Leeds CITY COUNCIL

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Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 5th November 2008

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2008/09

Electoral Wards Affected:	Specific Implications For:	
	Equality and Diversity	
	Community Cohesion	
	Narrowing the Gap	

Eligible for Call In	X	Not Eligible for Call In (Details contained in the report)	

EXECUTIVE SUMMARY

1. This report provides a review and update of the treasury management strategy for 2008/09.

2. The Council's level of external debt at 31st March 2008 is anticipated to be £1,407m, £43m lower than expected when the strategy was approved in February 2008.

3. Monitoring of volatile markets has enabled revenue savings of £3.4m to be made which includes £1.2m assumed within the budget. This is largely due to taking advantage of competitive investment rates by lending out unused balances until required and being able to secure long term borrowing at lower rates than assumed in the strategy.

4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

5. The level of debt is expected to remain within the Authorised limits for external debt as agreed by Council on 8th February 2008.

1.0 Purpose Of This Report

1.1 The 2008/09 treasury management strategy was approved by Executive Board on 8th February 2008. This report provides a review and update of the strategy for 2008/09.

2.0 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 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

2.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy statement for 2008/09 was approved by the Executive Board on 8th February 2008 and by full Council on 20th February 2008. This report provides Members with a review and update of the strategy for 2008/09.

3.0 Main Issues

3.1 ***Review of Strategy 2008/09***

3.1.1 The current borrowing forecasts are shown in Table 1.

Table 1

ANALYSIS OF BORROWING 2008/09 – 2010/11		**2008/09 This Report £m**	**2009/10 £m**	**2010/11 £m**
Net Borrowing at 1 April		1,222	1,407	1,460
New Borrowing for the Capital Programme – non HRA		128	49	54
New Borrowing for the Capital Programme – HRA		32	12	12
Debt redemption costs charged to Revenue		(24)	(28)	(29)
Reduced/(Increased) level of Revenue Balances		49	20	(1)
Net Borrowing at 31 March *		1,407	1,460	1,496
* Comprised as follows				
Long term Borrowing	Existing Fixed	1,368	1,438	1,389
	Existing Variable	40	60	90
	New Borrowing	90	31	36
Short term Borrowing		0	0	0
Total External Borrowing		1,498	1,529	1,515
Less Investments		91	69	19
Net External Borrowing		1,407	1,460	1,496
% Gross borrowing exposed to interest rate risk		9%	6%	8%
Capital Financing Requirement		1,563	1,596	1,634

Note:The Capital Financing Requirement (CFR) is the maximum the Council can borrow for capital purposes.

3.1.2 Table 1 above shows that 2008/09 net external borrowing is now forecast at £1,407m, which is £43m lower than forecast in the report to Executive Board on 8th February 2008. This is due to the year-end movement in balances where the levels of short term balances reduced the need to borrow funds, as reported to Executive Board in the 2007/08 annual report on 16th July 2008. This unusual level of year end movement is expected to revert back to normal levels for 2008/09 year end.

3.1.3 Since the Treasury Management Strategy 2008/09 report to Executive Board in February, the financial and money markets have been gripped by fear and severe volatility as the credit crisis has further deteriorated. In April the impact of the credit crunch began to spread to the wider UK economy and threats to growth enabled the Bank rate to be reduced to 5.00%. Both the UK and EU economies are behind the US economic business cycle so much of the pain felt in the US is now starting to impact on the UK economy.

3.1.4 The Bank of England (BoE) together with other policy rate setters were faced with the dilemma of increasing inflation and reducing growth known as stagflation. The BoE did not want inflation expectations to take hold and were therefore more likely to allow demand led inflation to subside through a slowing of economic growth. However the rapidly worsening credit conditions on an unprecedented scale led Governments around the World to take action as a number of banks and financial institutions began to fail. Some of the casualties include:

Fannie Mae and Freddie Mack – Largest mortgage facilitators	USA	$200bn - nationalisation
AIG – the world largest insurer	USA	$85bn – part nationalisation
Lehman Brothers – Investment bank	USA	In administration
Merrill Lynch – Investment bank	USA	Assisted Take-over
Northern Rock	UK	$215bn Nationalised
Bradford and Bingley	UK	$25bn nationalised and deposits sold off
Alliance and Leicester	UK	Sold
HBOS	UK	Assisted takeover
Fortis	Europe	Nationalised
Hypo Real estate	Europe	Rescue package
Glitnir	Iceland	Nationalised
Kaupthing	Iceland	Nationalised
Landsbanki	Iceland	Administration

