Leeds
CITY COUNCIL

Originator:	M Taylor
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Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 22nd July 2009

Subject: TREASURY MANAGEMENT ANNUAL REPORT 2008/09

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

Eligible for Call In	yes	Not Eligible for Call In (recommendations 7.3 & 7.4)	

EXECUTIVE SUMMARY

1. This is the Treasury Management annual report for 2008/09, as required under the Prudential Code which was introduced in April 2004. Prior to this, local authority borrowing was restricted by Government legislation, these restrictions were lifted by the introduction of the Prudential Code together with the requirement not to make revenue provision for debt repayment in the Housing Revenue Account. This created a mechanism to stimulate capital investment, encouraging local authorities to borrow whilst long term interest rates were a relatively low level.

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 2009 was £1,373m, £35m below the February 2009 forecast. This movement is due to slippage in the general fund capital programme requirement and 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 2008. The level of debt has remained within the Authorised limit for external debt as approved by the Council in February 2009.

3. Monitoring of market conditions has generated savings of £6.6m of which £1.2m were assumed in the budget. These savings have been generated through restructuring of long term debt and taking advantage of elevated investment returns.

4. The average rate of interest paid on the Council's external debt for 2008/09 has fallen to 4.35% compared to 4.51% for 2007/08.

5. The unprecedented volatility in the money markets, coupled with historic low levels of funding of debt with short life maturities has presented a number of opportunities to restructure long term debt into short dated maturities. To take advantage of these opportunities within acceptable levels of risk it is recommended that the lower and upper limits for Prudential Indicator 16, that sets the range of limits for holding debt of different maturities, be amended.

6. A combination of reduced future capital programme requirements, increased investment counter party risk and historically low temporary borrowing rates mean that it is now prudent to reduce the upper limit on investments over 364 days, back to £100m for 2009/10. Setting a new lower limit of £100m allows the Council flexibility to gain access to investment returns if market sentiment significantly improves and counter-party risk greatly diminishes.

7. The Audit commission, CIPFA and CLG Select Committee have produced reports since the Icelandic banking crisis. Many of the recommendations in these reports endorse the working procedures, debt and investment decisions in relation to risk and reporting framework that the Council has in place. Some of the recommendations relate to changes in the CIPFA Treasury Management Code of Practice which if adopted will be implemented by the Council but in the meantime will be subject to further consideration and reported back to Executive Board. Executive Board is asked to refer specific recommendations on governance and scrutiny to Central and Corporate Functions Scrutiny Board and the Corporate Governance and Audit Committee.

1 Purpose of This Report

1.1 This report provides members with a review of Treasury Management Strategy and operations in 2008/09.

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 2008/09 was approved by the Executive Board on 8th February 2008 and by full Council on 20th February 2008 and a 6 monthly update on progress was considered by the Executive Board on 5th November 2008. 2008/09 progress was again noted as part of the Treasury Management Strategy Report 2009/10 at the Executive Board meeting on the 13th February 2009.

3 Main Issues

3.1 Review of Strategy 2008/09

3.1.1 Table 1 below, shows that net borrowing in 2008/09 was £1,373m, £35m below expectations in February 2009. This movement is due to slippage in the general fund element of the capital programme and short-term temporary fluctuations in year-end balances.

Table 1

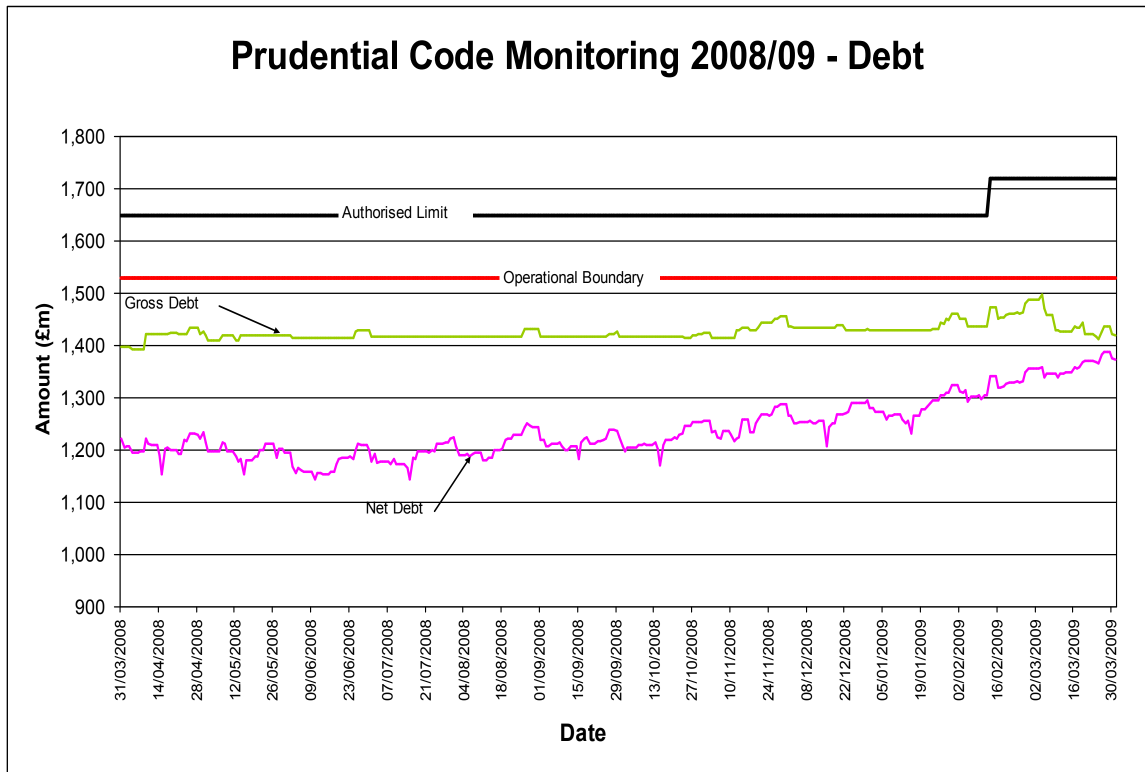
ANALYSIS OF BORROWING 2008/09		2008/09 Feb 09 £m	2008/09 This Report £m
Net Borrowing at 1 April		1,222	**1,222**
New Borrowing for the Capital Programme – Non HRA		128	**87**
New Borrowing for the Capital Programme – HRA		33	**30**
Debt redemption costs charged to Revenue (Incl HRA)		(24)	**(24)**
Reduced/(Increased) level of Revenue Balances		49	**58**
Net Borrowing at 31 March*		1,408	**1,373**
Capital Financing Requirement (Maximum Net Debt)		1,564	**1,521**
* Comprised as follows			
Long term borrowing	Fixed	1383	**1,292**
	Variable (less than one year)	40	**0**
	New Borrowing	31	**0**
Short term Borrowing		7	**127**
Total External Borrowing		1,461	**1,419**
Less Investments		53	**46**
Net External Borrowing		1,408	**1,373**
% borrowing funded by short term and variable rate loans		5%	**9%**

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 £27m on year-end debtors and creditors and £31m on the level of revenue balances. £26m 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.

