

**WEST LoTHIAN COUNCIL**  
**TREASURY MANAGEMENT**

**Interim Report for the 4 months to 31 July 2009**

**By Alan Logan**  
**Head of Finance**  
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## 1.0 Introduction

In accordance with the Standing Orders and Financial Regulations I am required to present to the Council Executive interim reports for periods 4, 6 and 9 on the operation of the Treasury Management function. This report for the four months to 31 July 2009 is issued in fulfilment of this reporting requirement.

The Annual Strategy Report approved by the Council Executive on 24 March 2009 set out the Treasury Management strategy for 2009/10 and this report assesses the implementation and outcome of the strategy for the first four months of the year.

Treasury Management as defined in the CIPFA 'Code of Practice for Treasury Management in the Public Services' is:-

"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of the optimum performance consistent with those risks."

## 2.0 Current Portfolio Position

The council's debt and investment position at the beginning and end of the period was as follows:-

1 April 2009			31 July 2009	
Principal £m	Rate %		Principal £m	Rate %
229.5	5.2%	<b>DEBT</b>	259.5	5.1%
61.5	0.8%	Fixed Rate Funding	61.5	0.7%
43.3	0.6%	Variable Rate Funding	20.0	0.3%
334.3	3.8%	Temporary Funding	341.0	4.0%
		Total Debt		
	30.4 yrs	Average Life of Debt		30.5 yrs
£m	Rate %	<b>INVESTMENTS</b>	£m	Rate %
80.5	5.7%	Cash Deposits	74.9	3.6%

The main change in debt during the period has been new fixed rate borrowing of £30 million to fund this year's capital programme, offset by a reduction in temporary borrowing of £23.3 million.

Investments have reduced by £5.6 million from the beginning of the period. Full details of the portfolio are provided in Appendix 1.

### 3.0 Performance Measurement

CIPFA's Directors of Finance Best Value Working Group and the Treasury Forum Group have developed and recommend in accordance with good practice the reporting of the following treasury management performance indicators (PI's). The council's PI's are detailed in the following table:

2008/09		2009/10
	<b>Headline Performance Indicator</b>	
	Average Cost of Servicing Loans Fund Advances in Year	
4.18%	• Loans Fund Interest Rate	Year End
0.11%	• Loans Fund Expenses Rate	Year End
4.29%		
	<b>Local Performance Indicators</b>	
42.35%	1. Percentage of Debt at year/period end which is Short Term or Variable	34.68%
46.40%	2. Percentage of Debt at year/period end repayable in each of the next 2 years	38.65%
3.47%	3. Average Interest Rate of Longer Term Borrowing raised in year/period	3.41%
29.8 years	4. Average Maturity of Longer Term Borrowing raised in year/period	8.5 years

### 4.0 The Strategy

#### 4.1 Interest Rate Forecasts

The basis of the Treasury Management strategy lies with determining appropriate borrowing and investment decisions in the light of the anticipated movement in both long and short term interest rates.

The strategy for 2009/10 was structured around the general forecasts for interest rates, but like any proposed strategy, there was a need for some flexibility of application dependent on prevailing economic conditions.

The 'average' City view suggested that bank rates would remain at 0.5% throughout the financial year. Our central forecast was in agreement with these forecasts. The forecast for PWLB rates was 2.3% for 5 years, 3.2% for 10 years and 3.9% for 50 year all in Q3 and Q4.

#### 4.2 Capital Finance Strategy

The Annual Strategy in March 2009 reported a new borrowing requirement of £51.6 million plus replacement borrowing of £107.8 million giving a total borrowing requirement for 2009/10 of £159.4 million.

Forecasts showed that there was a range of options available for borrowing strategy for 2009/10. Variable rate borrowing was expected to be cheaper than longer term borrowing and would remain attractive throughout the financial year. However, short, medium and long-term rates were forecast, in March 2009, to fall to attractive levels in Q3/Q4 2009 and a spread of borrowing in these areas was the most likely option. Consequently, the council would maintain a stable medium to long term portfolio and would draw the 2009/10 borrowing requirement from the PWLB at the most opportune time during the financial year. A portion of the borrowing requirement might also be taken using Lenders Option Borrowers Option

(LOBO) market loans for shorter fixed periods up to ten years, at appropriate times during the financial year, if these became available again after their disappearance from the market in autumn 2008.

