



Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 16th July 2008

Subject: TREASURY MANAGEMENT ANNUAL REPORT 2007/08

Electoral Wards Affected:

Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

Eligible for Call In

yes

Not Eligible for Call In

(Details contained in the report)

EXECUTIVE SUMMARY

1. This is the Treasury Management annual report for 2007/08, as required under the Prudential Code which was introduced in April 2004. Prior to this, local authority borrowing was restricted by Government legislation. This restriction together with the requirement to make revenue provision for debt repayment in the Housing Revenue Account was lifted by the introduction of the Prudential Code. This created a mechanism to stimulate capital investment, encouraging local authorities to borrow whilst interest rates were at all time lows.
2. The Council's level of external debt varies daily depending on cash flow and the level of creditors and debtors. This report shows that net external debt at 31st March 2008 was £1,222m, £90m below the report to Executive Board in February. This movement is not due to a change in the capital programme requirement but short-term temporary fluctuations in year-end balances. The level of debt should be viewed in the context of the Council's assets which were valued at £4bn as at 31st March 2007.
3. The level of debt has remained within the Authorised limit for external debt as re-affirmed by the Council in February 2008.
4. Monitoring of market conditions has generated savings of £13.5m of which £2m were assumed in the budget. These savings have been generated through restructuring of long term debt and taking advantage of elevated investment returns.
5. The average rate of interest paid on the Council's external debt for 2007/08 has fallen to 4.51% compared to 4.78% for 2006/07.

1 Purpose of This Report

- 1.1 This report provides members with a review of Treasury Management Strategy and operations in 2007/08.

2 Background Information

- 2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.
- 2.2 In accordance with the prudential code, the Council has also formally adopted the CIPFA Code of Practice on Treasury Management which requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy statement for 2007/08 was approved by the Executive Board on 9th February 2007 and by full Council on 21st February 2007 and a 6 monthly update on progress was considered by the Executive Board on 14th November 2007. 2007/08 progress was again noted as part of the Treasury Management Strategy Report 2008/09 at the Executive Board meeting on the 8th February 2008.

3 Main Issues

3.1 Review of Strategy 2007/08

- 3.1.1 Table 1 below, shows that net borrowing in 2007/08 was £1,222m, £90m below expectations in February 2008. This movement is not due to changes in the capital programme but short-term temporary fluctuations in year-end balances.

