included in the 2009/2010 accounts.

3. Interest Rates and Prospects for 2009/2010

The Councils' treasury advisors, as part of their service assisted in formulating a view on interest rates. However, there has been no change to the bank base rate since March 2009.

	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Base Rate	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**

4. Compliance with Treasury Limits

During the financial year the Councils' operated within the treasury limits and Prudential Indicators set out in the Councils' Treasury Policy Statement and annual Treasury Strategy Statement (see section 8).

5. Investment Strategy for 2009/2010

The Council had regard to the DCLG Guidance on Local Government Investments ("the Guidance") issued in March 2004 (revised in 2010) and the revised CIPFA Treasury Management Code and the revised Prudential Code ("the CIPFA TM Code").

Investment instruments identified for use in the financial year are listed under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits were set through the Councils' Treasury Management Strategy Statement and Investment Strategy.

Investment Objectives

All investments were in sterling. The general policy objective the Councils' was the prudent investment of its treasury balances. The Councils' investment priorities are the security of capital and liquidity of its investments.

The Councils' aimed to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. The DCLG maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Security of Capital - The Use of Credit Ratings

There are three principal credit rating agencies and in accordance with the CIPFA Code the Council makes use of all these to establish the credit quality of counterparties and investment schemes. The Council had also determined the minimum long-term, short-term and other credit ratings it deems to be "high" for each category of investment and has regard to institutions which have access to the 2008 Credit Guarantee Scheme.

Monitoring of credit ratings:

- All credit ratings were monitored continuously. The Council is alerted to changes through advice from Treasury Advisors.

- If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Councils' minimum criteria, the further use of that counterparty/investment scheme as a new investment was withdrawn immediately.

- If a counterparty is upgraded, so that it fulfils the Councils' criteria, it was not added immediately to the approved list as the list is approved by named institution. The list was changed in August 2009 at the time the Treasury Management Annual Report 2008-09 was approved to reflect the changed circumstances surrounding the Support Rating given to some banks.

Use of External Fund Managers

The external cash fund managers would continue to manage around £13.4 million on the behalf of Cheshire East Borough Council during the year. The fund manager would use their judgement / view on interest rates to invest in government bonds (ie gilts) and certificates of deposit. The performance of the fund managers during the year 2009/10 is summarised in Annex 1 to this report.

6. Borrowing strategy

There has been no new borrowing undertaken in 2009/2010. This has been due to delays in capital expenditure, the current availability of cash resources and the interest rate environment.

7. Economic events of 2009/10

After the particularly torrid economic recession and a severe downturn in growth that extended into early 2009, there were reports of nascent 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. 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. Green shoots of recovery were finally evident in the final quarter of 2009 with growth registering 0.4% for the quarter.

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 on an extraordinary scale 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.

The Bank appears to have successfully staved off the very real 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.

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.

Consumer Price Inflation, having hit a high of 5.2% in September 2008, began the year at 3.2% (Feb 2009 data), fell to a low of 1.1% in September 2009 as the 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 3.0% (Feb 2010 data).

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

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 a quite staggering £220bn in 2009/10. Standard & Poor's responded to the debt that the UK government was building up and a lack of a credible plan to reduce the debt burden by changing the UK's rating outlook from stable to negative.

The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by stubbornly high unemployment. The UK fiscal deficit remained acute. Cuts in public spending and tax increases were becoming inevitable and a credible plan to reduce the deficit was urgently required after the May General Election, the absence of which increased the potential of a sovereign downgrade. The likelihood of a hung parliament had grown and had the potential of being disruptive to financial markets.

Gilts and Money Market Rates

LIBOR and LIBID rates (i.e. the rates at which a banks are willing to borrow from and lend to other banks) which had been stubbornly high in early 2009, slowly moved lower towards the Bank Rate of 0.5%.

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%.

8. Prudential Indicators 2009/10

Authorised Limit for External Debt
The estimates and actuals for the authorised limits for 2009/10 are

	PI Limit	Actual
	£000	£000
Borrowing	218,000	134,762
Other long term liabilities	0	0

Operational Boundary for External Debt
The estimates and actuals for the operational boundary (lower than authorised limit due to cash flow variations) for 2009/10 are

	PI Limit	Actual
	£000	*£000*
Borrowing	210,000	134,762
Other long term liabilities	0	0

Upper Limits for Fixed and Variable Rate Interest Exposure

	PI Limit	Actual (peak)
	%	%
Upper limit for Fixed Interest Rate Exposure:	100	
Debt		100
Investments		50
Upper Limit for Variable Interest Rate Exposure	100	
Debt		0
Investments		100

Maturity Structure of Fixed Rate Debt

	PI Limit	Actual
	%	%
Upper limit on borrowing maturing in:		
Under 12 months	25	0
Over 12 months but less than 24 months	25	0
Over 24 months but less than 5 years	35	4
Over 5 years but less than 10 years	35	2
Over 10 years but less than 20 years	100	6
Over 20 years but less than 30 years	100	31
Over 30 years but less than 40 years	100	29
Over 40 years but less than 50 years	100	28
Over 50 years	100	0

Annex 1

EXTERNAL CASH FUND MANAGER

PERFORMANCE IN THE YEAR 2009-10

Budgeted return to be earned	0.65%	£85,804
Net return earned by fund manager (ie after deduction of fees)	1.18%	£155,768
Benchmark index for the year	0.99%	£130,687
7 day rate for the year	0.40%	£52,803