## 5.0 The Economy and Interest Rates

The following table provides details of interest rates at the start and end of the period to date:-

	<b>At 1 April 2009</b>	<b>At 31 July 2009</b>
Bank rates	0.50%	0.50%
5 year PWLB	2.54%	3.26%
10 year PWLB	3.36%	4.12%
50 year PWLB	4.57%	4.70%

The Bank of England's Monetary Policy Committee (MPC) reduced the bank rate to 0.5% in March 2009, being the final reduction in a series of very sharp cuts from October 2008 when the bank rate was 5.0%. This spectacular reduction in bank rate followed the credit crunch, the global banking crisis and the global economic recession including the UK. The bank rate at 0.5% is not expected to fall any further and is forecast to remain at this level till Q2 2010. However, to improve liquidity in financial markets and to encourage the banks to increase commercial and mortgage lending, the MPC introduced its quantitative easing (QE) programme in April 2009 with the purchase of up to £125 billion of asset purchases including UK government stocks (gilts).

Inflation, as measured by the Consumer Price Index (CPI), fell to 1.8% in June 2009 just below the MPC's inflation target of 2%. CPI is forecast to fall to below 1% in Q4 2009. The Retail Price Index (RPI) which includes mortgage rates and taxes fell to a negative of -1.6% in June 2009. The UK economy recorded negative growth of -0.8% in Q2 2009 but this was an improvement on Q1 2009 when the decline was -1.9%. The current annual rate of negative growth is -5.6%. UK government forecasts show economic growth turning positive in 2010 at 1.25%, rising to the long-term trend of 3.5% in 2011. Unemployment continues to rise and was 7.2% in Q2 2009. The only 'green shoots' of recovery are from retail sales which rose 1.2% in June and in the housing market with a rise in mortgage approvals, house sales and house prices which started in May.

PWLB in all periods, in contrast to expectations for falling rates with the lowest rates forecast to be during Q3 and Q4 2009, have risen steadily from the low point at the beginning of the financial year.

## 6.0 Capital Finance Activities

The original forecast new borrowing requirement for 2009/10 of £51.6 million has been revised to £59.1 million largely on lower than forecast capital receipts including council house sales. The revised replacement borrowing of £105.8 million brings the total borrowing requirement for 2009/10 to £164.9 million.

PWLB rates temporarily fell sharply in late June and this was a good opportunity to borrow a proportion of this year's borrowing requirement. £30 million was borrowed from the PWLB at an average rate of 3.41% for an average period of 8.5 years. Temporary borrowing has also reduced from the beginning of the financial year from £43.3 million to £20 million at 31 July 2009.

The remainder of the 2009/10 borrowing requirement of £134.9 million will be borrowed at opportune times during the financial year.

Details of borrowing are shown in Appendix 2.

## 7.0 **Debt Rescheduling**

### 7.1 *General Objective*

Debt rescheduling involves the reorganisation of existing debt in such a way as to reduce the interest charge and improve the maturity profile. The main objective is to generate interest savings as a result of any improvement in the average loans fund rate. A further objective is the smoothing out of the council's debt maturity profile thereby reducing the risk of large loan replacements in any one year at potentially unattractive rates in the future. The ability to reschedule is always determined by the benefit of the rescheduling proposal. Whilst interest rates may be attractive the premium costs, which may be prohibitive, must also be considered in any decision.

### 7.2 *Opportunities*

The Annual Strategy report stated that there may be similar opportunities to those made in 2008/09 to reschedule from long-term loans to PWLB variable or temporary borrowing. While there have been interest variations from those forecast, no debt rescheduling has been carried out in the year to date.