3.1.5 The list continues to grow as bank failures unleash more exposed financial positions between banks. The size of the problem is perhaps illustrated by the total size of the US household mortgage debt of $12tn of which the US government has pledged a bail out of $700bn. US annual Gross Domestic Product is $14tn. The UK Government has launched its own package of £500bn including the option of buying into UK banks. To put this into context national annual public expenditure is £618bn.

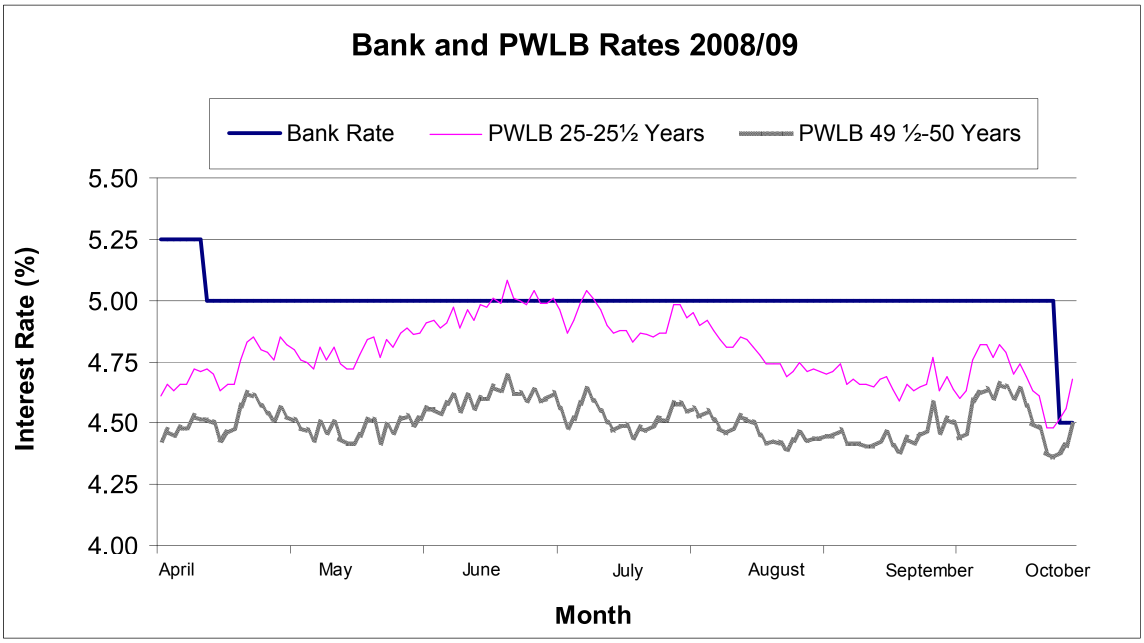
3.1.6 Write downs on exposures to the US sub prime market continue and to date banks have written down over $500 billion. It is unlikely that these losses will be halted until the house prices in America stop falling. The whole-sale funding market that banks in the past have used to package up mortgage debt and pass on to other financial institutions effectively remain closed, resulting in banks having to bring these loans onto their own balance sheets.

3.1.7 As stock markets across the world continued to fall heavily, coordinated action on 8th October was taken to reduce interest rates in the UK, USA, Sweden, Switzerland and ECB. However this unprecedented action failed to stem the fear within the equity markets with the effect that the FTSE fell nearly 21% in the week ending 10th October and the DOW Jones fell 18%. These falls have not been seen since the crash of October 1987.