3.1.3 Graph 1, below shows the level of debt during 2008/09 and its comparison with the prudential limits in operation during the year. 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 2008/09. 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.

Graph 1



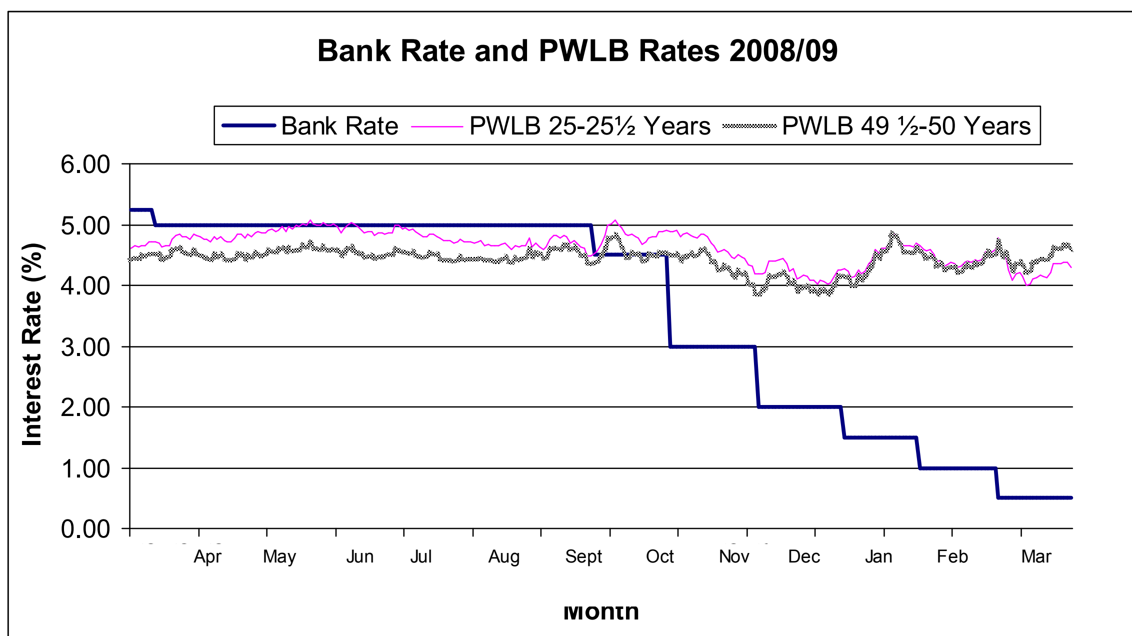
3.1.4 Graph 1 also shows that the Authorised Limit (Prudential Indicator 10) was increased as reported to Executive Board in February 09, and the Operational Boundary (Prudential Indicator 11) remained unchanged throughout the year. The outturn position on all prudential Indicators is shown in Appendix A.

3.1.5 The financial crisis of the past year has been described as the most turbulent since the great depression of the 1930s. The banking crisis has now infected the general economy to such an extent that it has taken an international coordinated approach on monetary and fiscal fronts to fight the threat of deflation and depression. The world economy has suffered a serious blow and is still in recovery. Its recovery will take a considerable amount of time, before stability returns to both the financial sector and the wider economy.

3.1.6 It has been a very eventful year within the financial markets and Appendix D charts the unfolding credit crunch crisis throughout the year showing what actions were taken around the world to stem the problems that were unraveling from the initial exposure to sub prime debt in America.

3.1.7 Graph 2 below shows the PWLB 45-50 year rate started the year at 4.43% (25 year at 4.62%) and was then generally within a band of 4.3 - 4.6% (4.6% - 5.0%) until mid October when there was a spike up to 4.84% (5.08%) followed by a plunge down to 3.86% (4.03) in December with the year closing out at 4.58% (4.28%). It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year. The graph also depicts how the bank rate plunged to an all time low of 0.50%.

Graph 2



3.1.8 Monitoring of long term interest rates has presented an opportunity to restructure £151.14m of PWLB loans as shown in Table 2 to generate current and future year revenue savings.

Table 2

Rescheduling 2008/09									
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
						16/02/09	20	1	0.65
28/01/09	5.74	7.75	4.40	3.8					
28/01/09	4	7.375	4.40	2.4					
28/01/09	30	4.20	4.41	-1.2					
28/01/09	25	4.20	4.42	-1.1					
28/01/09	20	4.05	4.42	-1.4					
28/01/09	27	4.25	4.46	-1.1					
28/01/09	18	4.25	4.45	-0.7					
28/01/09	21.4	4.30	4.46	-0.7					
Sub Total	**151.14**			**0**			**50**		
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	**176.14**			**0**			**70**		

3.1.9 Monitoring of market conditions has generated savings of £6.6m of which £1.2m were assumed in the budget. These saving were reported in the Revenue Outturn report to Executive Board on 17th June 2009. The savings have been generated by taking prudent advantage of elevated investment returns as a result of the credit crunch and through restructuring of long term debt into short term funding at historic low rates.

3.1.10 To meet the borrowing requirement for 2008/09, new loans of £95m were taken in 2007/08. 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 on 09/04/08 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 without penalty.

3.1.11 Members will recall from previous Treasury Management Reports that the ability to make premature repayments on PWLB loans has been reduced by the introduction of early penalty repayment rates. However increased volatility in the money markets presented the opportunity to prematurely repay £151.14m of PWLB loans as shown in Table 2 to generate current and future year revenue savings. These loans have been funded by maturing investments thus reducing counterparty risk, a 1 year PWLB loan at 0.65% and taking advantage of short term borrowing at historic low rates.

3.1.12 The opportunity to borrow £15m of the 2009/10 funding requirement in advance was taken, enabling funds to be invested out until required. In doing so the Council was able to take advantage of temporary higher interest rates on deposits as a result of the credit crunch. Details are shown in Table 3.

Table 3

Pre Funding for 2009/10 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
12/11/08	PWLB	15	4.5	3.59

3.1.13 Total long term borrowings undertaken in 2008/09 amounted to £70m compared to £754m in 2007/08 and £857m in 2006/07. Combined with total repayments of £176.14m, total turnover of long-term borrowing amounted to over £246.14m in 2008/09, a substantial reduction when compared to the 2007/08 figure of £1.4bn.

3.2 Interest Rate Performance

3.2.1 The average rate of interest paid on the Council's external debt for 2008/09 was 4.35% compared with 4.51%, 4.78%, 5.35% and 5.67% in 07/08, 06/07, 05/06 and 04/05 respectively. The average interest rate in 2007/08 was the lowest of all Metropolitan Councils as shown in Appendix B. Appendix C analyses debt as at 31st March 2009 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.

3.3 Prudential Indicators 2009/10

3.3.1 The continuing volatility within the financial and money markets altered significantly the shape of the interest rate yield curve. Opportunities now exist to borrow money in shorter period where the rates of interest payable are significantly below long term interest rates. To enable the Council to take advantage of these opportunities it is proposed to alter some of the prudential indicators for 2009/10 as are outlined below.

