Inverclyde council

AGENDA ITEM NO. 4

Report To:	**Policy & Resources Committee**	**Date**:	**22 September 2009**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/51/09/AP/CF**
Contact Officer:	**Alan Puckrin**	**Contact No**:	**01475 712223**
Subject:	**TREASURY MANAGEMENT – ANNUAL REPORT 2008/09 AND MONITORING REPORT FOR QUARTER 1 OF 2009/10**		

1.0 PURPOSE

1.1 The purpose of this report is to advise members of the operation of the treasury function and its activities for 2008/09 and for quarter 1 of 2009/10 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

2.0 SUMMARY

2.1 As at 31st March 2009 the Council had debt of £186,431,348 and investments of £41,964,207. The average rate of return achieved on investments during 2008/09 was 5.33% which exceeds the benchmark return rate for the year of 3.69%.

2.2 During 2008/09 the Council undertook debt restructuring (in quarter 4) and operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices apart from some short-term breaches as reported to Committee in May 2009.

2.3 The total debt outstanding as at 30th June 2009 was £189,907,389. The operational limit for external debt as approved by the Policy & Resources Committee in March 2009 is £212,960,000. The Council is therefore well within its operational limit. As at 30th June 2009 the Council had £17,943,405 invested in deposit accounts and a further £35,000,000 invested externally with third parties as per the Council's Investment Strategy.

2.4 The Council are within the limits set for the Prudential Indicators and Council Policy Limits reported to the Committee except for the Policy Limit on the maximum proportion of debt repayable in any one year. The Council's limit, to reduce refinancing risk, is now 20% but the Council have debt repayable in one year (2077/78) of 21.063%. Given that the refinancing of this debt is so far away, exceeding the limit is not a matter for concern.

2.5 In order to achieve ongoing savings for the Council, some debt restructuring was undertaken during quarter 1 of 2009/10. As a result, for a few hours on one occasion during the quarter, the Council exceeded its TMP limit with the Bank of Scotland.

3.0 RECOMMENDATIONS

3.1 It is recommended that the Committee notes the contents of the annual report on Treasury Management for 2008/09 and the ongoing work to ensure the delivery of financial benefits for the Council.

3.2 It is recommended that the Committee homologates the action taken which resulted in the Council exceeding its TMP limit with the Bank of Scotland on a short-term basis due to a debt restructuring exercise that was undertaken during quarter 1 of 2009/10.

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

4.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 has been adopted by this Council and the Council fully complies with its requirements. The primary requirements of the Code are:

1. The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. The creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. The receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year.
4. The delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Annual Report for 2008/09

4.2 Treasury Management in this context is defined as: "The management of the local authority'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 optimum performance consistent with those risks."

4.3 This annual treasury report covers:

- the Council's treasury position as at 31st March 2009;
- performance measurement;
- the strategy for 2008/09;
- the economy in 2008/09;
- the borrowing outturn for 2008/09;
- compliance with treasury limits and Prudential Indicators;
- investment strategy and outturn for 2008/09;
- debt rescheduling;
- other issues.

Treasury Management is a complex area with its own terminology and acronyms. In order to aid the Committee's understanding a Glossary of Terms is attached as Appendix 1.

4.4 Treasury Position As At 31st March 2009

The Council's debt and investment position was as follows:

	31st March 2009		31st March 2008	
	Principal	Rate	Principal	Rate
	£000		£000	
Fixed Rate Funding:				
- PWLB	75,782		70,785	
- Market *	61,000		102,400	
	136,782	4.190%	173,185	4.373%
Variable Rate Funding:				
- PWLB	0		0	
- Market *	41,900		500	
- EIB	23		69	
- Temporary	7,726		33	
	49,649	3.975%	602	10.111%
Total Debt	**186,431**	**4.133%**	**173,787**	**4.393%**

* - Market Loans are shown as variable when they have less than 1 year to go until their next call date.

	31st March 2009		31st March 2008	
	Principal	Return	Principal	Return
	£000		£000	
Investments:				
- External	40,000	5.106%	5,000	5.630%
- Deposit Accounts	1,797	0.500%	32,374	5.380%
Total Investments	**41,797**	**4.908%**	**37,374**	**5.413%**

4.5 Performance Measurement

One of the key changes in the revision of the Code in 1996 was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in 4.4 above).

4.6 Strategy For 2008/09

The Council's strategy for 2008/09 was based on a view of a declining rate of growth of GDP in the UK economy from the peak of 3.3% in Q3 2007 to 2% in 2008. The Bank Rate was expected to continue falling from 5.75% in November 2007 to reach 5.00% in Q2 2008 and then to fall to 4.75% in Q3 2008 until an increase in Q4 2009 back to 5.00%. This was based around the dilemma facing the MPC of balancing the opposing risks of inflationary pressures driven by spikes in oil prices against concerns around the impact of the credit crunch both on the UK housing market and economy and even more so on the US housing market and economy and the knock on impact on world growth rates.