3.1.8 On Monday 13th October the Government announced that it was preparing to invest £37bn to re-capitalise major UK Banks following a week in which the share price of 4 major banks had declined by between 35% and 62% on these already depressed stocks. RBS (£20bn), HBOS (£11.5bn), Lloyds (£5.5bn) and Barclays (£6.6bn from own sources) are to get a capital injection in the form of a mix of ordinary shares and preference shares. This government injection of capital is on the basis that these banks will start to lend to each other again and start lending in the mortgage market. In addition, as the Government is now a major shareholder, it has announced it will block dividend payments this year and Barclays has followed suit. These moves by the UK authorities are being followed by both a wave EU states and by the US in efforts to calm the troubled financial sector. It is early days yet but initial market reactions have been positive and only time will tell whether this will be sufficient to prevent the banking sector falling further into decline.

3.1.9 The UK bank rate now stands at 4.50% and is expected to fall further in 2009, the real rates in the money markets are still around 6%, but there are some signs in these early days that these rates are beginning to come down.

3.1.10 Since the February report both short and long term rates remain volatile. The following graph shows how long term rates have fluctuated between 4.36% and 4.69% for 50 year loans. Whilst current 50 year PWLB rates currently stand at 4.75%, the Council's advisors expect these rates to fall to 4.35% by the end of March 2009. The Council has a borrowing requirement of £90m and any further borrowing, subject to anticipated slippage in the capital programme, should take place at levels lower than 4.40%.



3.1.11 The Council's advisors forecast that the Bank Rate will be again be lowered in 2009 to a low of 4.0%. Other economic forecasters predict bank rates could go as low as 2.5%.

3.1.12 Despite the volatility experienced in the markets the ability to re-structure PWLB debt continues to be hampered by the differential rates on re-scheduling introduced by the PWLB in November of 2007. A number of market loans have been called by the lender and replaced with a combination of new market and PWLB loans as shown in table 2. On 31/03/08 a £25m LOBO was called together with a £5m LOBO on 04/04/08. These two LOBOs were replaced with a new £30m PWLB loan of a 5 year maturity. Two further LOBOs were called and replaced with two new LOBO's of similar profiles. 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

Table 2

Rescheduling 2007/08									
Premature Repayments						New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Premium/ (Discount) (£m)		Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB						PWLB			
						09/04/08	30	5	4.23
Sub Total	**0**			**0**			**30**		
LOBOs (Call date)						LOBOs			
04/04/08	5	4.00				07/05/08	10	70	4.19
02/05/08	10	3.96				14/05/08	10	70	4.10
12/05/08	10	3.99							
Sub Total	**25**			**0**			**20**		
Total	**25**			**0**			**50**		

3.1.13 The forecast borrowing requirement for 2008/09 is now £185m of which £95m was pre-funded in 2007/08. Details were included in the Treasury Management Annual report 2007/08 considered by Executive Board on 16th July 2008, but are shown again in Table 3 for completeness. This leaves a borrowing requirement of £90m still to be arranged in 2008/09. The levels of capital programme slippage and cash reserves will continue to be monitored before additional monies are borrowed in the light of the current economic conditions as outlined above.

3.1.14 A capital re-alignment report was presented to Executive Board on 8th October 2008 highlighting the need to reduce the capital programme as capital receipts have fallen away. If this trend continues, there will be the need to further curtail capital expenditure or borrow additional monies. For each £5m of additional borrowing the additional cost would be in the region of £450k.

Table 3

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		

3.1.15 Monitoring of market conditions have enabled the Council to borrow in advance of need at low rates and place monies and surplus cash balances with financial institutions at elevated investment rates until required. This together with securing replacement borrowing at less than assumed in the budget has enabled savings of £3.4m to made to date, of which £1.2m was assumed within the budget set in February.

3.2 ***Borrowing Limits for 2008/09, 2009/10 and 2010/11***

3.2.1 The Council is required to set various limits for 2008/09, 2009/10 and 2010/11 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code. These limits including prudential indicators are detailed in Appendix A.

3.2.2 New borrowing limits for 2008/09 were approved by Council on 20th February 2008 and are set out below in Table 4.

Table 4

	2008/09 February 2008 £m	**2008/09 ThisReport £m**
Authorised Limits		
Borrowing	1,650	1,650
Other Long Term Liabilities	40	40
Total	**1,690**	**1,690**
Operational Boundary		
Borrowing	1,530	1,530
Other Long Term Liabilities	30	30
Total	**1,560**	**1,560**

3.2.3 It is anticipated that the authority will continue to remain within the authorised limits for 2008/09. Both the authorised limit and operational boundary are made up of a limit for borrowing and one for other long term liabilities and the Director of Resources has authority, under the Prudential Code, to vary these two elements within the overall limits. Current performance against borrowing limits is shown in Appendix B.