Maturity Structure of Fixed Rate Borrowing

3.3.2 The Council is required to set upper and lower limits for the maturity structure of its borrowings. This is designed to limit the risk of exposure to high interest rates by restricting the level of maturing debt in any given year. The limits represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

3.3.3 The unprecedented volatility in the money markets, coupled with historic low interest rates for short dated maturities has presented a number of opportunities to restructure long term debt into the short dated maturities. However the scope to place monies in these shorter dates is governed by Prudential Indicator 16 as shown below.

Maturity structure of fixed rate borrowing during 2008/09	Lower Limit	Cumulative Upper Limit
under 12 months	0%	30%
12 months and within 24 months	0%	30%
24 months and within 5 years	0%	40%
5 years and within 10 years	0%	50%
10 years and above	30%	90%

3.3.4 To take advantage of historic low short dated rates and a further tightening within some of the early narrow bands it is recommended that the following revised profile be adopted:

Maturity structure of fixed rate borrowing during 2009/10	Lower Limit	Upper Limit	Cumulative Upper Limit
under 12 months	0%	10%	10%
12 months and within 24 months	0%	10%	20%
24 months and within 5 years	0%	30%	50%
5 years and within 10 years	0%	25%	75%
10 years and above	25%	90%	90%

Recommended: Upper and Lower limits on fixed rate maturity structure as above.

Upper Limit for sums invested for over 364 Days

3.3.5 With the introduction of the Prudential Code in April 2004, Councils with external debt are allowed to hold investments for more than 364 days, a freedom not previously allowed. The Prudential code requires that Councils set limits on investments for periods longer than 364 days. This limit was increased from £100m to £150m in 2007/08 to facilitate borrowing in advance of need.

3.3.6 Currently the Council has external investments of £25m over 364 days which are all with UK clearing banks. A combination of reduced future capital programme requirements, increased investment counter party risk and historic temporary low borrowing rates mean that it is now prudent to reduce the upper limit to levels

back to £100m for 2009/10. Setting a new lower limit of £100m allows the Council flexibility to gain access to investment returns if market sentiment and counter-party risk changes.

Recommended: Upper limit on sums invested for periods longer than 364 days:

Total principal sum invested for a period longer than 364 days	**2009/10 £m**
Upper limit	100

3.4 Recommendations following the Collapse of Icelandic Banks

3.4.1 Following the collapse of the Icelandic banks, a number of reports have been produced with new recommendations and guidance for Local Authorities. Reports have been produced by the Audit Commission, CIPFA and the Communities and Local Government (CLG) Select Committee. The Audit Commission report concerns itself largely with its own auditing procedure and so is not directly relevant to our operations. Many of the recommendations in the other two reports endorse the working procedures, debt/investment risk decisions and reporting framework that the Council already has in place. Some of the recommendations relate to changes in the CIPFA Treasury Management Code of Practice which if adopted, will be implemented by the Council. The full conclusions and recommendations of the three reports are included in Appendix E.

3.4.2 In view of the nature of these reports it is recommended that Executive Board refer the recommendations made in the CIPFA Treasury Management Panel Bulletin and the CLG Select to the Central and Corporate Functions Scrutiny Board and Corporate Governance and Audit Committee for further consideration.

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 2008/09 seeks approval in accordance with the code.

4.3 Any changes proposed to the borrowing limits require the approval of Full Council and Executive Board are requested to recommend changes in respect of two indicators.

5 Legal And Resource Implications

5.1 The treasury management annual report for 2008/09 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 17th June 2009.

6 Conclusions

6.1 The treasury management annual report 2008/09 details the transactions undertaken in 2008/09 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.

6.2 Due to the ongoing volatility in the financial and money markets it is proposed to change two of the prudential indicators from 2009/10 onwards governing the levels of investments that can be held over 364 days and the amount of fixed debt that can be held in different maturity periods. The latter enables the Council to take advantage of historic low short term interest rates with prudent levels of risk.

7 Recommendations

That Executive Board:

7.1 Note the treasury management outturn position for 2008/09.

7.2 Refer the recommendations of the CIPFA Treasury Management Panel Bulletin and the CLG Select Committee to the Central and Corporate Functions Scrutiny Board and the Corporate Governance and Audit Committee for further consideration.

7.3 Recommend to full Council the limits of fixed debt from 2009/10 onwards that are held in different periods as outlined in paragraph 3.3.4

7.4 Recommend to full Council the upper limit on sums invested for periods longer than 364 days for 2009/10 as outlined in paragraph 3.3.6

Associated documents:

a) Treasury Management Strategy 2008/09 - Executive Board 8th February 2008.
b) Treasury management Update 2008/09 – Executive Board 5th November 2008.
c) Treasury Management Strategy 2009/10 – Executive Board 13th February 2009.
d) Local Authority Investments CLG Select Committee 11th June 2009
e) Treasury Management in Local Authorities – Post Icelandic Banks Collapse – CIPFA Treasury Management Panel Bulletin March 2009.
f) Risk and Return – English Local Authorities and the Icelandic Banks – Audit Commission March 2009.

Appendix A

Leeds City Council - Prudential Indicators 2008/09

No.	PRUDENTIAL INDICATOR	Feb 08 Report	Feb 09 Report	Outturn (This Report)
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	8.14%	7.76%	7.54%
2	HRA	13.47%	14.64%	14.31%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	48.67	57.25	57.78
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	235,947	235,593	198,861
7	HRA	164,253	104,646	116,802
	TOTAL	400,200	340,239	315,663
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	679,693	775,789	735,264
9	HRA	748,000	788,375	785,489
	TOTAL	1,427,693	1,564,164	1,520,753

No.	PRUDENTIAL INDICATOR	2008/09		
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 4)**			
	borrowing	1,600,000	1,720,000	1,720,000
	other long term liabilities	40,000	40,000	40,000
	TOTAL	1,640,000	1,760,000	1,760,000
11	**Operational boundary - (Note 4)**			
	borrowing	1,460,000	1,530,000	1,530,000
	other long term liabilities	30,000	30,000	30,000
	TOTAL	1,490,000	1,560,000	1,560,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	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)			

No.	Maturity structure of fixed rate borrowing during 2008/09	Lower Limit	Cumulative Upper Limit	Actual 31/03/2009
16	under 12 months	0%	30%	2%
	12 months and within 24 months	0%	30%	9%
	24 months and within 5 years	0%	40%	21%
	5 years and within 10 years	0%	50%	4%
	10 years and above	30%	90%	64%

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 09 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.**

Appendix B

Average Rate of External Debt 2007/08			
Authority Name	**Rank**	**Total Debt at 31.3.08 £m**	**Gross Average Rate of Interest on Total Debt 2007/08 %**
Leeds	**1**	**1,222**	**4.51**
Sunderland	2	204	4.61
Walsall	3	238	4.62
Tameside	4	179	4.91
Solihull	5	205	4.93
Sefton	6	126	5.00
Bolton	7	395	5.06
Stockport	8	248	5.18
Wolverhampton	9	461	5.26
Calderdale	10	116	5.35
St Helens	11	115	5.57
Liverpool	12	844	5.65
Doncaster	13	335	5.65
Wakefield	14	243	5.67
Kirklees	15	556	5.70
Oldham	16	424	5.71
Newcastle upon Tyne	17	756	5.80
Weighted Average			**5.84**
Trafford	18	102	5.96
Wirral	19	291	6.02
Dudley	20	436	6.14
Salford	21	551	6.20
Rotherham	22	483	6.24
Manchester	23	785	6.32
Birmingham	24	1,948	6.50
Sheffield	25	954	6.53
Gateshead	26	376	7.03
Wigan	27	367	7.29
Barnsley	no return		
Bradford	no return		
Bury	no return		
Coventry	no return		
Knowsley	no return		
North Tyneside	no return		
Rochdale	no return		
Sandwell	no return		
South Tyneside	no return		