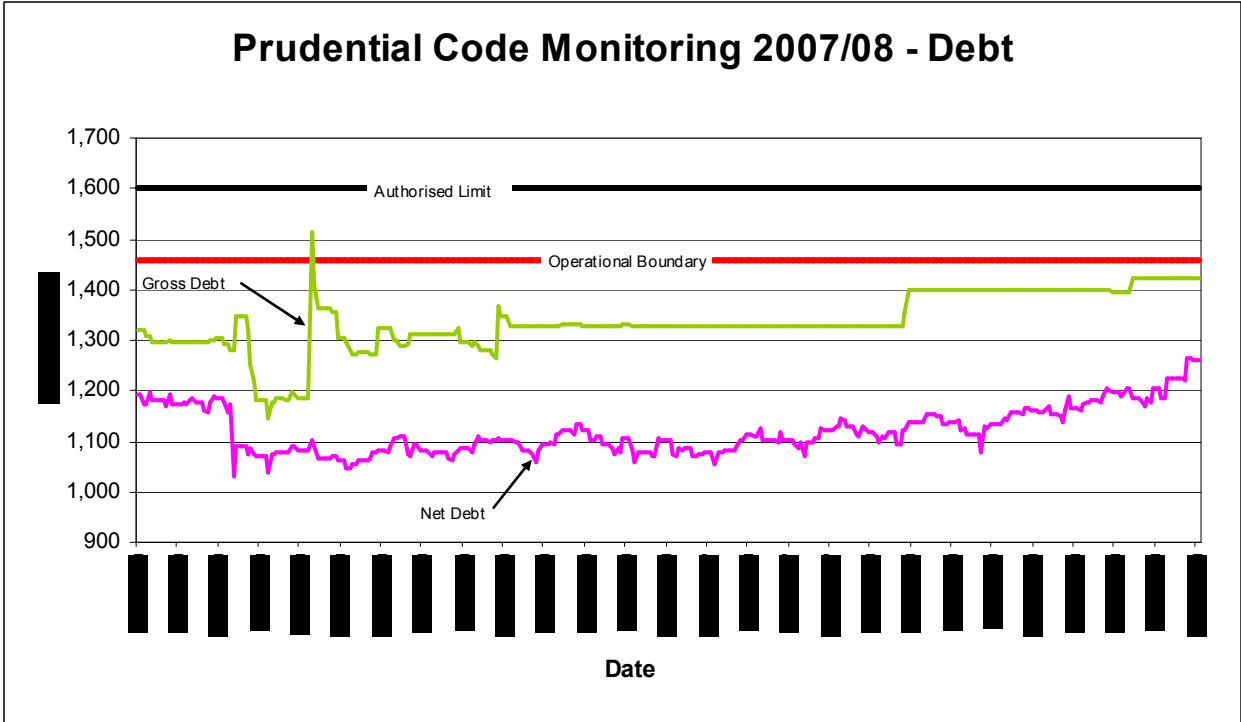
Table 1

ANALYSIS OF BORROWING 2007/08	2007/08 Feb 08	2007/08 This Report
	£m	£m
Net Borrowing at 1 April	1,198	1,198
New Borrowing for the Capital Programme – Non HRA	33	24
New Borrowing for the Capital Programme – HRA	112	120
Debt redemption costs charged to Revenue (Incl HRA)	(27)	(27)
Reduced/(Increased) level of Revenue Balances	(4)	(93)
Net Borrowing at 31 March*	1,312	1,222
Capital Financing Requirement (Maximum Net Debt)	1,456	1,427
* Comprised as follows		
Long term borrowing		
Fixed	1357	1,383
Variable	25	0
Short term Borrowing	0	14
Total External Borrowing	1,382	1,397
Less Investments	70	175
Net External Borrowing	1,312	1,222
% borrowing funded by short term and variable rate loans	2%	1%

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes.

- 3.1.2 Temporary year-end fluctuations comprise £53m on year-end debtors and creditors and £40m on the level of revenue balances. £25m of revenue balances relates to Major Repairs Renewal reserves on the Housing Revenue Account accumulated due to slippage in the HRA capital programme. The overall movement on revenue balances is a result of year-end short-term movements and is not expected to affect the long term borrowing requirement. These short term balances have been invested in the money markets and have achieved elevated levels of returns.
- 3.1.3 Prudential Indicator 10 and 11 in Appendix A shows the prudential limits set by the Council in February 2007 remained unchanged throughout the year.
- 3.1.4 Graph 1, below shows the level of debt during 2007/08 and its comparison with the prudential limits on debt set by the Council in February 2007. The authorised limit is the maximum permitted amount of borrowing the Council can have outstanding at any given time and has not been breached during 2007/08. The operational boundary is a key management tool and can be breached temporarily depending on cash flow. This limit acts as a warning mechanism to prevent the authorised limit from being breached. The operational boundary was breached on 30th May 2007 for one day as the Council borrowed £360m as part of a rescheduling exercise.

