



Treasury Management Progress Report 2007/08 to 30 September 2007

SUMMARY

- 1.1 This report covers the Council's treasury management activity for the first half of the financial year 2007/08.
- 1.2 Treasury management activity during the year has resulted in some savings for the Council, mainly as a result of increasing interest rates for investments, and the decision to restructure a number of existing loans.
- 1.3 The list of counterparties with which the Council can place investments could be extended to include other local authorities that wish to borrow temporarily.
- 1.4 Subject to any issues raised at the meeting, I support the following recommendations.

RECOMMENDATIONS

- 2.1 To note the progress report on Treasury Management to 30 September 2007 and forecasted savings of £1m to 31 March 2008.
- 2.2 To modify the Treasury Management Strategy to allow the Council to lend to other local authorities up to a maximum of £10m which is in line with the highest credit-rated building societies.



Treasury Management Progress Report 2007/08 to 30 September 2007

SUPPORTING INFORMATION

1. This report updates the Cabinet on progress in treasury management activity for this financial year up to 30 September 2007. The Council has undertaken a significant amount of borrowing, in line with the capital programme, since the strategy was set at Cabinet on 20 February 2007. In addition, market interest rates have increased significantly this year, mainly as a result of the 'sub-prime' mortgage crisis in the United States that started in July 2007. This has actually had a positive impact on the treasury management budget in the short term.
2. **Borrowing**
 - 2.1 The strategy for borrowing takes account of; the latest regulatory framework, the existing borrowing structure, the potential borrowing requirement for the year, sources of new borrowing and external factors influencing borrowing decisions.
 - 2.2 Our original strategy for 2007/08 agreed by Cabinet in February 2007 identified an annual borrowing figure of £33.6m. £8.5m of this was to be financed internally, giving an increase in the Council's net borrowing requirement of £25.1m. As £4.2m of this had been borrowed during 2006/07, this resulted in a maximum borrowing requirement for the year of £20.9m. This included £17m of borrowing to finance the public realm and other works in the city.
 - 2.3 The Capital Strategy 2008/09 to 2010/11 Report agreed by Cabinet on 4 September 2007 showed the latest position on capital expenditure financed by borrowing to be £28.6m. This was less than the original £33.6m mainly because of £5m slippage relating to the refurbishment of the Council House. The Council's net borrowing requirement has therefore also reduced by £5m for 2007/08 down to £15.9m.
 - 2.4 So far in 2007/08, the Council has borrowed a total of £96.3m from the Public Works Loans Board - PWLB. However, this includes £78.9m of borrowing to finance early redemption of existing loans. In addition, in June 2007, the Council repaid a £22.7m LOBO - Lenders Option Borrowers Option loan, which was borrowed on the money market in June 2003. So, our actual net borrowing for the year to date is negative at minus £5.3m. This means that our net borrowing requirement for 2007/08 currently stands at £21.2m.

- 2.5 The table below summarises the movement from the original position in February 2007 to the current revised position:

| 2007/08 Borrowing Requirement | Feb 2007 | Oct 2007 |
|---|-----------------|-----------------|
| | £m | £m |
| Supported Capital Expenditure (Revenue) | 10.1 | 11.4 |
| Unsupported Borrowing | 23.5 | 17.2 |
| Gross Borrowing Requirement | 33.6 | 28.6 |
| Public Finance Initiative adjustment | -0.3 | -0.3 |
| Minimum Revenue Provision | -8.2 | -8.2 |
| Net increase in debt | 25.1 | 20.1 |
| Borrowing in advance | -5.0 | -4.2 |
| 2007/08 borrowing requirement | 20.1 | 15.9 |
| New loans taken out | - | -96.3 |
| Loans repaid | - | 101.6 |
| Current borrowing requirement | 20.1 | 21.2 |

- 2.6 Two rescheduling exercises have so far been undertaken in 2007/08, in conjunction with Butlers – our treasury management advisors. In total the Council borrowed £78.9m from the PWLB at a relatively low rate and used this to pay off PWLB debt at a higher rate, thereby generating annual savings for the Council of approximately £453,000. There is usually a one-off charge, or ‘premium’, made by the PWLB for redeeming debt in this way, but the loans redeemed were selected such that the net premium totalled only £5,637.
- 2.7 Interest rates were such that it was necessary during the first rescheduling exercise for the Council to borrow temporarily from the money markets. As interest rates were at that time falling it was better to redeem the loans first, and then borrow later. The Council therefore borrowed approximately £60m for three days. Although these loans were sourced through the money markets, most of the lenders were in fact other local authorities.
- 2.8 Earlier in the year, when borrowing rates were around 4.7% - 4.8%, Butlers forecast that long-term interest rates would reach a low of around 4.5% by March 2008. However, they fell back to this level in August 2007 and the Council borrowed at between 4.45% and 4.55%. For the remaining £21.2m that we can borrow in 2007/08, we will continue to monitor interest rates and borrow when rates appear to be advantageous for the Council.
- 2.9 Market conditions and the careful planning of loans have enabled the authority to borrow at an average rate of 4.56%, against a budgeted rate of 4.75%, and for an average period of 45.7 years. This is shown in the table below:

| Date | Amount (£m) | Period (years) | Interest Rate % |
|--------------|--------------------|-----------------------|------------------------|
| 23 May 2007 | 4.0 | 25.3 | 4.80 |
| 7 Jun 2007 | 5.0 | 25.2 | 4.90 |
| 2 Aug 2007 | 5.0 | 46.1 | 4.55 |
| 2 Aug 2007 | 5.0 | 46.6 | 4.55 |
| 2 Aug 2007 | 6.0 | 47.4 | 4.55 |
| 2 Aug 2007 | 4.0 | 48.1 | 4.55 |
| 2 Aug 2007 | 3.0 | 48.6 | 4.55 |
| 2 Aug 2007 | 7.0 | 49.4 | 4.55 |
| 2 Aug 2007 | 6.0 | 49.6 | 4.55 |
| 2 Aug 2007 | 4.0 | 49.6 | 4.55 |
| 2 Aug 2007 | 3.5 | 48.4 | 4.55 |
| 2 Aug 2007 | 3.0 | 47.8 | 4.55 |
| 2 Aug 2007 | 6.0 | 47.1 | 4.55 |
| 2 Aug 2007 | 4.0 | 47.1 | 4.55 |
| 2 Aug 2007 | 2.0 | 46.4 | 4.55 |
| 2 Aug 2007 | 5.0 | 47.8 | 4.55 |
| 23 Aug 2007 | 3.8 | 45.7 | 4.45 |
| 24 Aug 2007 | 2.0 | 45.8 | 4.50 |
| 24 Aug 2007 | 3.0 | 46.2 | 4.50 |
| 24 Aug 2007 | 4.0 | 47.0 | 4.50 |
| 24 Aug 2007 | 5.0 | 48.8 | 4.50 |
| 24 Aug 2007 | 6.0 | 49.7 | 4.50 |
| Total | 96.3 | 45.7 | 4.56 |

2.10 The repaid loans as part of the restructure are as follows:

| Date | Amount (£m) | Period to maturity (years) | Interest Rate % |
|--------------|--------------------|-----------------------------------|------------------------|
| 30 Jul 2007 | 2.9 | 5.9 | 9.125 |
| 30 Jul 2007 | 5.0 | 14.6 | 4.875 |
| 30 Jul 2007 | 13.0 | 20.1 | 4.750 |
| 30 Jul 2007 | 5.0 | 22.1 | 5.050 |
| 30 Jul 2007 | 5.0 | 24.1 | 5.050 |
| 30 Jul 2007 | 6.0 | 22.6 | 4.900 |
| 30 Jul 2007 | 5.0 | 26.6 | 4.900 |
| 30 Jul 2007 | 4.0 | 23.6 | 4.900 |
| 30 Jul 2007 | 2.5 | 19.1 | 4.625 |
| 30 Jul 2007 | 10.0 | 1.9 | 9.625 |
| 28 Aug 2007 | 3.0 | 3.3 | 9.000 |
| 28 Aug 2007 | 2.5 | 17.5 | 4.875 |
| 28 Aug 2007 | 2.5 | 16.5 | 5.000 |
| 28 Aug 2007 | 3.0 | 18.6 | 5.000 |
| 28 Aug 2007 | 2.5 | 16.6 | 4.875 |
| 28 Aug 2007 | 3.0 | 24.5 | 4.800 |
| 28 Aug 2007 | 2.0 | 14.5 | 4.750 |
| 28 Aug 2007 | 2.0 | 15.5 | 4.875 |
| Total | 78.9 | 17.0 | 5.792 |

- 2.11 Excluding any further borrowing for 2007/08, and accounting for principal repayments between now and April, the amount of PWLB debt at the year-end is £339.498m at a weighted average rate of 4.641% and the spread is as follows:

| Period remaining | Debt Outstanding £m | Average Rate % |
|------------------|------------------------|-------------------|
| Under 1 year | 3.013 | 9.472 |
| 1 – 2 years | 0.027 | 3.018 |
| 2 – 3 years | 0.188 | 3.000 |
| 3 – 4 years | 0.063 | 3.751 |
| 4 – 5 years | 0.006 | 4.250 |
| 5 – 10 years | 0.631 | 8.814 |
| 10 – 20 years | 21.505 | 5.260 |
| 20 – 30 years | 127.263 | 4.676 |
| Over 30 years | 186.800 | 4.456 |
| Total | 339.498 | 4.641 |