Source: CIPFA Capital Expenditure and Treasury Management Statistics 2007-08

Debt as at 31st March 2009 — Appendix C

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

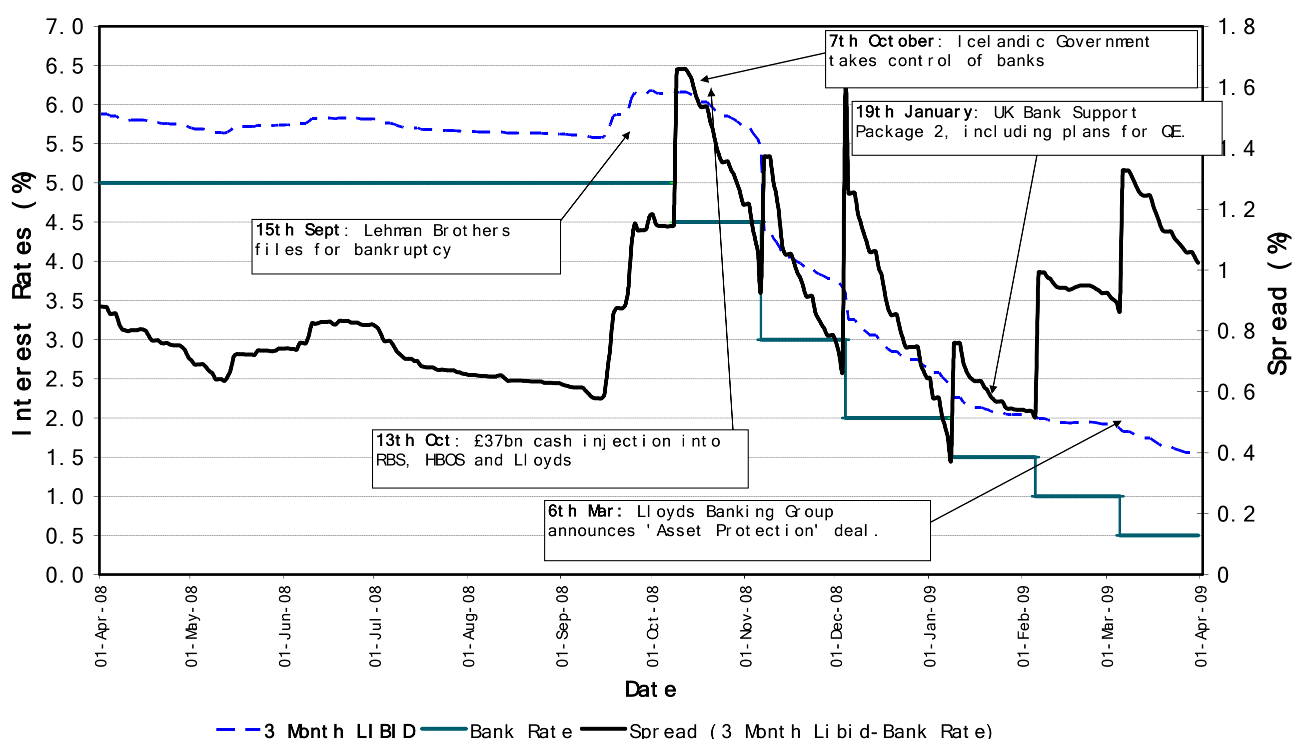
Year Ending 31st March	to 4%	4% to 4.99%	5% to 5.99%	6% to 6.99%	7% to 7.99%	Greater Than 8%	Principal
Fixed Rate Loans - LOBO to First Option							
2010	60,000	55,000	-	-	-	2	115,002
2011	30,000	80,000	-	-	-	-	110,000
2012	15,000	65,000	-	-	-	-	80,000
2013	20,000	40,000	-		-	-	60,000
2014	15,000	95,000	-	-	-	-	110,000
2015	-	25,000	-	-	-	-	25,000
2016	10,000	15,000	-	-	-	-	25,000
2017	-	-	-	-	-	-	-
2018	-	-	-	-	-	-	-
2020	-	-	-	-	-	-	-
2022	-	-	-	-	-	-	-
2024	-	-	-	-	-	-	-
2025	-	-	-	-	-	-	-
2026	-	-	-	-	-	-	-
2027	-	-	-	-	-	-	-
2028	-	-	-	-	-	-	-
2034	-	-	-	-	-	-	-
2035	-	-	-	-	-	-	-
2043	-	-	-	-	-	-	-
2049	-	-	-	-	-	-	-
2050	-	-	-	-	-	-	-
2051	-	-	-	-	-	-	-
2052	-	78,600	-	-	-	-	78,600
2053	-	180,000	-	-	-	-	180,000
2054	-	83,000	-	-	-	-	83,000
2055	-	86,000	-	-	-	-	86,000
2056	-	76,230	-	-	-	-	76,230
2057	-	131,000	-	-	-	-	131,000
2058	-	116,000	-	-	16,000	-	132,000
Sub Total	**150,000**	**1,125,830**	**-**	**-**	**16,000**	**2**	**1,291,832**
Temporary Loans							
2010	127,429	-	-	-	-	-	127,429
Sub Total	**127,429**	**-**	**-**	**-**	**-**	**-**	**127,429**
CABP	**277,429**	**1,125,830**	**-**	**-**	**16,000**	**2**	**1,419,261**
Memo : LOBO Variable Rate Loans to Maturity							
2044	-	-	-	-	-	-	-
2055	5,000	15,000	-	-	-	-	20,000
2056	10,000	50,000	-	-	-	-	60,000
2066	10,000	50,000	-	-	-	-	60,000
2067	55,000	15,000	-	-	-	-	70,000
2077	50,000	15,000	-	-	-	-	65,000
2078	-	140,000	-	-	-	-	140,000
2079	-	20,000					20,000
Sub Total	**130,000**	**305,000**	**-**	**-**	**-**	**-**	**435,000**

LOBO's Shown at Maturity in Bottom Memo Section.
LOBO's included in main section at next option date. (Highlighted)

Appendix D

The Financial Crisis – " The Credit Crunch"

1. The following graph shows the major events of the financial year and the impact they had on both PWLB and investment rates. The financial crisis, commonly known as the 'credit crunch', had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England.



2. On 1st April 2008 Bank Rate was 5% and the Bank of England was focused on fighting inflation. Market fears were that rates were going to be raised as CPI, the Government's preferred inflation target, was well above the 2% target. As a result elevated investment levels were available. The money markets were also reflecting some concerns about liquidity at this time and, as shown in the graph, the spread between Bank Rate and 3 month LIBOR was greater than had historically been the case.