The effect on interest rates for the UK was therefore expected to be as follows:

- Shorter-term interest rates
  The "average" City view anticipated that the Bank Rate would fall to 4.75% in 2008/09 and then remain stable based on a balance of risks around rising inflationary pressures on the one hand and falling growth rates and concerns over the impact of the credit crunch on the other hand.

- Longer-term interest rates
  The view on longer-term fixed interest rates (for 50 years) was that they would remain static around 4.45% for the whole of the year. The 25 year rate was also expected to flat around 4.50%-4.55%.

Against this background, and with regard to the level of Council investments, caution was to be adopted with the 2008/09 treasury operations. The Chief Financial Officer was to monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Committee in the quarterly reports.

4.7 The Economy In 2008/09 and Interest Rates

This year can only be described as unparalleled and extraordinary. The financial crisis, commonly known as the ‘credit crunch’, had a major downward impact on the levels of interest rates around the world.

On 1st April 2008 the Bank Rate was 5.25% and the Bank of England was focused on fighting inflation. The money market yield curve reflected these concerns with one year deposits trading well above the 6% level.

This phase continued throughout the summer until 15th September 2008 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. This also led to an immediate spike up in investment rates.

On 7th October 2008 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, and Lloyds) as liquidity in the markets dried up. The Monetary Policy Committee meantime had reduced interest rates by 0.5% on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or ‘disconnect’ as it became known, against the Bank Rate widened out. On the other hand the short end rates for the PWLB fell dramatically as investors invested in Government debt thereby forcing government gilt yields lower.

Market focus now shifted from inflation 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 duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities across the curve. 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.

The New Year of 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. 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.

In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. 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.

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.

Appendix 2 gives further details of the key dates and events during 2008/09.

4.8 Borrowing Outturn For 2008/09

As previously reported to Committee, the Council has undertaken the following borrowing during the year:

August 2008

- £20,000,000 from the PWLB at 4.39% for 49½ and 50 years

December 2008

- £4,000,000 from the PWLB at 2.48% for 3 years
- £4,000,000 from the PWLB at 3.09% for 5 years
- £7,000,000 from the PWLB at 4.00% for 33½ years.

The above list excludes short-term borrowing undertaken as part of debt restructuring exercises that took place in January 2009 and March 2009.

4.9 Compliance With Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices apart from some short-term breaches as approved by Committee in May 2009. The outturn for the Prudential Indicators (for which outturn figures are required) is shown in Appendix 3.

4.10 Investment Strategy and Outturn For 2008/09

Internally Managed Investments - The Council manages its investments in-house and invests with institutions that meet the approved counterparty criteria as included in the Council's Treasury Policy and Treasury Management Practices. The Council invests for a range of periods from overnight to 364 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

Investment Strategy – The Bank Rate started on a downward trend from 5.75% with the first cut to 5.50% in December 2007 and a further cut to 5.25% in February 2008. The Council's treasury advisers forecast that this trend would continue with further cuts to 5.00% in Q2 and 4.75% in Q3 2008 before rising back to 5.00% in Q4 2009 and stabilise there for the foreseeable future. The treasury advisers advised that Councils should, therefore, seek to lock in longer period investments at higher rates ahead of these cuts for some element of their investment portfolio which represents their core balances. They also advised that, for 2008/09, their clients should budget for an investment return of 4.90%-5.00% on investments placed during 2008/09.

This Council sought to invest funds in accordance with the agreed strategy and in accordance with its counterparty criteria prior to interest rates falling dramatically during the year. As previously reported to Committee, this Council had no investments with any of the Icelandic banks or their UK subsidiaries.

Members should note that Officers continue to monitor market news and movements on bank credit ratings and take advice from the Council's Treasury Advisers as to the implications for the Council of particular market moves, changes in credit ratings, or banking news. None of the movements or news has as yet required the Council to move funds or led to any changes in Treasury Policy but additional caution is, understandably, being adopted.

Investment Outturn for 2008/09 – The result of the investment strategy undertaken by the Council is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (7-day LIBID uncompounded)
£51,175,524	5.33%	3.69%

The Council have outperformed the benchmark by 1.64% resulting in additional income to the Council of £836,000.

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

4.11 Debt Rescheduling

Rescheduling Strategy – The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates meant that PWLB to PWLB debt restructuring is normally considered much less attractive than before that date. Significant interest savings were, however, still considered to be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans. This, however, did not prove to be viable as due to the credit crunch, the supply of LOBO finance generally dried up during the year.

Elevated concerns around the credit crunch at times during the year led to occasional wild swings in PWLB rates within a matter of a few weeks. In addition, due to the perceived increased risk around holding spare cash as investments and the likely poor rate of return available on such investments once the MPC had made further cuts in Bank Rate, it was decided to seek to repay some PWLB debt from investments or from temporary borrowing in advance of maturing investments.