Graph 1

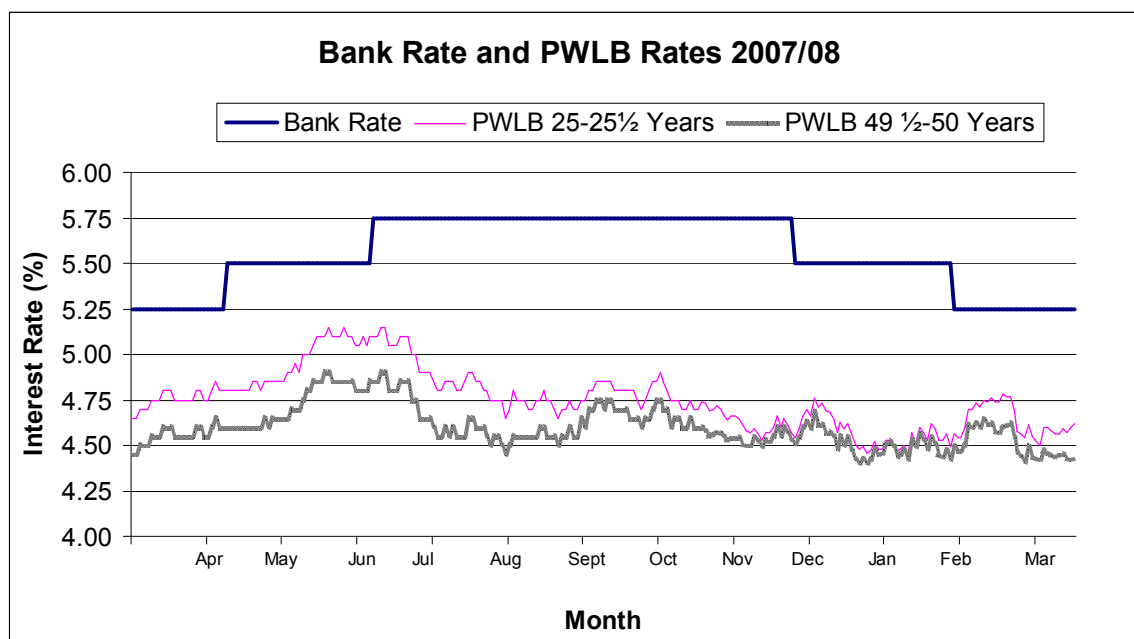


- 3.1.5 As reported in the Treasury Management Strategy 2008/09 on 8th February 2008, The Bank of England raised the bank rate upwards in May and July 2007 to a peak of 5.75% in response to the growing threat of inflation. On 9th August 2007 the problems connected to the US sub-prime housing market began to impact on the global markets. The bank BNP Paribas in Paris closed down two funds heavily involved in lending to this sector and both the Federal Reserve in the US and the European Central Bank injected very substantial amounts of liquidity into the wholesale markets. Concerns gripped the markets as lenders were unsure whether the counterparties to which they were lending would default on their loans. This concern caused the price of money that banks lend to each other to

increase substantially above the Bank of England bank rate. The impact of the credit crunch began to spread to the wider economy with signs that there were greater risks to growth and as a result the Bank rate was reduced in December and February to 5.25%. The rate has subsequently fallen to 5.00% in April 2008.

- 3.1.6 The Public Loans Works Board (PWLB) 45-50 year rate started the year at 4.45% and fell to a low of 4.38% in March 2008. The high point, of which there were several, for 45-50 year was 4.90% before finishing the year at 4.42%. The volatility in yields was a direct reflection of the turnaround in interest rate sentiment brought about by the sub-prime crisis in the US. These movements are illustrated in the following graph.

Graph 2



- 3.1.7 Monitoring of long term interest rates has presented opportunities to restructure £670.19m of loans as shown in Table 2 to generate current and future year revenue savings. This included £575.19m of PWLB loans and a further £95m of market loans of which £35m were rescheduled prior to the start of 2007/08. These market loans are termed Lenders Option Borrowers Option (LOBO) and contain clauses which allow the lender, at pre-determined dates, to vary the interest rate on the loan. If one of these options is exercised and the new rate is not accepted, the borrower then has the option to repay the loan. The restructuring of market loans was in response to lenders exercising their option to terminate loans. These loans were then re-established with similar maturity profiles.
- 3.1.8 New replacement borrowing totaled £644.23m, which was £25.96m less than repaid. £25m was part of a rescheduling exercise that fell across two financial years and was replaced in early April 2008.
- 3.1.9 Monitoring of market conditions has generated savings of £13.5m of which £2m were assumed in the budget. These saving were reported in the Revenue Outturn report to Executive Board on 11th June 2008. The savings have been generated through restructuring of long term debt and taking advantage of elevated investment returns as a result of the credit crunch. Savings as a result of rescheduling are reported in accordance with the new accounting changes governing premiums and discounts on the rescheduling of loans.

3.1.10 Rescheduling opportunities presented themselves until 1st November 2007 when the PWLB radically changed their terms of operation. Up to that point there had been various opportunities to improve the terms of the debt holdings by restructuring into other periods, whilst being mindful of the requirements of the new accounting regulations.

3.1.11 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 (basis points) in the shorter dated maturities to over 45bp in the longer ones. They also introduced daily movements of 1bp instead of 5 bp and rates in half year periods throughout the maturity range (previously had been mainly in 5 year bands). These changes effectively prevented the Council from restructuring the portfolio into new PWLB borrowing, in the current rate environment.