3. This phase continued throughout the summer until the 15th September when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. As can be seen from the

charts this also led to an immediate spike up in investment rates as markets grappled with the implications this might have on other financial institutions, their credit standing and indeed their viability. On 7th October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. The Monetary Policy Committee meantime had reduced interest rates by 50bp on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out. On the other hand the short end of the PWLB fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower.

4. Market focus now shifted from inflation concerns to concerns about recession, depression and deflation. Although CPI was still well above target it was seen as no barrier to interest rates being cut further. The MPC further cut interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities. In December as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates to 2%-a drop this time of 1%. The whole interbank yield curve shifted downwards but the 'disconnect' at the short end remained very wide, negating to some degree the impact of the cuts in Bank Rate. 50 year PWLB rates dropped below 4% at the turn of the year, marking the low point, as it turned out, in this maturity.

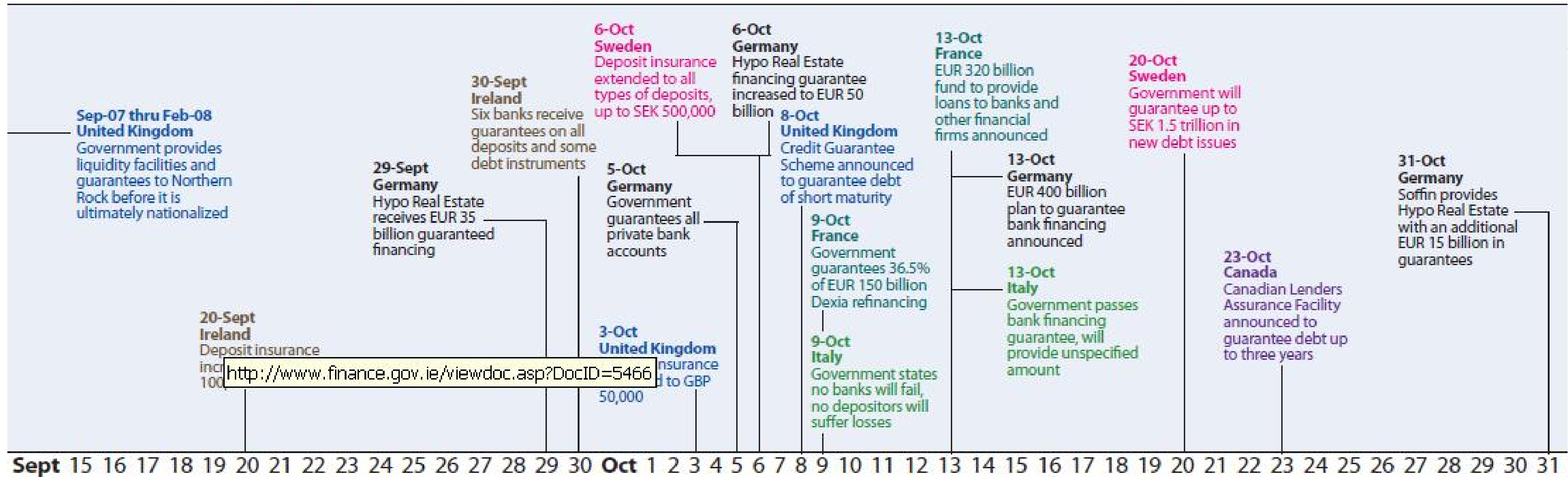
5. 2009 brought little relief to the prevailing sense of crisis and on 8th January the MPC reduced rates by 0.5% to 1.5%, a record low. More Government support for the banking sector was announced on 19th January 2009. The debt markets had a sharp sell-off at this stage as they took fright at the amount of gilt issuance likely to be needed to finance the help provided to the banks. There was also discussion about further measures that could be introduced to kick start lending and economic activity. These included quantitative easing by the Bank of England, effectively printing money.

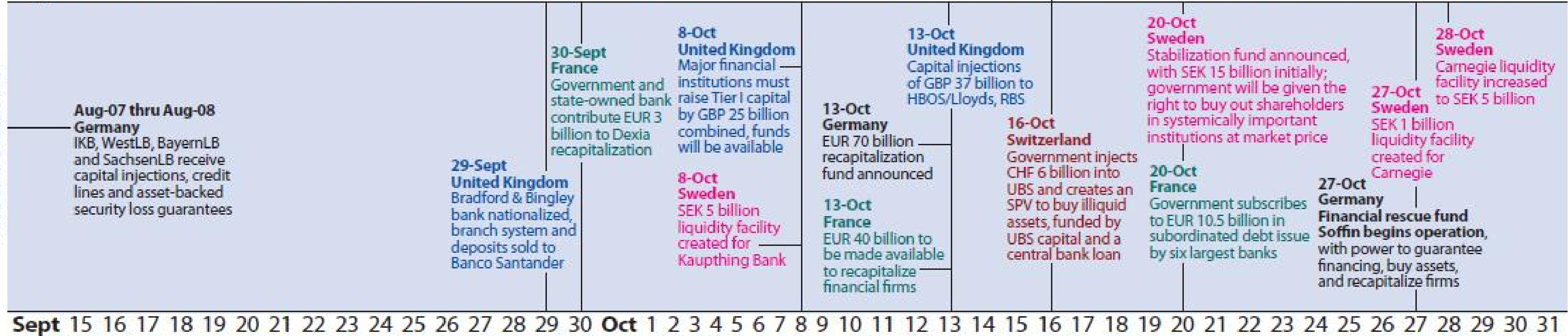
6. In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Interbank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The MPC cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. This scheme would focus on buying up to £75bn of gilts in the 5-25 year maturity periods and £10 -15bn of corporate bonds. This led to a substantial rally in the gilt market, particularly in the 5 and 10 year parts of the curve, and PWLB rates fell accordingly. Finally at the end of March it was announced that the Dunfermline Building Society had run into difficulties and its depositors and good mortgages were taken over by Nationwide whilst the Treasury took on its doubtful loans.