3.3 ***Investment Strategy & Limits***

3.3.1 With effect from the 1st April 2004, new legislation and guidance on Local Government Investments was issued and this allows Councils with external debt to hold investments for more than 364 days, a freedom not previously allowed. Councils are required to set a limit on these investments before the start of the year. Council on 21st February 2007 approved a limit on investments for periods longer than 364 days of £150m. No further change is proposed to this limit.

3.3.2 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. The Council's surplus monies have been invested until required in accordance with an approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's own view of the credit worthiness of counter parties.

3.3.3 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good. The Council has taken further action to limit exposure to a group of financial to £30m and ensured that lending is spread on a geographical basis. It is anticipated that the Council's investments will naturally reduce as capital programme expenditure increases. The management and investment of surplus monies will continue to be monitored on a daily basis as the national and international crisis affecting the financial markets unfolds. There is strong evidence that the major Governments of the World are and will take action to support their banks. It seems only a matter of time before many national Governments adopt the stance of the Irish Government to guaranteeing both commercial and retail deposits.

4.0 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 Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

4.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy statement for 2008/09 was approved by the Executive Board on 8th February 2008 and by full Council on 20th February 2008.

5.0 Legal and Resource Implications

5.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

6.0 Conclusions

6.1 The Council's level of external debt at 31st March 2008 is anticipated to be £1,407m, £43m lower than expected when the strategy was approved in February 2008.

6.2 Treasury Management activity has enabled revenue savings of £3.4m to be generated to date, including £1.2m that was assumed in the budget. The Director of Resources will continue to monitor market conditions to identify any further opportunities for increasing revenue savings.

6.3 It is anticipated that the authority will remain within the approved limits for 2008/09 as outlined in Table 4 and paragraph 3.2.3.

7.0 Recommendations

That the Executive Board:

7.1 Note the update on Treasury Management borrowing and investment strategy for 2008/09.

8.0 Background Papers

8.1 Report to Executive Board on 8th February 2008 entitled, 'Treasury Management Strategy 2008/9'

8.2 Report to Council on 20th February 2008 entitled, 'Treasury Management Strategy 2008/9'

Appendix A

Leeds City Council - Prudential Indicators 2008/09 - 2010/11

No.	PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	8.14%	11.13%	11.00%
2	HRA	14.43%	15.05%	13.89%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	63.26	87.46	88.73
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	259,351	195,280	135,301
7	HRA	106,363	53,070	53,853
	TOTAL	365,714	248,350	189,154
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	775,187	795,633	821,001
9	HRA	788,105	800,554	812,830
	TOTAL	1,563,292	1,596,187	1,633,831

No.	PRUDENTIAL INDICATOR			
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 4)**			
	borrowing	1,650,000	1,650,000	1,650,000
	other long term liabilities	40,000	40,000	40,000
	TOTAL	1,690,000	1,690,000	1,690,000
11	**Operational boundary - (Note 4)**			
	borrowing	1,530,000	1,560,000	1,590,000
	other long term liabilities	30,000	30,000	30,000
	TOTAL	1,560,000	1,590,000	1,620,000
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**	150,000	150,000	150,000
	(per maturity date)			

16	Maturity structure of fixed rate borrowind during 2006/07	Lower Limit	Cumulative Upper Limit	Actual 31/03/2008
	under 12 months	0%	30%	7.7%
	12 months and within 24 months	0%	30%	8.1%
	24 months and within 5 years	0%	40%	13.6%
	5 years and within 10 years	0%	50%	2.9%
	10 years and above	25%	90%	67.6%

Notes.