## 8.0 **Management of Cash Flows and Investments**

### 8.1 *Internally Managed Investments*

Cash flows are monitored daily, the objective being to identify immediately any surplus funds available for temporary investment. The procedure allows for same day lending of cash surpluses to institutions approved in our Treasury Management Practices and leaves the bank current account balance at zero, the optimum level. The council's investment priorities are the security of capital and the liquidity of its investments. The council will also aim to achieve the optimum return on its investments commensurate with appropriate levels of security and liquidity.

### 8.2 *Investment Strategy*

The strategy approved by the Council Executive on 24 March 2009 was that maturing investments would be offset against temporary borrowing during the first six to nine months of 2009/10. However, external borrowing rates were forecast to be at very low attractive rates in Q3 and Q4 2009 and thereafter to rise steadily. Consequently, it may be more advisable to undertake fixed rate borrowing before the end of 2009 rather than run down investments. I stated that I required flexibility in this respect, however, to secure the best outcome for the council, taking account of the need to secure our capital.

### 8.3 *Investment Results*

Detailed below are the results of the investment strategy undertaken by the council during the period:-

<b>Average Investment</b>	<b>Rate of Return</b>	<b>Benchmark Return*</b>
£77.9m	4.45%	0.48%

\* The benchmark is 7 Day London Interbank Bid (LIBID) Rate

The majority of investments were fixed for up to twelve months when interest rates were significantly higher and have resulted in a return of 3.97% above the benchmark, resulting in additional investment income of £1,030,000 for the period.

During the period the amount lent to approved organisations ranged from a low of £59.7 million to a high of £97.3 million.

Investments at 31 July 2009 were £74.9 million of which £67.5 million has been invested for fixed periods ranging from nine to twelve months at an average rate of return of 3.93%, with the remaining £7.4m overnight at 0.75%. £69.0 million of the total investments represents balances on the council's General Fund, HRA, Capital, Insurance and Repair Funds. £1.6 million relates to funds held by other bodies such as trusts administered by the council and the Municipal Bank. The balance of £4.3 million represents temporary funds to pay future liabilities plus cash flow surpluses caused by spending lagging behind income, the majority of which is received on a regular basis through AEF support, council tax and house rents.

Investments at 31 March 2010 are forecast at £60 million, assuming investments are retained.

Authorised institutions, their investments limits and investments made at 31 July 2009 are detailed in Appendix 3.

New investment regulations are expected to be enacted by the Scottish Government during 2009/10 and their impact on future investment policy will be reported separately to the Council Executive.

## **9.0 Monitoring of Prudential Indicators**

The CIPFA Prudential Code was introduced to ensure the capital plans of local authorities are affordable, prudent and sustainable. To demonstrate compliance with these objectives the Code sets nine indicators designed to support and record local decision making. The 2009/10 indicators were originally approved by council in February 2009 and council agreed that the indicators would be monitored and revised, if required, throughout the year by the Council Executive. The purpose of each of the prudential indicators and the performance is set out in Appendix 4. It is recommended that Council Executive approves the change to the Capital Expenditure and Capital Financing Requirement indicators as detailed in Appendix 4. These changes reflect revisions to the phasing of capital expenditure and lower than forecast capital receipts resulting in increased borrowing to fund the approved capital programmes. The revised General Services and Housing Capital Expenditure indicators are £89.234 million and £38.180 million respectively, with a revised Capital Financing Requirement of £319.483 million and £83.562 million for General Services and Housing Capital respectively.

## **10.0 Conclusion**

This report details the treasury activities undertaken in the first four months of 2009/10. Actions taken complied with the Annual Strategy for 2009/10, approved by the Council Executive on 24 March 2009, and the Treasury Management Policy Statement.

A further interim report for the six months to 30 September 2009 will be submitted to the Council Executive in October 2009.