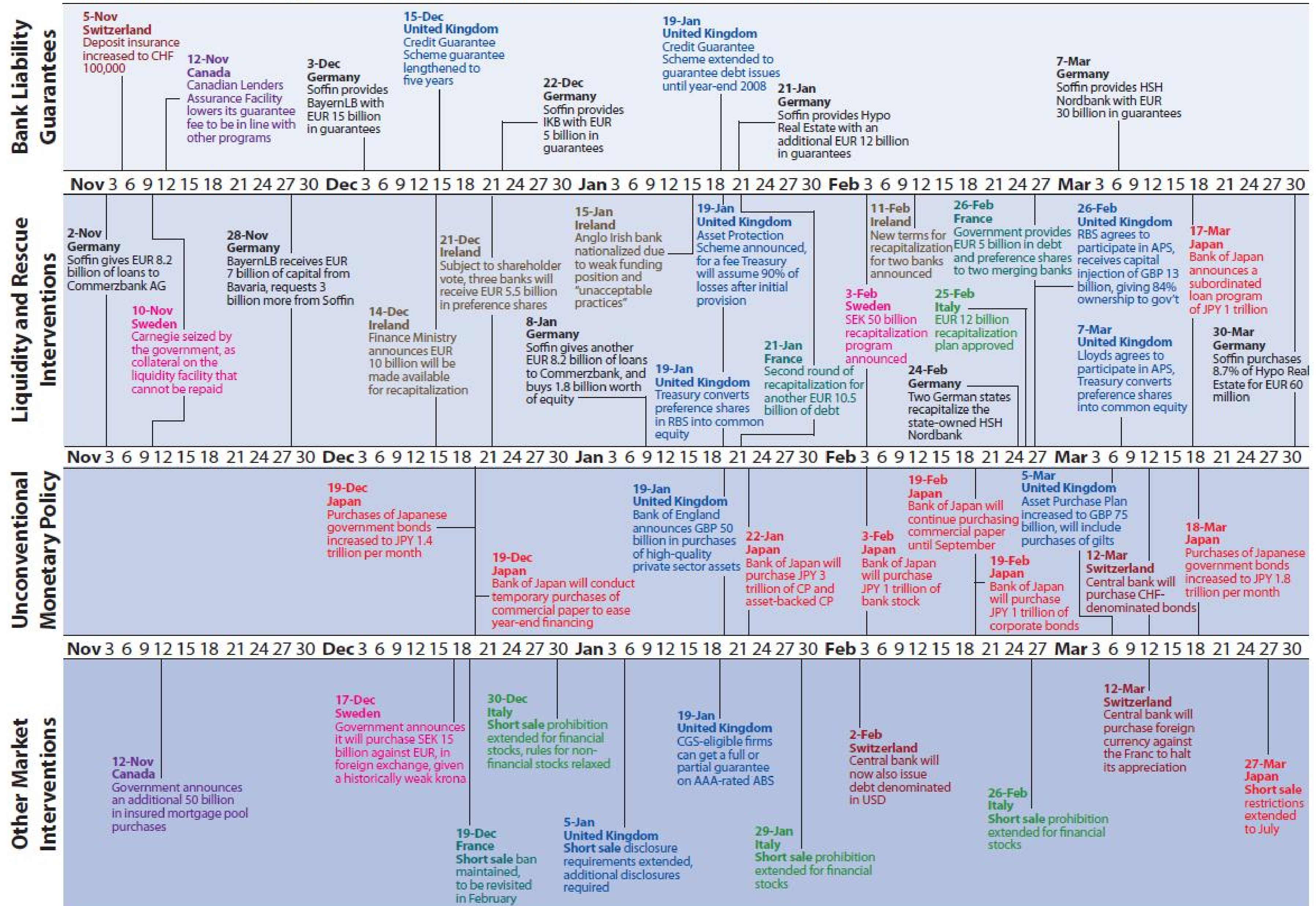
7. The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place. Investment income returns have been badly hit but lower borrowing rates in short to medium periods had allowed indebted local authorities to benefit.

8. The following timeline shows the international response to the financial crisis.

International Responses to the Crisis Timeline (Sept 2008 - Oct 2008)