Table 2

Rescheduling 2007/08								
Premature Repayments					Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate (%)	Premium/ (Discount) (£m)	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB					PWLB			
02/05/07	24	4.7	4.8	(0.360)	04/05/07	50	49.5	4.55
02/05/07	25	4.75	4.8	(0.188)	04/05/07	19	48.5	4.55
02/05/07	20	4.7	4.8	(0.302)	30/05/07	112	49	4.6
09/05/07	25	5.625	5.1	1.476	30/05/07	30	47	4.6
09/05/07	25	5.625	5.1	1.530	30/05/07	34	47.5	4.6
09/05/07	20	5.625	5.1	1.266	30/05/07	42	49.5	4.6
09/05/07	20	5.625	5.25	0.756	30/05/07	86	45	4.6
09/05/07	6.75	5.625	4.95	0.578	30/05/07	56	46	4.6
09/05/07	22	4.4	4.7	(1.227)	22/06/07	42.23	47.5	4.85
09/05/07	22	4.4	4.65	(1.039)	22/06/07	10	49.5	4.85
09/05/07	26	4.4	4.65	(1.235)	02/08/07	79	45	4.55
09/05/07	22	4.4	4.65	(1.051)	02/08/07	14	50	4.55
09/05/07	22	4.4	4.65	(1.058)				
31/05/07	30	4.25	4.7	(2.447)				
31/05/07	20	4.25	4.7	(1.645)				
31/05/07	20	4.25	4.7	(1.658)				
08/06/07	10	10.875	5.5	3.852				
08/06/07	9.4	11.25	5.5	3.864				
08/06/07	10.35	7.875	5.45	1.987				
08/06/07	2.4	6.25	5.25	0.263				
08/06/07	0.75	5.625	5.1	0.049				
08/06/07	20	4.3	4.8	(1.689)				
08/06/07	30	4.3	4.7	(2.576)				
26/06/07	19.21	7.875	5.65	3.339				
26/06/07	30	4.25	4.8	(3.339)				
20/07/07	0.32	7.875	5.65	0.055				
20/07/07	31	5.875	5.25	2.428				
20/07/07	7.01	7.75	4.85	3.796				
20/07/07	30	4.25	4.9	(3.529)				
20/07/07	25	4.25	4.85	(2.751)				
Sub Total	575.19			(0.855)	Sub Total	574.23		
LOBOs					LOBOs			
Arranged in 06/07					Arranged in 06/07			
18/04/07	20	4.5			18/04/07	20	70	4.45
25/04/07	15	4.4			25/04/07	15	70	4.25
Sub-total	35				Sub-total	35		
Arranged in 07/08					Arranged in 07/08			
03/04/07	5	3.40			02/07/07	15	70	4.295
03/04/07	10	3.38			03/07/07	10	70	4.290
05/04/07	10	3.48		(0.554)	03/07/07	10	70	4.285
02/05/07	10	3.96						
31/03/08	25	3.65						
Sub-total	60				Sub Total	35		
Sub Total	95			(0.554)	Sub Total	70		
Total	670.19			(1.409)	Total	644.23		

3.1.12 To meet the borrowing requirement for 2007/08 new loans of £100m were taken in 2006/07 in advance of need and an additional £15m was taken in 2007/08 as shown in Table 3.

3.1.13 As reported in the February 2008 report £70m of 2008/09 funding requirement was taken in advance and was increased to £95m. The Council has again been able to take advantage of higher interest rates on deposits as a result of the credit crunch, and again invest the amounts until they are required. Details are shown in Table 3.

Table 3

New Borrowing for 2007/08 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
Undertaken in 2006/07				
19/05/06	PWLB	20	43	4.25
19/05/06	PWLB	20	44	4.25
19/05/06	PWLB	30	50	4.25
19/05/06	PWLB	30	42	4.25
Undertaken in 2007/08				
02/08/07	PWLB	15	45	4.55
		115		
Pre Funding for 2008/09 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
20/12/07	LOBO	20	70	4.08
21/12/07	LOBO	25	70	4.06
21/12/07	LOBO	25	70	4.07
07/03/08	PWLB	25	5	4.20
		95		

3.1.14 Total borrowings undertaken in 2007/08 amounted to £754m compared to £857m in 2006/07 which was a substantial increase on new borrowings of £275m undertaken in 2005/06. Combined with total repayments of £670m total turnover of long-term borrowing amounted to over £1.4bn in 2007/08.