**ALAN LOGAN**  
**HEAD OF FINANCE**

Date: 19 August 2009



# WEST LoTHIAN COUNCIL

## Current Portfolio

1 April 2009			DEBT	31 July 2009		
Principal £m	£m	Rate %		Principal £m	£m	Rate %
168.8			<b>Fixed Rate Funding</b>	198.8		
60.6			• PWLB	60.6		
<u>0.1</u>	229.5	5.2%	• Market	<u>0.1</u>	259.5	5.1%
			• European Investment Bank (EIB)			
			<b>Variable Rate Funding</b>			
60.0			• PWLB	60.0		
1.1			• Municipal Bank	1.1		
<u>0.4</u>	61.5	0.8%	• Covenant	<u>0.4</u>	61.5	0.7%
			<b>Temporary Funding</b>			
	<u>43.3</u>	<u>0.6%</u>	• Market		<u>20.0</u>	<u>0.3%</u>
	<u>334.3</u>	<u>3.8%</u>	Total Debt		<u>341.0</u>	<u>4.0%</u>
		<u>30.4 yrs.</u>	Average Life of Debt			<u>30.5 yrs.</u>
	<b>£m</b>	<b>Rate %</b>	<b>INVESTMENTS</b>		<b>£m</b>	<b>Rate %</b>
	<u>80.5</u>	<u>5.7%</u>	Cash Deposits		<u>74.9</u>	<u>3.6%</u>

## WEST LoTHIAN COUNCIL

## Borrowing in 2009/10

Date	Amount Advanced £m	Details	Repayment Period
30 June 2009	10.0	2.69%	4.5 years
30 June 2009	10.0	3.57%	9 years
30 June 2009	10.0	3.97%	12 years
<u>£30.0m</u>			average rate <u>3.41%</u> average life <u>8.5 years</u>

## APPROVED ORGANISATIONS FOR INVESTMENT

	Investment Limit	Investment at 31 July £
<b><u>Council Bankers</u></b>		
Lloyds Banking Group (inc Bank of Scotland)	<b>50,000,000</b>	19,435,000
Maximum fixed rate investments per credit rating, which is currently F1+ AA-, with the balance as overnight funds as a contingency.	15,000,000 (fixed) Balance £35,000,000 overnight	
<b><u>Rated F1+ short term with AA+ long term*</u></b>	<b>20,000,000</b>	
No institutions in this category		
<b><u>Rated F1+ short term with AA long term*</u></b>	<b>17,500,000</b>	
HSBC Bank plc		0
<b><u>Rated F1+ short term with AA- long term*</u></b>	<b>15,000,000</b>	
Abbey National plc/Alliance & Leicester plc		0
Nationwide Building Society		15,000,000
Barclays Bank plc		12,500,000
Royal Bank of Scotland plc/Ulster Bank		5,000,000
<b><u>Rated F1+ short term with A+ long term*</u></b>	<b>12,500,000</b>	
Clydesdale Bank **		15,000,000
<b><u>Rated F1 short term with A+ long term*</u></b>	<b>8,000,000</b>	
No institutions in this category		
<b><u>Rated F1 short term with A long term*</u></b>	<b>5,000,000</b>	
Coventry Building Society		5,000,000
Leeds Building Society		0
<b><u>Local Authorities</u></b>	<b>10,000,000</b>	
All UK Local Authorities		0
UK Public Bodies		0
<b><u>UK Nationalised Banks – not credit rated</u></b>	<b>15,000,000</b>	
Northern Rock (maximum 3 months)		0
<b><u>Insufficiently Rated**</u></b>		
Yorkshire Building Society (repaid 5 August 2009)		3,000,000
<b>TOTAL</b>		<b><u>74,935,000</u></b>

\*As rated by the credit rating organisation Fitch  
IBCA

\*\*Deals transacted prior to rating downgrade



## MONITORING OF PRUDENTIAL INDICATORS – 2009/10

**CAPITAL EXPENDITURE INDICATORS** (Items 1 and 2)**1. CAPITAL EXPENDITURE****Purpose of the Indicator**

The purpose of this indicator is to inform Executive of current capital spending plans.