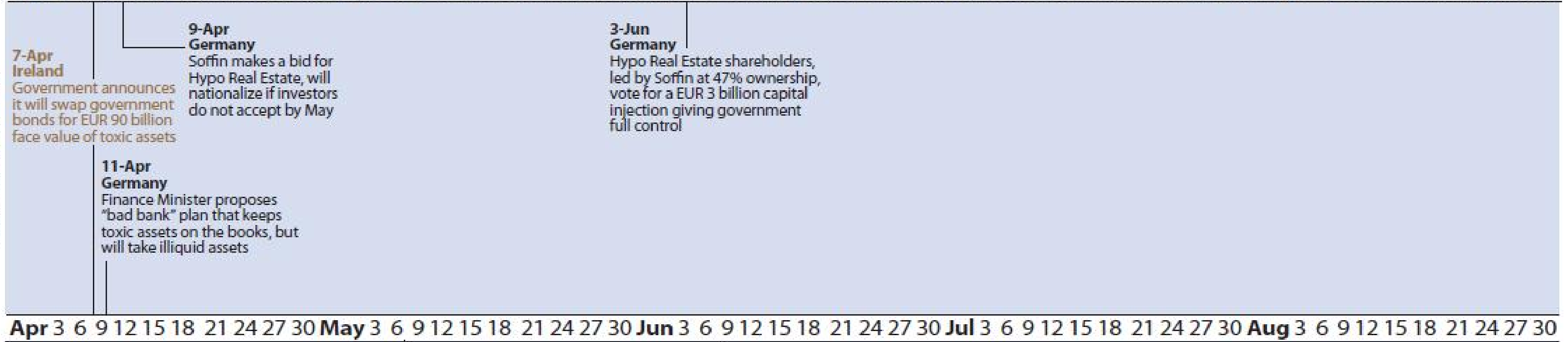


International Responses to the Crisis Timeline (Nov 2008 - Mar 2009)
Bank Liability Guarantees
5-Nov Switzerland Deposit insurance increased to CHF 100,000
12-Nov Canada Canadian Lenders Assurance Facility lowers its guarantee fee to be in line with other programs
3-Dec Germany Soffin provides BayernLB with EUR 15 billion in guarantees
15-Dec United Kingdom Credit Guarantee Scheme guarantee lengthened to five years
22-Dec Germany Soffin provides IKB with EUR 5 billion in guarantees
19-Jan United Kingdom Credit Guarantee Scheme extended to guarantee debt issues until year-end 2008
21-Jan Germany Soffin provides Hypo Real Estate with an additional EUR 12 billion in guarantees
7-Mar Germany Soffin provides HSH Nordbank with EUR 30 billion in guarantees
Nov 3 6 9 12 15 18 21 24 27 30 Dec 3 6 9 12 15 18 21 24 27 30 Jan 3 6 9 12 15 18 21 24 27 30 Feb 3 6 9 12 15 18 21 24 27 Mar 3 6 9 12 15 18 21 24 27 30
Liquidity and Rescue Interventions
2-Nov Germany Soffin gives EUR 8.2 billion of loans to Commerzbank AG
10-Nov Sweden Carnegie seized by the government, as collateral on the liquidity facility that cannot be repaid
28-Nov Germany BayernLB receives EUR 7 billion of capital from Bavaria, requests 3 billion more from Soffin
14-Dec Ireland Finance Ministry announces EUR 10 billion will be made available for recapitalization
21-Dec Ireland Subject to shareholder vote, three banks will receive EUR 5.5 billion in preference shares
15-Jan Ireland Anglo Irish bank nationalized due to weak funding position and "unacceptable practices"
8-Jan Germany Soffin gives another EUR 8.2 billion of loans to Commerzbank, and buys 1.8 billion worth of equity
19-Jan United Kingdom Asset Protection Scheme announced, for a fee Treasury will assume 90% of losses after initial provision
19-Jan United Kingdom Treasury converts preference shares in RBS into common equity
21-Jan France Second round of recapitalization for another EUR 10.5 billion of debt
3-Feb Sweden SEK 50 billion recapitalization program announced
11-Feb Ireland New terms for recapitalization for two banks announced
25-Feb Italy EUR 12 billion recapitalization plan approved
24-Feb Germany Two German states recapitalize the state-owned HSH Nordbank
26-Feb France Government provides EUR 5 billion in debt and preference shares to two merging banks
26-Feb United Kingdom RBS agrees to participate in APS, receives capital injection of GBP 13 billion, giving 84% ownership to gov't
7-Mar United Kingdom Lloyds agrees to participate in APS, Treasury converts preference shares into common equity
17-Mar Japan Bank of Japan announces a subordinated loan program of JPY 1 trillion
30-Mar Germany Soffin purchases 8.7% of Hypo Real Estate for EUR 60 million
Nov 3 6 9 12 15 18 21 24 27 30 Dec 3 6 9 12 15 18 21 24 27 30 Jan 3 6 9 12 15 18 21 24 27 30 Feb 3 6 9 12 15 18 21 24 27 Mar 3 6 9 12 15 18 21 24 27 30
Unconventional Monetary Policy
19-Dec Japan Purchases of Japanese government bonds increased to JPY 1.4 trillion per month
19-Dec Japan Bank of Japan will conduct temporary purchases of commercial paper to ease year-end financing
19-Jan United Kingdom Bank of England announces GBP 50 billion in purchases of high-quality private sector assets
22-Jan Japan Bank of Japan will purchase JPY 3 trillion of CP and asset-backed CP
3-Feb Japan Bank of Japan will purchase JPY 1 trillion of bank stock
19-Feb Japan Bank of Japan will continue purchasing commercial paper until September
19-Feb Japan Bank of Japan will purchase JPY 1 trillion of corporate bonds
5-Mar United Kingdom Asset Purchase Plan increased to GBP 75 billion, will include purchases of gilts
12-Mar Switzerland Central bank will purchase CHF-denominated bonds
18-Mar Japan Purchases of Japanese government bonds increased to JPY 1.8 trillion per month
Nov 3 6 9 12 15 18 21 24 27 30 Dec 3 6 9 12 15 18 21 24 27 30 Jan 3 6 9 12 15 18 21 24 27 30 Feb 3 6 9 12 15 18 21 24 27 Mar 3 6 9 12 15 18 21 24 27 30
Other Market Interventions
12-Nov Canada Government announces an additional 50 billion in insured mortgage pool purchases
17-Dec Sweden Government announces it will purchase SEK 15 billion against EUR, in foreign exchange, given a historically weak krona
19-Dec France Short sale ban maintained, to be revisited in February
30-Dec Italy Short sale prohibition extended for financial stocks, rules for non-financial stocks relaxed
5-Jan United Kingdom Short sale disclosure requirements extended, additional disclosures required
19-Jan United Kingdom CGS-eligible firms can get a full or partial guarantee on AAA-rated ABS
29-Jan Italy Short sale prohibition extended for financial stocks
2-Feb Switzerland Central bank will now also issue debt denominated in USD
26-Feb Italy Short sale prohibition extended for financial stocks
12-Mar Switzerland Central bank will purchase foreign currency against the Franc to halt its appreciation
27-Mar Japan Short sale restrictions extended to July

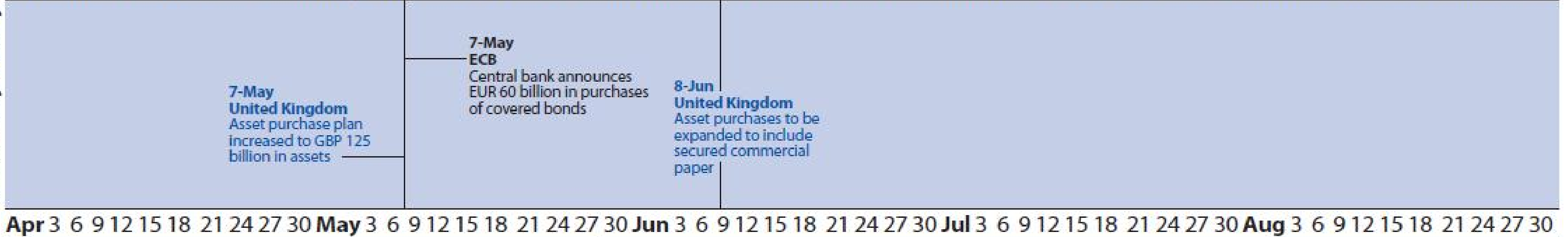
International Responses to the Crisis Timeline (Apr 2009 - Aug 2009)

Bank Liability Guarantees

Liquidity and Rescue Interventions



Unconventional Monetary Policy



Other Market Interventions

Appendix E

Report 1

Seventh Report From The Communities And Local Government Committee: Local Authority Investments: Session 2008-09: HC 164-1

Conclusions and recommendations

Local authorities' investments and reserves

1. We conclude that it would be inappropriate to seek to restrict local authorities' investment options. Although interest rates are now at historically low levels, returns on investments are usually an important source of local authorities' revenues and investment by local authorities an element in the health of the UK financial sector. The primary consideration of local authority investment, as emphasised by CIPFA, should remain security and liquidity; but yield should not be neglected. The risk involved in seeking yield should be mitigated by robust and responsive Codes, guidelines and best practice. (Paragraph 37)

Local authorities' financial teams

2. We endorse the Audit Commission's censure of these rudimentary mistakes in organisations responsible for investing large amounts of public money. However, as the Commission's research has found, those seven authorities were not necessarily the only local authorities at fault. (Paragraph 42)

3. It is obvious from our written evidence, and from the research carried out by the Audit Commission, that there are some local authorities with excellent treasury management services, but there are also local authorities with a less effective service. One of the objectives of the CIPFA Codes and Codes of Practice should be to ensure that all local authorities are aware of the level of expertise which is necessary to run a successful treasury management operation, and have all the checks and balances in place to ensure adequate monitoring, on an ongoing basis, of both the framework within which its treasury management team operates and the individual decisions which are made on a day-to-day basis. (Paragraph 49)

4. We recommend that the Government, CIPFA and the LGA study ways in which local authorities, particularly smaller ones, could join together to share expertise and pool treasury management resources. The sharing of information and expertise, such as identifying banks that are in the same financial group, might have lessened the failures that occurred during the Icelandic crisis. (Paragraph 56)

Scrutiny of the treasury management function

5. We endorse the Minister's suggestion and recommendations by CIPFA and the Audit Commission that all local authorities should have an Audit Committee with specific responsibility for the scrutiny of the treasury management function. Guidance to local authorities to that effect should be given through appropriate amendment to the CIPFA Codes. (Paragraph 68)

6. Members of audit committees need to take their responsibilities for that scrutiny seriously and need to ensure that they are properly trained. The CIPFA Treasury Management Code of Practice should make explicit the need for specific training in treasury management to be undertaken by those Councilors with responsibility for overseeing treasury management

arrangements, and the Audit Committee should be charged with ensuring that it is available and with monitoring its adequacy. (Paragraph 69)

7. Guidance from CIPFA notes that it is open to an authority to appoint someone other than an elected member and from outside the authority either to serve on or to chair the audit committee. The co-option of external members to audit committees in this manner offers an additional opportunity to local authorities to enhance the expertise available to the authority in the scrutiny of its treasury management function, and we encourage all local authorities to consider taking advantage of it. (Paragraph 70)

