

CLACKMANNANSHIRE COUNCIL

Report to Council of 14th August, 2008

Subject: Annual Treasury Report 2007-2008

Prepared by: Bill McLean, Payments Manager

1.0 SUMMARY

- 1.1. The purpose of this report is to present to the Council the treasury position as at 31st March 2008

2.0 RECOMMENDATIONS

- 2.1. It is recommended that the Council note this report.

3.0 INTRODUCTION AND BACKGROUND

- 3.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by Clackmannanshire Council on 19th February 2002 and the Council fully complies with its requirements. The primary requirements of the Code are:-

- 1 Creation and maintenance of a Treasury Management Policy Statement that sets out the policies and objectives of the Council's treasury management activities.
- 2 Creation and maintenance of Treasury Management Practices that set out the manner in which the Council will seek to achieve those policies and objectives.
- 3 Receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year.
- 4 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.

- 3.2. Treasury management in this context is defined as:

"The management of the local authority's 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."

3.3 This annual report covers:

- the Council's current treasury position;
- performance measurement;
- the strategy for 2007/2008;
- the state of the economy in 2007/2008;
- borrowing and investment rates in 2007/2008;
- the borrowing outturn for 2007/2008;
- compliance with treasury limits and Prudential Indicators;
- investment outturn for 2007/2008;
- debt rescheduling.

4.0 CURRENT TREASURY POSITION

4.1. The Council's debt position at the beginning and end of the year was as follows:

	Principal 31.3.2008	Rate	Principal 31.3.2007	Rate
Fixed Rate Funding:				
- PWLB	£ 89.704m		£ 75.778m	
- EIB	£ 0.243m		£ 0.280m	
- Market	£ <u>9.000m</u> £ 98.947m	5.4%	£ <u>18.500m</u> £ 94.558m	5.4%
Variable Rate Funding:				
- PWLB	£ 0.000m		£ 0.000m	
- EIB	£ 0.000m			
- Market	£ <u>9.500m</u> £ 9.500m	4.2%	£ <u>0.00m</u> £ 0.00m	0.0%
Total Debt	£108.447m	5.3%	£ 94.558m	5.4%
Investments:				
- In House	£ 8.501m		£ 0.000m	
- With Managers	£ <u>0.000m</u> £ 8.501m		£ <u>0.636m</u> £ 0.636m	
Total Investments	£ 8.501m	6.0%	£ 0.636m	6.5%

5.0 THE STRATEGY FOR 2007/2008

5.1. Our treasury strategy for 2007/2008 was based on the view that the rate of growth of GDP in the UK economy would continue to be steady and that bank rate would remain at 5% until the final quarter of the year when it would fall to 4.75%.

5.2. The effect on interest rates for the UK was therefore expected to be as follows:

Shorter-term interest rates - The "average" City view anticipated that the trend growth in the UK, US and EU would eventually lead to a decrease in the UK bank rate from 5.00% to 4.75% by the end of March 2008.

Longer-term interest rates - The view on longer-term fixed interest rates, 50 years, was that they would remain static around 4.25% for the whole of the year and that the 25 year rate would also remain flat around 4.50%.

5.3. **The Adopted Treasury Strategy** - The agreed strategy put to Council, based upon the above forecast, was that we should opt for very long dated borrowing at any time in the financial year.

6.0 THE ECONOMY

6.1 **Shorter-term interest rates** – Base rate started 2007/08 at 5.25% and it was expected that there would be increases throughout the year. An increase to 5.5% duly occurred on 10th May 2007 but not before the Governor of the Bank of England had written a letter to the Chancellor in April explaining why Consumer Price Index (CPI) had risen to 1% or more above the official CPI inflation target of 2%. The Bank of England's Inflation Report issued in May showed inflation would be above target for the two year horizon and another increase was delivered on 5th July when the bank rate rose to 5.75% and the markets fully expected the bank rate to increase again. One year interbank was priced at over 6%, GDP growth was continuing to strengthen and the housing market was still robust. The August Inflation Report showed bank rate needed to rise to 6% to keep inflation at target in two years time.

August, as it turned out, was the peak of interest rates as what has become known as 'the credit crunch' hit the markets and the global economy. The crunch originated in the US through the sub-prime housing market. Although originating in the US, world wide investors, particularly banks, had invested in packages of sub-prime loans, attracted by the higher yields offered. Fears arose that a large number of these investments would turn out to be worthless and this, in turn, would lead to bankruptcies amongst the banking sector. As a result of these fears, and the ensuing reluctance of banks to lend to each other, the Federal Reserve Bank injected \$38bn of liquidity into the markets on 9th August. The European Central Bank (ECB) followed suit but the Bank of England stood on the sidelines only making cash available at 1% above bank rate. On 17th August the Federal Reserve cut interest rates by 50 basis points (bp) to 5.25%. The dislocation in the markets continued throughout the summer until on 14th September it was announced that the Bank of England had provided billions of pounds of financial support to Northern Rock.

Northern Rock had been affected by the drying up of the wholesale money markets which provided 80% of its funding. On 17th September the Chancellor announced a Government guarantee for all deposits held at the stricken bank. The following day the Federal Reserve cut US rates by a further 50 bp (0.5%) although oil rose to \$80 a barrel and continued to climb reaching a peak, briefly, of \$100 per barrel in November. At its October meeting the Monetary Policy Committee (MPC) declined to cut bank rate, being concerned about the inflation outlook. UK data continued to be robust during the autumn although CPI dropped to 1.8% in September. Three month London Interbank Bid Rate (LIBID) still remained well above Bank Rate. On 31st October the Federal Reserve cut rates yet again to 4.50% and the following day they added \$41bn of reserves in an attempt to free up the markets. The MPC eventually cut Bank Rate on 6th December to 5.50% as concerns about the economy and the credit crunch mounted. On 11th December the Federal Reserve cut rates again, this time by 25 bp.

