Leeds
CITY COUNCIL

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Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 4th November 2009

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2009/10

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

Eligible for Call In √ | 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 2009/10.

2. The Council's level of external debt as at 31st March 2010 is anticipated to be £1,513m in line with the strategy that was approved in February 2009.

3. Monitoring of money and financial markets has enabled revenue savings of £7.3m to be made against £6.2m assumed in the budget. This is largely due to repaying long term debt and funding at short-term historic low rates. A further £0.9m of treasury savings are expected to materialise before the year end as a result of completing a MRP review, enabling total annual savings against the budget of £2m.

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 25th February 2009.

1.0 Purpose Of This Report

1.1 The 2009/10 treasury management strategy was approved by Executive Board on 13th February 2009. This report provides a review and update of the strategy for 2009/10.

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 2009/10 was approved by the Executive Board on 13th February 2009 and by full Council on 25th February 2009. This report provides Members with a review and update of the strategy for 2009/10.

3.0 Main Issues

3.1 ***Review of Strategy 2009/10***

3.1.1 The current borrowing forecasts are shown in Table 1.

Table 1

ANALYSIS OF BORROWING 2009/10 – 2011/12		**2009/10 This Report £m**	**2010/11 £m**	**2011/12 £m**
Net Borrowing at 1 April		1,373	1,513	1,575
New Borrowing for the Capital Programme – non HRA		144	81	91
New Borrowing for the Capital Programme – HRA		10	11	3
Debt redemption costs charged to Revenue		(25)	(29)	(31)
Reduced/(Increased) level of Revenue Balances		11	(1)	0
Net Borrowing at 31 March *		1,513	1,575	1,638
* Comprised as follows				
Long term Borrowing	Existing Fixed	1,294	1,326	1,398
	Existing Variable	30	110	55
	New Borrowing	112	62	63
Short term Borrowing		108	98	143
Total External Borrowing		1,544	1,596	1,659
Less Investments		31	21	21
Net External Borrowing		1,513	1,575	1,638
% Gross borrowing exposed to interest rate risk		16%	17%	16%
Capital Financing Requirement		1,650	1,712	1,774

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

3.1.2 Table 1 above shows that 2009/10 net external borrowing is now forecast at £1,513m in line with the report to Executive Board on 13th February 2008.

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3.1.3 Since the Treasury Management Annual Report 2008/09 to Executive Board in July, the level of volatility in the financial and money markets has continued to ease. There remains continuing uncertainty in the economy with mixed data relating to housing, fuel costs, GDP and inflation. The improving financial markets have led to strong equity rallies in the UK and abroad. Other major economies, including the US, have exited the recession and as a result Sterling has lost value as the UK recovery has lagged behind that of other economies.

3.1.4 There are signs of recovery in the UK economy with some sectors showing growth, however the fragility of the recovery with rising unemployment implies that the bank rate may stay lower for longer. At its meeting in August, the Monetary Policy Committee (MPC) increased the amount of asset purchases under the Bank's quantitative easing (QE) programme by £50bn to £175bn, but it has had limited success in boosting credit or money supply growth.

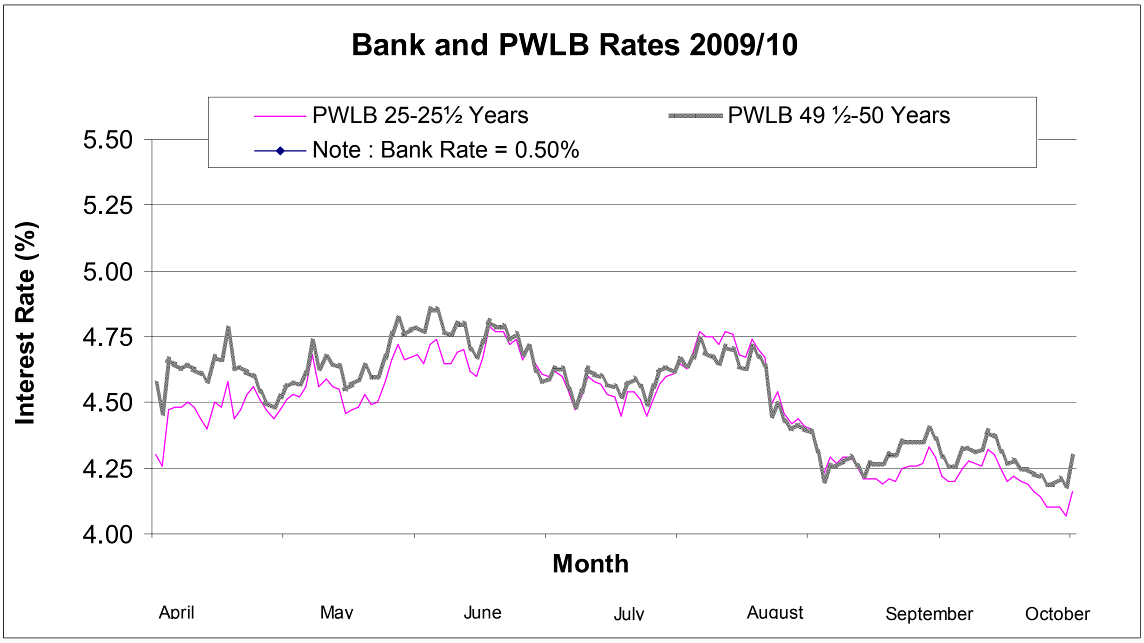
3.1.5 Net lending to businesses increased in August for the first month since March, however, the household sector as a whole reduced unsecured debt in August. Banks are likely to remain reluctant to lend while conditions in the labour market are still deteriorating. The claimant count rose by 25,200 in July and 24,400 in August. While these were smaller rises than in the first quarter, they were enough to take the claimant count above 1.6m, the highest level since Q2 1997.