3.2 Interest Rate Performance

3.2.1 The average rate of interest paid on the Council's external debt for 2007/08 was 4.51% compared with 4.78%, 5.35% and 5.67% in 06/07, 05/06 and 04/05 respectively. This is below the average for metropolitan districts for 2006/07 as shown in Appendix B. Appendix C analyses debt as at 31st March 2007 by interest rate bands and the year of maturity or first option date for LOBO loans. The final maturity of LOBO loans is shown as a memo item in the table at the bottom of Appendix C.

4 Implications For Council Policy And Governance

- 4.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.
- 4.2 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. This treasury management report for 2007/08 seeks approval in accordance with the code.

5 Legal And Resource Implications

- 5.1 The treasury management annual report for 2007/08 recognises the final borrowing undertaken to fund the capital programme of both General Fund and HRA. The revenue costs of this borrowing have been met within the revenue account and were reported in the revenue outturn report presented to Executive Board on 11th June 2008.

6 Conclusions

- 6.1 The treasury management annual report 2007/08 details the transactions undertaken in 2007/08 to fund the capital programme requirements for both General Fund and HRA. Treasury activity during the year was conducted within the approved borrowing limits for the year and resulted in significant savings to the revenue budget.

7 Recommendations

That the Executive Board :

- 7.1 Note the treasury management outturn position for 2007/08.

Associated documents:

- a) Treasury Management Strategy 2007/08 - Executive Board 9th February 2007.
- b) Treasury management Update 2007/08 – Executive Board 14th November 2007.
- c) Treasury Management Strategy 2008/09 – Executive Board 8th February 2008.

Leeds City Council - Prudential Indicators 2007/08

No.	PRUDENTIAL INDICATOR	Feb 07 Report	Feb 08 Report	Outturn (This Report)
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
1	Ratio of Financing Costs to Net Revenue Stream General Fund - Excluding DSG (Note1)	8.01%	8.14%	7.96%
2	HRA	14.94%	13.47%	13.76%
Impact of Unsupported Borrowing on Council Tax & Housing Rents		£ . P	£ . P	£ . P
3	increase in council tax B7 (band D, per annum) (Note 2)	37.24	48.67	48.57
4	increase in housing rent per week	0.00	0.00	0.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
Estimate of total capital expenditure				
6	Non HRA	198,108	235,947	210,708
7	HRA	170,227	164,253	132,696
	TOTAL	368,335	400,200	343,404
Capital Financing Requirement (as at 31 March)		£'000	£'000	£'000
8	Non HRA	694,580	679,693	671,256
9	HRA	652,373	748,000	755,768
	TOTAL	1,346,953	1,427,693	1,427,024

No.	PRUDENTIAL INDICATOR	£'000	£'000	£'000
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS				
10	Authorised limit for external debt - (Note 4) borrowing other long term liabilities TOTAL	1,550,000 40,000 1,590,000	1,600,000 40,000 1,640,000	1,600,000 40,000 1,640,000
11	Operational boundary - (Note 4) borrowing other long term liabilities TOTAL	1,460,000 30,000 1,490,000	1,460,000 30,000 1,490,000	1,460,000 30,000 1,490,000
14	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
15	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
17	Upper limit for total principal sums invested for over 364 days (Note 5) (per maturity date)	150,000	150,000	150,000

16	Maturity structure of fixed rate borrowind during 2006/07	Lower Limit	Cumulative Upper Limit	Actual 31/03/2008
	under 12 months	0%	30%	0%
	12 months and within 24 months	0%	30%	8%
	24 months and within 5 years	0%	40%	17%
	5 years and within 10 years	0%	50%	4%
	10 years and above	25%	90%	71%

Notes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.
- The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.
- In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.
- Limits are the same as the Feb 08 report.
- Prudential indicator 12 relates to actual external debt at 31st March, which is reported in the main body of this report.
- Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003.