3 Factors influencing borrowing decisions

- 3.1 In early 2007, Butlers produced their economic outlook and interest rate forecasts for 2007/08. Their advice at that time was that long-dated PWLB debt offered the best value for borrowing, and that the rates for such debt would fall steadily over the course of the year to reach a low of around 4.25% around December-January.
- 3.2 In an ideal world, given such a forecast, borrowers would hold off borrowing until the low point had been reached. However, for 2007/08 the Council had an initially high borrowing requirement of £20.1m and also faced the possibility of having to replace the LOBO loan of £22.7m in June 2007, giving a large overall requirement of £42.8m. It would not have been prudent in such circumstances to hold off borrowing anything until the year-end so our course of action was to borrow whenever the long-term interest rates looked to have reached a low point.
- 3.3 The table below shows how interest rates have actually developed over the course of 2007/08:

| Rates | 1 Apr 07 | 1 May 07 | 1 Jun 07 | 1 Jul 07 | 1 Aug 07 | 1 Sep 07 | 1 Oct 07 |
|--------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | % | % | % | % | % | % | % |
| Base rate | 5.25 | 5.25 | 5.50 | 5.50 | 5.75 | 5.75 | 5.75 |
| PWLB 3 years | 5.50 | 5.60 | 5.80 | 5.90 | 5.70 | 5.45 | 5.20 |
| PWLB 7 - 8 years | 5.25 | 5.30 | 5.55 | 5.75 | 5.45 | 5.25 | 5.20 |
| PWLB 20 - 25 years | 4.80 | 4.90 | 5.00 | 5.25 | 5.00 | 4.85 | 4.95 |
| PWLB 25 – 30 years | 4.65 | 4.75 | 4.85 | 5.10 | 4.85 | 4.75 | 4.80 |
| PWLB 30 – 35 years | 4.60 | 4.65 | 4.80 | 5.00 | 4.75 | 4.65 | 4.75 |
| PWLB 35 – 40 years | 4.55 | 4.60 | 4.75 | 4.95 | 4.70 | 4.60 | 4.75 |
| PWLB 40 – 45 years | 4.50 | 4.60 | 4.70 | 4.85 | 4.65 | 4.60 | 4.70 |
| PWLB 45 – 50 years | 4.45 | 4.55 | 4.65 | 4.80 | 4.60 | 4.55 | 4.70 |

- 3.4 The Treasury Management Strategy – agreed by the Council in February 2007 – adopted the approach of taking mostly long-dated fixed-rate debt, where borrowing is necessary, with the current preference for long-dated loans over short-dated loans being subject to review if market conditions change. It is proposed that this approach be continued.
- 3.5 For the Council's remaining £21.2m of borrowing for 2007/08 we will continue to monitor long-term interest rates and borrow whenever a low point seems to have been reached.

4 Investments

- 4.1 The increase in short term interest rates as a result of the bank base rate increases this year has resulted in greater returns than those originally budgeted. The cash balance held by the Council has also continued to outperform the budgeted position in the short term. It is not anticipated that the current level of cash balances of over £150m can be sustained, as there are a number of significant pressures on the Council, which are likely to lead to a significant reduction in the cash balance available for investment over the next couple of years.
- 4.2 The Council's ability to secure a good rate of return has depended on its ability to act flexibly when market conditions suggest a particular investment is good value. The general strategy is therefore to take either short or long dated investments that outperform market expectations, informed by the view of our treasury advisers.

The following investment activity had taken place as at 1 October 2007.

| | |
|---|---------------|
| Value of investment held at: | |
| 1 April 2007 | £112.300m |
| 1 October 2007 | £152.645m |
| Average value of investments April – Sep 2007 | £142.638m |
| Total interest earned on investments | £3.939m |
| Average return on portfolio | 5.523% |
| Average LIBID 7 day rate | 5.648% |
| Average LIBID 3 month rate | 5.944% |
| Average LIBID 12 month rate | 6.092% |
| Weighted average Base Rate (2007/08 to date) | 5.567% |

- 4.3 Although disappointing when compared with the LIBID rates, the Council's return on investments of 5.523% compares favourably with the rate of 4.967% achieved over the course of 2006/07. The return on investments has been affected by a number of 'forward' deals that were made in 2006 at what were then very attractive rates. In hindsight these investments have proven to be less attractive, as the Bank of England base rate has so far been increased three times over the course of 2007. Such forward deals do, however, allow the Council to 'lock in' interest rates for a portion of its portfolio, rather than have the entire portfolio exposed to variations in rates.

5 Treasury Management Strategy

- 5.1 In addition to the institutions on the Council's approved list, the opportunity exists for the Council to lend to other local authorities. It is often the case that other local authorities need to borrow for short periods to cover cashflow deficits, in the same way that the Council needed to borrow £60m during our rescheduling exercise. In this case the Council could treat them as a counterparty with a high credit rating, similar to that of a credit-rated building society. Adding these authorities to the Council's counterparty list would also make it easier to spread our investments over a wider base. It is normal practice for most local authorities to lend to others.
- 5.2 It is therefore recommended that other local authorities in the UK be added to the Council's list of counterparties.

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| Background papers: | Cabinet reports 31 Jul 2007, 20 Feb 2007, 31 Oct 2006 |
| List of appendices: | Appendix 1 – Implications |

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| IMPLICATIONS |
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Financial

1. As detailed in the report.

Legal

2. As detailed in the report.

Personnel

3. None.

Equalities impact

4. None.

Corporate priorities

5. The objectives and outcomes of the Council's Treasury Management Strategy contribute to minimising council tax and providing value for money.