3.1.6 Inflationary pressures in the economy eased further. CPI inflation has fallen to 1.1% in September, largely as a result of falls in the annual rate of food and utility price inflation. However, core inflation has risen at a higher rate when compared to other advanced economies. The rise most likely reflects the lagged impact of the pound's depreciation last year, and so should prove temporary. RPI inflation stands at -1.4%.

3.1.7 The most upbeat news was from the housing market. The Nationwide house price index rose 3.8% in Q2, the largest quarterly rise since Q2 2004. House prices by this measure are now only 13.5% below their peak. And while the Halifax measure remained more downbeat, it too posted increases in the quarter. However, the rise in house prices appeared to be largely driven by the scarcity of homeowners putting their homes up for sale, suggesting that the rises may therefore only be temporary

3.1.8 The UK bank rate has stood at a record low of 0.50% for 7 months and many economists forecast that the rate will not start to rise until towards the end of next year. The Council's own treasury management advisors do not see the bank rate rising until quarter 3 of 2010. Some economists conclude that they do not see rates rising to 4.5% for 5 years.

3.1.9 Since the February report both short and long term rates remain volatile. The following graph shows how long term rates have fluctuated between 4.18% and 4.85% for 50 year loans. Whilst current 50 year PWLB rates currently stand at 4.24%, the Council's advisors expect these rates to rise to 4.70% by the end of March 2010.



3.1.10 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. The PWLB have issued a consultation paper on views on whether the rates should be changed more frequently and whether the differential should be lowered. Views will be submitted before the deadline for the consultation of 08/01/2010.

3.1.11 In the Treasury Management annual report to Executive Board on 22/07/2009 members were updated on the rescheduling of £151.14m in 2008/09 of PWLB debt into short term debt. A similar exercise was undertaken in April where £88m of long dated debt (attracting an average interest rate of 4.36%) was repaid and funded through surplus cash balances and short term loans at less that 0.5%. To mitigate against future increases in interest rates and smooth volatility some of these loans (both 2008/09 and 2009/10) have been refinanced as shown in Table 2.

Table 2

Rescheduling2009/10							
Premature Repayments				New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
22/04/2009	46	4.30	4.77	30/06/2009	30	9	3.57
22/04/2009	27	4.35	4.77	30/06/2009	30	12	3.97
22/04/2009	15	4.55	4.77	10/08/2009	30	14	4.19
				10/08/2009	30	9	3.83
Sub Total	**88**				**120**		
LOBOs (Call date)				Market Loans			
				31/07/2009	5	1	0.55
				03/08/2009	5	1	0.55
				03/08/2009	5	1	0.55
				06/08/2009	5	1	0.55
				31/07/2009	2	2	1.50
				01/09/2009	3	2	1.50
				12/08/2009	10	2	1.55
				03/09/2009	5	2	1.40
				04/09/2009	5	1	0.55
Sub Total	**0**				**45**		
Total	**88**				**165**		

3.1.12 The rescheduling of debt through the continued monitoring of the financial and money markets has enabled savings of £7.3m to be made against £6.2m assumed in the budget. This is largely due to repaying long term debt and funding at short-term historic low rates. A further £0.9m of treasury savings are expected to materialise before the year end as a result of completing a MRP review, enabling total annual savings against the budget of £2m.