8. Whether a local authority has an Audit Committee or not, elected members should ensure that they pay proper attention to scrutiny of the Annual Investment Strategy (AIS), and of the decisions which are taken under it. We recommend that CIPFA, in reviewing its Codes, consider what further guidance is necessary to local authorities to ensure that elected members are given—and take—appropriate opportunities to scrutinise their AIS. We also recommend that CIPFA develop and include in its revised Codes more rigorous requirements for reporting to elected members on decisions taken by officials under the AIS. (Paragraph 71)

Credit rating agencies

9. The lack of information about the appropriate use of credit ratings in the Government guidance and in the CIPFA Codes is an omission. Some local authorities have relied too heavily on credit ratings, without appreciating that they should be viewed within the context of other financial and economic information and advice. We welcome the new guidance from the CIPFA Treasury Management Panel, but believe that there is room to go further. We recommend that the Government revise the informal commentary on its statutory guidance, to include information about the appropriate use of credit ratings. We also recommend that the CIPFA Codes include guidance to local authorities on the nature of credit ratings, highlighting the risks of over-reliance on them. Credit ratings should not be used in isolation as a justification for the soundness of an investment and local authorities should be made aware of the fact that credit ratings should be viewed within the context of wider financial and economic information and advice. (Paragraph 81)

Treasury management advisors

10. Responsibility for local authorities' investment decisions lies, and must continue to lie, with the local authorities themselves. However, the claim by some treasury management advisers that they give information only, not advice, on investment counterparty creditworthiness to local authorities is, in our view, misleading. (Paragraph 99)

11. The involvement of treasury management advisers in local authority treasury management will only be valuable if local authorities understand the level of service they require, and if the advisers themselves are clear about the level of service they are providing. Treasury management advisers must decide, define and communicate what services they are providing clients, particularly in relation to the provision of "information" and/or "advice". The local authority itself nevertheless remains ultimately responsible for any investment made, and CIPFA should warn local authorities about over-reliance on treasury management advisers, whose services have been shown to be variable and, in some cases, inadequate. (Paragraph 100)

12. We recommend that the Audit Commission carry out a value for money study of the services that local authorities have received from treasury management advisers, with a view

to advising local government on the value that they offer in the differing circumstances applying to individual authorities. Paragraph 101)

13. We recommend that the CIPFA Codes give more detailed advice to local authorities on the services which they may expect to receive from treasury management advisers, and how to use them effectively. The guidance should make clear that such advisers may give varying types and levels of information or advice. (Paragraph 105)

14. The Financial Services Authority (FSA) should take a more active role in the regulation of treasury management advisers. The evidence which we have examined has raised concerns about potential conflicts of interest and questions as to whether there are any financial transactions between treasury management advisers and brokers that might compromise the independence of advice being given to local authorities. There is a strong case for a full investigation by the FSA of the services provided by local authority treasury management advisers. We recommend that such an investigation be carried out as soon as possible. (Paragraph 120)

15. Our examination of the role of treasury management advisers in the Icelandic debacle has raised wider questions about their influence on local authorities' treasury management practice. First, there is confusion, and perhaps some deliberate ambiguity, about what services they offer. It is clear to us that some local authorities believed that they could place reliance on their treasury management advisers in a way that some of the treasury management advisers themselves now seek to argue was misguided. Second, there is concern about the independence of treasury management advisers that may be part of companies that will benefit from the investment decisions of the local authorities that they advise. Third, there is a lack of clarity about the extent to which local authorities can assume that treasury management advisers are properly regulated. While local authorities must ultimately take responsibility for their investment decisions, a range of regulatory and advisory bodies appear to us to have been complacent in their approach to the role of treasury management advisers. The Audit Commission, CIPFA and the FSA must all re-examine the role and reliability of treasury management advisors and their discharge of duties of care for local authorities in managing this aspect of treasury management. (Paragraph 121)

Report 2

The Audit Commission

16. Notwithstanding the Audit Commission's disclaimers about what auditors can and cannot do, the guidance issued after the Icelandic banking collapse shows that there *were* questions that auditors could properly have asked to ensure that local authorities were following agreed treasury management procedures. If the Audit Commission's auditors had followed this guidance as normal practice before the Icelandic banking collapse, local authorities might have been alerted to some of the failures in treasury management procedure which, in some cases, led to funds being put at risk. (Paragraph 132)

17. The Audit Commission took it for granted that treasury management was a well managed function, and, consequently, was not an area of concern for auditors. Even if it could not reasonably have been expected to foresee the collapse of a country's entire banking system, the Audit Commission should have been aware of the greater risk to treasury management as a result of the prevailing financial climate and should have adjusted its practice accordingly. The Audit Commission
failed to realise that treasury management was becoming an increasingly risky area and, in that respect, it must share some of the blame for the potential loss of funds in the Icelandic

banks. If it had viewed treasury management within the increasingly volatile economic context, it would have put treasury management higher in its auditing procedures, and if it had done that, it is possible that less public money would now be at risk. We recommend that the Audit Commission review its own auditing procedure and prioritisation of the areas of local authority activity it chooses to audit, in order to ensure that such complacency does not happen in future. (Paragraph 135)

Report 3

The CIPFA Codes

18. We recommend that CIPFA add to the issues that need to be covered in a local authority's annual investment strategy (AIS) the use, or not, of an external advisor; schemes of delegation and the role of the Section 151 officer; and the use of and procedures regarding credit rating agencies. The guidance need not be prescriptive about the way in which the AIS should address these issues, but it should ensure that proper attention is paid to these previously under-scrutinised areas. (Paragraph 141)

Central Government and local authority treasury management

19. We welcome the Government's willingness, as expressed by the Minister for Local Government in evidence to us, to revise its approach to investment guidance, and we trust that it will look closely again at that guidance in the light of the conclusions of this Report, especially at the issues surrounding the use of credit ratings. However, the failures in treasury management identified by our inquiry and by the Audit Commission's work have for the most part occurred not because
of CLG's guidance, but because of local authorities not following the guidance properly. (Paragraph 145)

20. We agree with the Government's approach to assisting those local authorities that have funds at risk in the failed Icelandic banks, which we consider to be an appropriate way of protecting the council tax payer whilst avoiding the "moral hazard" inherent in an unconditional, open-ended guarantee of local authorities' investments. The Government will have to monitor closely the amount of money that local authorities eventually get back from Iceland to ensure that any actual losses do not seriously disadvantage either local council tax payers or local service uses. However, democratically accountable local authorities are ultimately responsible for their investments and it is they who should take the consequences - whether in the budget or at the ballot box - of their investment decisions. (Paragraph 152)

21. We seek reassurance that regular meetings at an appropriately senior level are held between the Audit Commission, the local authority associations, CIPFA and CLG to ensure that the treasury management system is kept under review. We also recommend that these meetings include links with the financial regulatory bodies—the Financial Services Authority and the Bank of England—to ensure consistent and up-to-date information is passed onto these bodies. (Paragraph 156)

22. The majority of stakeholders in treasury management agree that the cost of early repayment of debt to the PWLB needs to be reviewed. We add our voice to those recommending that the Government carry out an urgent review of the arrangements for early repayment of debt to the PWLB. (Paragraph 166)