	<b>2009/10</b>
	<b>£'000</b>
	<b>Estimate</b>
General	89,234
Services	
Housing Capital	<u>38,180</u>
<b>Total</b>	<u><b>127,414</b></u>

**Performance**

The updated General Services capital budget for 2009/10 of £93.176 million was approved by the Council Executive on 23 June 2009. An allowance of £4 million for overprogramming is not now required and the revised General Services capital expenditure indicator is now £89.234 million, as detailed in the General Services Capital Monitoring Report to this meeting of Executive.

The Housing Capital Report for 2009/10 was also approved by the Council Executive on 7 April 2009 with Housing capital expenditure of £37.148 million. Revisions to the phasing of capital expenditure, as detailed in the Housing Capital Monitoring Report to this meeting of Executive, now require the Housing capital expenditure indicator to be amended to £38.180 million.

Executive are asked to approve the revised General Services and Housing capital expenditure prudential indicators to £ 89.234 million and £38.180 million respectively.

**2. CAPITAL FINANCING REQUIREMENT****Purpose of the Indicator**

The capital financing requirement measures the Council's underlying need to borrow for a capital purpose. This is basically the Council's total outstanding debt, which is required to finance the Council's planned capital expenditure.

	<b>2009/10</b>
	<b>£'000</b>
	<b>Estimate</b>
General	319,483
Services	
Housing Capital	<u>83,562</u>
<b>Total</b>	<u><b>403,045</b></u>

**Performance**

The capital financing requirement for 2009/10, approved by council in February 2009, was £319.483 million and £75.186 million for General Services and Housing Capital respectively. Capital receipts for 2009/10 are now forecast to be lowered than the original estimates, particularly from council house sales. As a result, to maintain the approved capital programmes for 2009/10 the capital financing requirement requires to be increased to £319.483 million and £83.562 million for General Services and Housing Capital respectively. While current outstanding debt is still well within the above levels it is expected to rise towards the year end as expenditure on the capital programmes, which is required to be financed by borrowing, increases.

Executive are asked to approve the revised General Services and Housing capital financing requirement prudential indicators to £ 319.483 million and £83.562 million respectively.

### **AFFORDABILITY INDICATORS** (Items 3 and 4)

#### **3. RATIO OF FINANCING COSTS TO NET REVENUE STREAM**

##### **Purpose of the Indicator**

This indicator provides a measure of the proportion of the budget that is being allocated to financing of capital expenditure. For the General Fund this is the ratio of financing costs of borrowing against net expenditure financed by government grant and local taxpayers. For the HRA the indicator is the ratio of financing costs to gross house rental income.

	<b>2009/10 Estimate</b>
General Fund	6.2%
HRA	13.0%

##### **Performance**

The actual percentages for 2009/10 will not be available until after the end of the financial year. However, as mentioned in the Budget Report for the General Fund the 2009/10 level is below the level in 2002/03 when the ratio was 7.6%. For the HRA the proportion of the budget allocated to loans charges is lower in 2009/10 than in 2003/04, when the ratio was 13.1%. Accordingly capital spending plans will not result in an increased percentage of the revenue budget being required for loans charges.

#### **4. ESTIMATES OF INCREMENTAL IMPACT OF NEW CAPITAL INVESTMENT DECISIONS ON COUNCIL TAX AND HOUSE RENTS**

##### **Purpose of the Indicator**

This is a key affordability indicator which demonstrates the incremental impact of planned capital expenditure and associated borrowing has on Council Tax and Rent levels.

<b>Incremental impact of capital spending on:</b>	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
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Council Tax (Band D)	Nil	Nil	Nil
Average Weekly House Rents	£1.57	£0.55	£0.57

### Performance

There are no monitoring implications for these indicators which were approved by Council prior to the start of the financial year.