1 **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.**

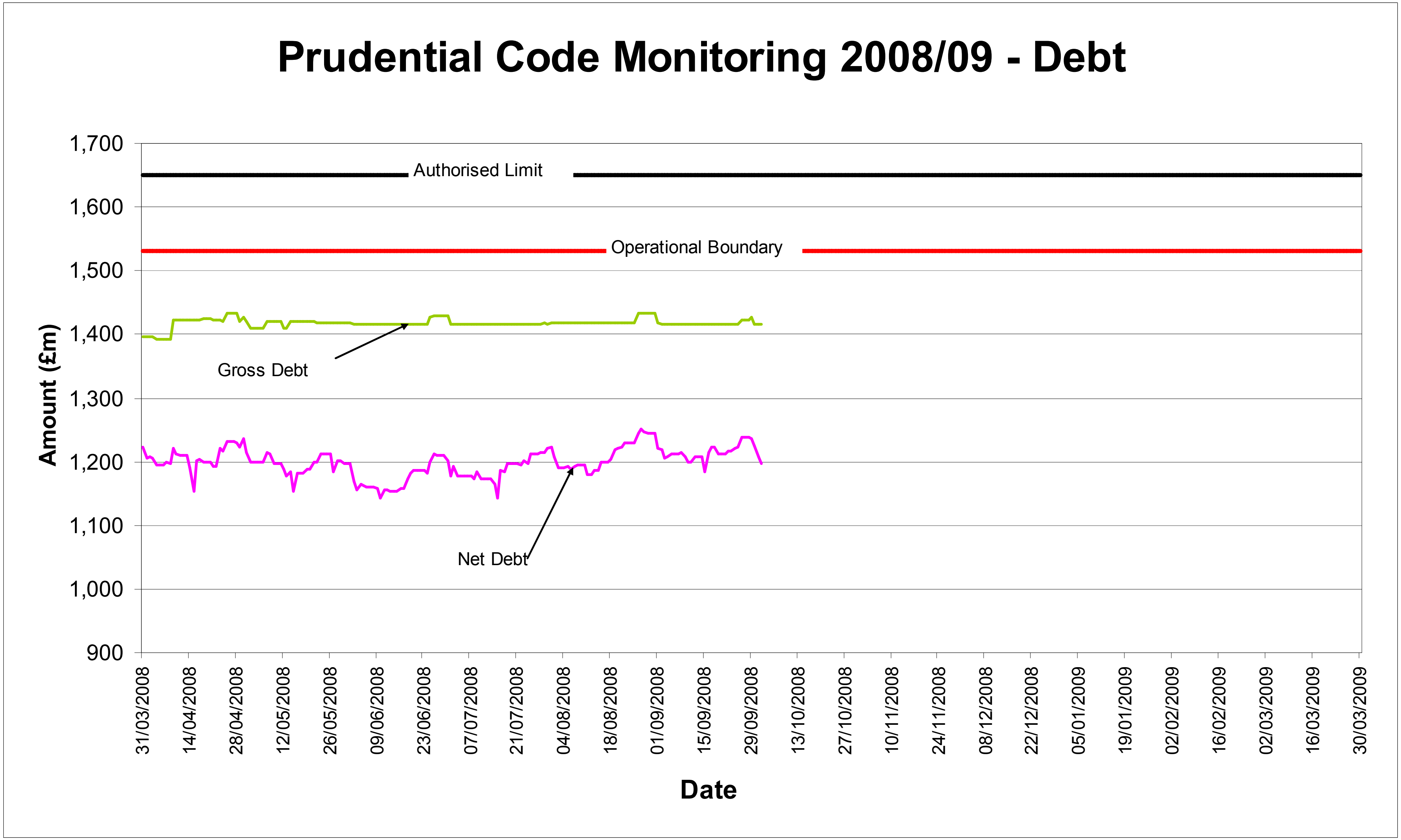
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

3 **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.**

4 **Limits are the same as the Feb 08 report.**

5 **Prudential indicator 12 relates to actual external debt at 31st March, which is reported in the main body of this report.**

6 **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.**


Prudential Code Monitoring 2008/09 - Debt
Amount (£m)
1,700
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2008
14/04/2008
28/04/2008
12/05/2008
26/05/2008
09/06/2008
23/06/2008
07/07/2008
21/07/2008
04/08/2008
18/08/2008
01/09/2008
15/09/2008
29/09/2008
13/10/2008
27/10/2008
10/11/2008
24/11/2008
08/12/2008
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02/02/2009
16/02/2009
02/03/2009
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