3.1.13 Nine market loans of a total value of £65m have not been called by the lenders and continue to run at their existing rates. The average rate of these loans is 4.01%

3.1.14 The forecast borrowing requirement for 2009/10 is now £127m of which £15m was pre-funded in 2008/09. Details were included in the Treasury Management strategy report 2009/10 considered by Executive Board on 13th February 2009, but are shown again in Table 3 for completeness. This leaves a borrowing requirement of £112m still to be arranged in 2009/10. The levels of capital programme slippage, cash reserves, economic conditions and short term interest rates will continue to be monitored before additional monies are borrowed.

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
		15		

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3.2 ***Borrowing Limits for 2009/10, 2010/11 and 2011/12***

3.2.1 The Council is required to set various limits for 2009/10, 2010/11 and 2011/12 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 2009/10 were approved by Council on 13th February 2009 and are set out below in Table 4.

Table 4

	2009/10 February 2009 £m	**2009/10 This Report £m**
Authorised Limits		
Borrowing	1,780	1,780
Other Long Term Liabilities	380	380
Total	**2,160**	**2,160**
Operational Boundary		
Borrowing	1,640	1,640
Other Long Term Liabilities	370	370
Total	**2,010**	**2,010**

3.2.3 It is anticipated that the authority will continue to remain within the authorised limits for 2009/10. 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. The limit for 2010/11 was reduced to £100m by Council on 16th September 2009. The limit from 2011/12 onwards remains unchanged at £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 continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns surplus monies will be invested in accordance with the 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.

3.4 *Recommendations following the Collapse of Icelandic Banks*

3.4.1 Members will recall from the Treasury Management Annual report 2008/09 that the recommendations made in the CIPFA Treasury Management Panel Bulletin and the CLG Select Committee be forwarded to the Central and Corporate Functions Scrutiny Board and Corporate Governance and Audit Committee for further consideration.

3.4.2 Formal observations from the reports will shortly be presented to the Central and Corporate Functions Scrutiny Board and Corporate Governance and Audit Committee. The outcome of which will be reported back in future Treasury Management strategy updates.

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 2009/10 was approved by the Executive Board on 13th February 2009 and by full Council on 25th February 2009.

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 2010 is anticipated to be £1,513m in line with expectations in February 2009.

6.2 Treasury Management activity has enabled revenue savings of £7.3m to be made against £6.2m assumed in the budget. This is largely due to repaying long term debt and funding at short-term historic low rates. A further £0.9m of treasury savings are expected to materialise before the year end as a result of completing a MRP review, enabling total annual savings against the budget of £2m.

6.3 It is anticipated that the authority will remain within the approved limits for 2009/10 as outlined in Table 4 and paragraph 3.2.2.

7.0 Recommendations

That the Executive Board:

7.1 Note the update on Treasury Management borrowing and investment strategy for 2009/10.

Associated documents:

a) Treasury Management Strategy 2009/10 - Executive Board 13th February 2009.
b) Treasury Management Annual Report 2008/09 – Executive Board 22nd July 2009.

Appendix A

Leeds City Council - Prudential Indicators 2009/10 - 2011/12

No.	PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	9.44%	11.68%	12.37%
2	HRA	13.26%	12.96%	12.91%
x	= HRA Debt charges	33,629	35,866	37,162
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	82.17	84.81	85.60
4	increase in housing rent per week	0.00	0.00	1.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	316,522	241,027	145,033
7	HRA	60,226	50,391	39,993
	TOTAL	376,748	291,418	185,026
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	853,793	905,762	965,475
9	HRA	795,795	806,299	808,812
	TOTAL	1,649,588	1,712,061	1,774,287

No.	PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	1,780,000	1,830,000	1,900,000
	other long term liabilities	380,000	380,000	380,000
	TOTAL	2,160,000	2,210,000	2,280,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,640,000	1,690,000	1,760,000
	other long term liabilities	370,000	370,000	370,000
	TOTAL	2,010,000	2,060,000	2,130,000
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**	100,000	150,000	150,000
	(per maturity date)			

16	Maturity structure of fixed rate borrowing 2009/10	Lower Limit	Cumulative Upper Limit	Projected 31/03/10
	under 12 months	0%	10%	2.0%
	12 months and within 24 months	0%	10%	8.1%
	24 months and within 5 years	0%	30%	22.6%
	5 years and within 10 years	0%	25%	7.7%
	10 years and above	25%	90%	59.6%