Appendix B

Average Rate of External Debt 2006/07			
Authority Name	Rank	Total Debt at 31.3.07 £m	Gross Average Rate of Interest on Total Debt 2006/07 %
Knowsley	1	119	4.32
Walsall	2	220	4.40
Sunderland	3	200	4.53
Leeds	4	1,198	4.78
Stockport	5	240	5.02
Sefton	6	106	5.04
Solihull	7	184	5.20
Tameside	8	168	5.20
Bolton	9	375	5.29
Calderdale	10	111	5.46
Barnsley	11	416	5.60
Newcastle upon Tyne	12	688	5.62
Liverpool	13	836	5.78
St Helens	14	116	5.81
Trafford	15	93	5.89
Wolverhampton	16	392	5.90
Wakefield	17	235	5.91
Doncaster	18	301	5.91
Kirklees	19	488	5.94
Weighted Average Metropolitan	20		6.00
Salford	21	519	6.05
Dudley	22	407	6.32
Rotherham	23	378	6.35
South Tyneside	24	208	6.42
Oldham	25	412	6.43
Manchester	26	952	6.44
Sheffield	27	855	6.85
Birmingham	28	1,561	7.30
Wigan	29	367	7.34
Gateshead	30	322	7.51
Bury	31	113	
Bradford	no return		
Coventry	no return		
North Tyneside	no return		
Rochdale	no return		
Sandwell	no return		
Wirral	no return		

Source: CIPFA Capital Expenditure and Treasury Management Statistics 2006-07

Debt as at 31st March 2008
Appendix C

Table below shows a breakdown of the maturity structure of the authority giving totals within interest bands

Year Ending 31st March	to 4%	4% to 4.99%	5% to 5.99%	6% to 6.99%	7% to 7.99%	Greater Than 8%	Principal
Fixed Rate Loans - LOBO to First Option							
2009	45,000	95,000	20	-	-	3	140,023
2010	45,000	60,000	-	-	-	-	105,000
2011	30,000	80,000	-	-	-	-	110,000
2012	15,000	45,000	-	-	-	-	60,000
2013	20,000	-	-	-	-	-	20,000
2014	-	-	-	-	-	-	-
2015	-	15,000	-	-	-	-	15,000
2016	-	15,000	-	-	-	-	15,000
2017	-	-	-	-	-	-	-
2018	-	-	-	-	-	-	-
2020	-	-	-	-	-	-	-
2022	-	-	-	-	-	-	-
2024	-	-	-	-	-	-	-
2025	-	-	-	-	-	-	-
2026	-	-	-	-	-	-	-
2027	-	-	-	-	-	-	-
2028	-	-	-	-	-	-	-
2034	-	-	-	-	-	-	-
2035	-	-	-	-	-	-	-
2043	-	-	-	-	-	-	-
2049	-	-	-	-	-	-	-
2050	-	-	-	-	-	-	-
2051	-	-	-	-	-	-	-
2052	-	100,000	-	-	-	-	100,000
2053	-	207,000	-	-	-	-	207,000
2054	-	101,000	-	-	-	-	101,000
2055	-	106,000	-	-	-	-	106,000
2056	-	101,230	-	-	-	-	101,230
2057	-	161,000	-	-	5,740	-	166,740
2058	-	116,000	-	-	20,000	-	136,000
Sub Total	155,000	1,202,230	20	-	25,740	3	1,382,993
Temporary Loans							
2009	14,485	-	-	-	-	-	14,485
Sub Total	14,485	-	-	-	-	-	14,485
CABP	169,485	1,202,230	20	-	25,740	3	1,397,478
Memo : LOBO Variable Rate Loans to Maturity							
2044	-	5,000	-	-	-	-	5,000
2055	-	20,000	-	-	-	-	20,000
2056	20,000	50,000	-	-	-	-	70,000
2066	20,000	40,000	-	-	-	-	60,000
2067	65,000	15,000	-	-	-	-	80,000
2077	50,000	15,000	-	-	-	-	65,000
2078	-	140,000	-	-	-	-	140,000
Sub Total	155,000	285,000	-	-	-	-	440,000

LOBO's Shown at Maturity in Bottom Memo Section.

LOBO's included in main section at next option date. (Highlighted)