2008 was ushered in with major fears about the global economy. Stock markets fell sharply and government bond yields fell. On 22nd January the Federal Reserve cut rates, this time by a massive 0.75bp to 3.5%, and once more on 30th January to 3%. The MPC followed suit in February cutting Bank Rate by 25 bp to 5.25%. On 18th February it was announced that the Government would nationalise Northern Rock. The year ended with the money markets anxious and nervous and 3 month cash 75bp above bank rate.

- 6.2 **Longer-term interest rates** – The PWLB 45-50 year rate started the year at 4.45% and fell to a low of 4.38% in March 2008. A radical change to the PWLB rate structure was introduced by the UK Debt Management Office (DMO) on 1st November when they moved to single basis point moves in their rates and introduced a separate repayment rate at the same time, at a level significantly below the rate at which they would lend new money.

7.0 **BORROWING AND INVESTMENT RATES 2007/2008**

12-month bid rates: One year LIBID was on a rising trend until September 2007. Initially the increase was due to the interest rate outlook and the expectation that the MPC would need to increase rates to counter inflation. The sub prime crisis then took over as lenders became nervous about lending for long periods. The one year rate reached a level of over 6.5% in September 2007 before easing back to just over 5.5% by the end of the calendar year. In 2008 interest rate expectations veered towards rate cuts and the one year moved down to 5.1%. Following the February bank rate cut and Inflation rate report it edged back up again to 5.4% and continued higher to 5.8% in March.

8.0 **BORROWING OUTTURN 2007/2008**

- 8.1. **Treasury Borrowing** – the borrowing undertaken by the Council was:

Loan taken out	Amount	Interest Rate	Term
2 nd August 2007	£ 4.0m	4.55%	47.5 years
24 th October 2007	£ 6.0m	4.60%	48.5 years
29 th November 2007	£ 4.0m	4.52%	25.5 years

As comparative performance indicators, average PWLB maturity loan interest rates for 2007/08 were:

1 year	5.18%
25-30 year	4.74%
45-50 year	4.60%

9.0 COMPLIANCE WITH TREASURY LIMITS

- 9.1. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Strategy Statement.

10.0 INVESTMENT OUTTURN FOR 2007/2008

- 10.1. **Internally managed investments** - The Council manages its investments in-house and invests within the institutions listed in the Approved Counterparty List. Normally the Council invests for a range of periods from overnight to 364 days, dependent on the cash flow situation, its interest rate view and the interest rates on offer.
- 10.2. **Externally managed investments** – The Council employs the services of various brokers to manage its investments. Restrictions are set as to the amounts and institutions the funds can be invested with in order to limit risk. Brokers have not been used in the past two years as we have secured better rates in-house.
- 10.3. **Investment Strategy** – The expected short-term investment strategy for in-house managed funds was that as interest rates were low we would look elsewhere eg banking institutions, other than the market, for investment opportunities.

11.0 DEBT RESCHEDULING

- 11.1 Our advisers started 2007/08 with the expectation that the 50 year PWLB would reach a level of 4.25% during the financial year but by the end of June the rate rose to around 4.85%, generating a revised recommendation to review taking new long term borrowing at levels around 4.50%, although the forecast still allowed for rates to reduce to 4.25% later in the year. Later in the year long term rates fell back to, and below, 4.50%.

On 1st November 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 between the two rates ranged from 26bp in the shorter dated maturities to over 40bp in the longer ones. These changes effectively prevented the Council from restructuring the portfolio into new PWLB borrowing.

12.0 CONCLUSION

- 12.1. This report seeks to increase the awareness and importance of the treasury management function and to make officers accountable to the Council for actions taken in support of the treasury strategy.

13.0 IMPLICATIONS FOR THE COUNCIL

13.1 Financial implications: As noted in the report

13.2 Staff implications: None

13.3 Strategic aims:

- Create strong, active, safe and caring communities
- Achieve local economic prosperity and stability
- Make the most of Clackmannanshire's unique built and natural environment
- Develop a culture of personal achievement where everyone is valued
- Improve the health of the people of Clackmannanshire
- Represent and promote the interests of all of the people of Clackmannanshire
- Ensure that the people of Clackmannanshire receive the highest quality services for the public pound

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Report to Council

To accompany all Reports to Council

To: Head of Administration And Legal Services

Author: Bill McLean	Date: 26th June 2008
Service: Corporate Development Services	
Date of Meeting: 14th August 2008	
Title of Report: Annual Treasury Report	

Recommendation that the attached report be:

1. Given unrestricted circulation	<input checked="" type="checkbox"/>	
2. Taken in private	<input type="checkbox"/>	

(tick appropriate box)

By virtue of paragraph ____ of schedule 7A, Local Government (Scotland) Act 1973.

Appendices attached to this report (if none, state "none")

1. None
- 2.
- 3.
- 4.

List of Background Papers (if none, state "none")

1. CIPFA's Code of Practice on Treasury Management
- 2.
- 3.
- 4.

Note: All documents specified must be kept available by the author for public inspection for four years from the date of the meeting at which the report is considered.