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.**

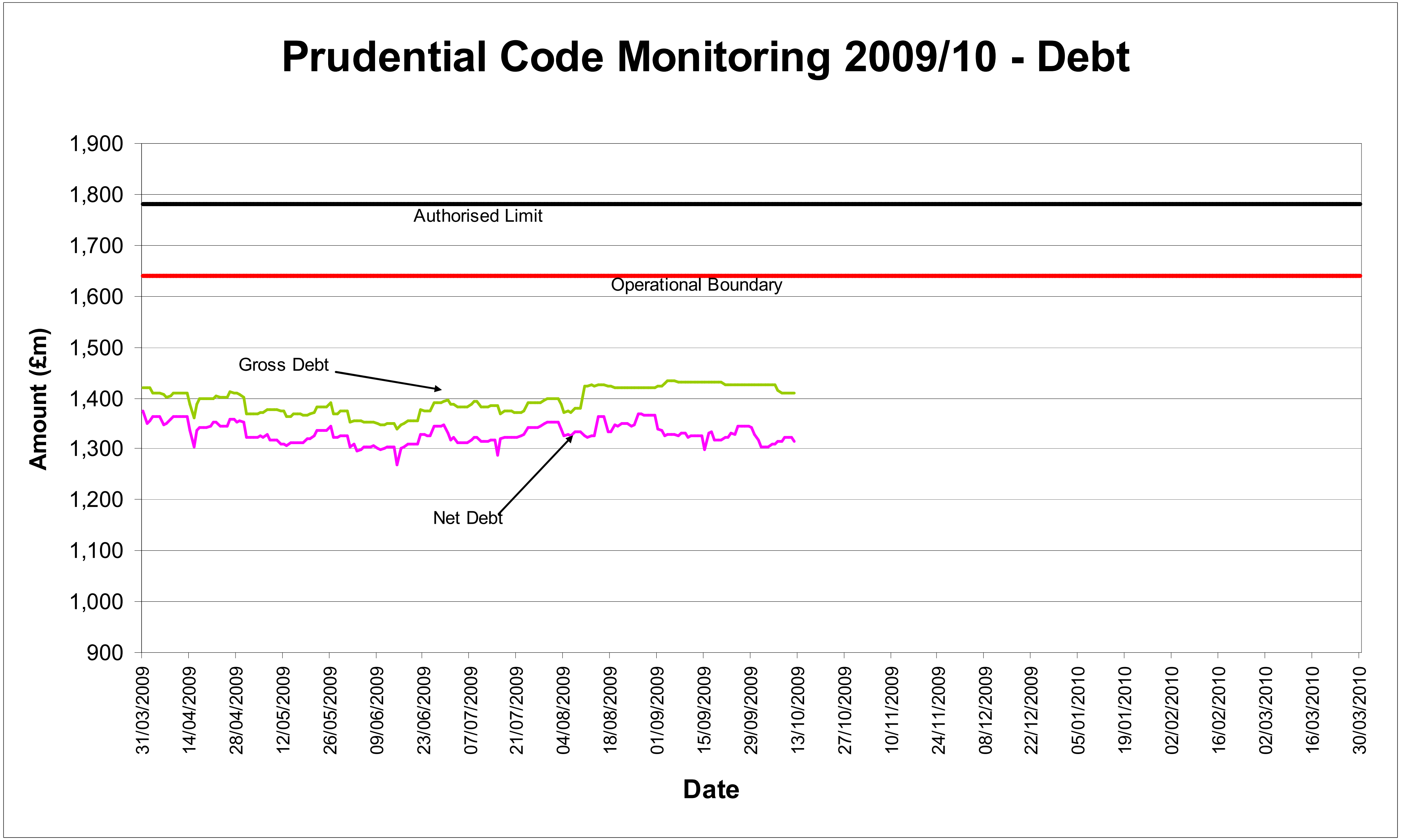
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

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 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **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.**
From 2009/10 CIPFA is proposing to account for PFI schemes under IFRIC 12 resulting in PFI borrowings being brought onto Local Authority Balance Sheets

Appendix B



Prudential Code Monitoring 2009/10 - Debt
Amount (£m)
1,900
1,800
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
31/03/2009
14/04/2009
28/04/2009
12/05/2009
26/05/2009
09/06/2009
23/06/2009
07/07/2009
21/07/2009
04/08/2009
18/08/2009
01/09/2009
15/09/2009
29/09/2009
13/10/2009
27/10/2009
10/11/2009
24/11/2009
08/12/2009
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02/02/2010
16/02/2010
02/03/2010
16/03/2010
30/03/2010
Date