## **FINANCIAL PRUDENCE INDICATOR** (Item 5)

### **5. NET EXTERNAL BORROWING AND THE CAPITAL FINANCING REQUIREMENT**

#### **Purpose of the Indicator**

This indicator records the extent that net external borrowing (gross external borrowing less investments) is less than the capital financing requirement (indicator 2 above). This is a key indicator of prudence and is designed to ensure that, over the medium term, external borrowing is only for a capital purpose. The values are measured at the end of the financial year.

	<b>2009/10</b>
	<b>£'000</b>
	<b>Estimate</b>
Net External Borrowing	342,602
Capital Financing Requirement	<u>403,045</u>
Under limit by	<u><u>60,443</u></u>

### Performance

These figures are measured at the end of the financial year when a comparison will be provided for this indicator.

## **TREASURY AND EXTERNAL DEBT INDICATORS** (Items 6 to 9)

### **6. AUTHORISED LIMIT FOR EXTERNAL DEBT**

#### **Purpose of the Indicator**

The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long term liabilities such as covenant repayments and finance lease obligations. This limit provides a maximum figure to which the Council could borrow at any given point during the financial year.

<b>Authorised Limit for:</b>	<b>2009/10</b>
	<b>£'000</b>
Gross External Borrowing	476,507
Other Long Term Liabilities	<u>4,245</u>
External Debt	<u><u>480,752</u></u>

### Performance

The current level of external debt is £136 million below the authorised limit.

## 7. OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

### Purpose of the Indicator

This is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point during the financial year. In comparison, the authorised limit is the maximum allowable level of borrowing.

<b>Operational Boundary for:</b>	<b>2009/10</b>
	<b>£'000</b>
Gross External Borrowing	466,507
Other Long Term Liabilities	<u>3,245</u>
External Debt	<u>469,752</u>

### Performance

The current level of external debt is £125million below the operational boundary.

## 8. ACTUAL EXTERNAL DEBT

### Purpose of the Indicator

This is a factual indicator showing actual external debt for the previous financial year.

	<b>31 March 2009</b>
	<b>£'000</b>
Actual External Borrowing	334,183
Actual Other Long Term Liabilities	<u>2,481</u>
Actual External Debt	<u>336,664</u>

### Performance

The actual external debt reported in the annual accounts for the previous year is required to be shown as an indicator for comparison purposes only.

## 9. TREASURY MANAGEMENT INDICATOR

The Prudential Code links with the existing CIPFA Code of Practice for Treasury Management in the Public Services.

### Purpose of the Indicator

The Treasury Management indicator consists of five elements that are intended to demonstrate good professional practice is being followed with regard to Treasury Management.

### Performance

These elements are as follows:

### 9.1 The first is to state if the Council has adopted the CIPFA Treasury Management Code.



The Council adopted the CIPFA Treasury Code on 25 March 1997 as an indication of good treasury management practice. No ongoing monitoring is required for this element.

The next two elements cover limits for fixed and variable rate borrowing.

## **9.2 Upper limit of fixed rate borrowing for the 3 years to 2011/12**

Approved limit - 100%

Current level - 82%

## **9.3 Upper limit of variable rate borrowing for the 3 years to 2011/12**

Approved limit - 35%

Current level - 18%

The fourth element requires limits to be set for the maturity of fixed rate borrowing.

## **9.4 Maturity structure of fixed rate borrowing for 2009/10**

	<b>Approved Upper Limit</b>	<b>Approved Lower Limit</b>
Under 12 months	35%	0%
12 months and within 24 months	35%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and over	100%	25%

The current maturity levels of debt are comfortably within these upper and lower limits.

## **9.5 Total principal sums invested for periods longer than 364 days**

Because the Council is not debt-free it is prohibited from investing for longer than 364 days so this element of the indicator is not relevant to West Lothian Council at the current time.

### **Performance**

The Treasury Management indicator confirms sound professional practice is being followed by the Council in undertaking Treasury Management. The approved values and parameters provide sufficient flexibility in undertaking operational Treasury Management.

## **CONCLUSION**

In monitoring the above prudential indicators Council is fulfilling its duty under the Prudential Code. The monitoring indicates that spending plans remain affordable, prudent and sustainable.