Rescheduling Outturn For 2008/09 – The Council undertook debt restructuring in January, February and March 2009 as reported to Committee in May 2009.

4.12 Other Issues
The Council's contract with its treasury advisers, which ran until 30th June 2009, has been extended for a further 2 years.

5.0 Report For Quarter 1 of 2009/10

5.1 A quarterly report on the Council's treasury management position and activities is required to be submitted to Committee under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

5.2 The Council's position can be split into 4 main areas for consideration:

a. Prudential Code & CIPFA Code of Practice
b. Overall Debt Position
c. Overall Investment Position
d. Debt Rescheduling and Borrowing During The Period.

In addition, it is proposed to consider the prospects for interest rates.

5.3 Prudential Code & CIPFA Code of Practice

Appendix 4 shows Prudential Indicators and indicators forming part of the Council's Treasury Policy as agreed by the Policy & Resources Committee in March 2009.

The Council's Policy Limit for the maximum proportion of debt repayable in any one year has been reduced from 30% to 20% for 2009/10. This limit is intended to ensure that the Council spreads the maturity of its debt to reduce refinancing risks. Appendix 4 shows that the Council is above the limit but this is in relation to one year only (2077/78) and so far away as not to be a matter for concern.

5.4 Overall Debt Position

The total debt outstanding as at 30th June 2009 was £189,907,389. The operational limit for external debt as approved by the Policy & Resources Committee in March 2009 is £212,960,000. The Council is therefore well within its operational limit.

The average length of the debt outstanding as at 30th June 2009 was 43.60 years (down from 48.11 years at last quarter) with an average interest rate of 3.76%, a reduction of 0.37% from last quarter. This is largely due to debt rescheduling undertaken during the quarter (including borrowing received in early April resulting from restructuring undertaken in March and reported to the last Committee). Further analysis of the debt position is shown in Appendix 5.

5.5 Overall Investment Position

As at 30th June 2009 the Council had £17,943,405 invested in deposit accounts and a further £35,000,000 invested externally with third parties as per the Council's Investment Strategy. Further details are given in Appendix 6.

All lending by the Council is undertaken in accordance with the Council's Treasury Policy and Treasury Management Practices.

5.6 Debt Rescheduling and Borrowing During The Period

During the quarter the Council undertook a restructuring exercise involving the repayment in April of £15m of PWLB loans with the repayment funded from Temporary Borrowing for 3 months. The Temporary Borrowing was repaid in July 2009 from maturing investments.

This restructuring resulted in the Council paying a premium of £349,327.73 (which will be charged against the General Fund in 2009/10) but will result in ongoing savings for the Council due partly to being able to re-borrow later at lower interest rates and partly due to the net reduction in interest costs arising from reducing investments (due to the differential between borrowing rates and investment rates).

The Council has not undertaken any borrowing during the quarter, other than in connection with the restructuring exercise.

Whilst undertaking the debt restructuring it was necessary for the Council to obtain funding for the debt repayment before actually repaying the loans to the PWLB. As a result and due to the level of fixed term investments with them, the Council exceeded its TMP limit for funds with the Bank of Scotland for a few hours on 21st/22nd April. Approval is being sought from Committee for this short-term exceeding of the TMP limit.

5.7 Prospects For Interest Rates

The Bank Rate set by the Bank of England was reduced to 0.50% on 5th March 2009 and has remained at that level.

The Council's Treasury Advisers expect that the Bank Rate will remain at 0.50% until Quarter 1 of 2010 and will then increase to 1.00% in Quarter 2 of 2010, to 1.50% in Quarter 3 of 2010, to 2.00% in Quarter 4 of 2010, to 2.50% in Quarter 1 of 2011, and to 3.00% in Quarter 2 of 2011.

5.8 The Council have not entered into any further fixed term deposits during this quarter. Details of the Council's investments are shown in Appendix 6.

5.9 It is proposed to continue to monitor and review the interest rates that are available in the market for investments (including deposit accounts) and take appropriate action in line with the Council's Treasury Policy and Treasury Management Practices.

5.10 Movements in Financial Markets/Banking Sector
This quarter has seen some stability in financial markets compared to recent quarters with few significant movements in the banking sector and the wider economy (including with interest rates, as indicated above).

Members should note that Officers continue to monitor market news and movements on bank credit ratings and take advice from the Council's Treasury Advisers as to the implications for the Council of particular market moves, changes in credit ratings, or banking news. None of the movements or news has as yet required the Council to move funds or led to any changes in Treasury Policy but additional caution is, understandably, being adopted.

Market conditions during the quarter led to the Council undertaking the debt restructuring referred to above to reduce the ongoing impact on loan charges of the fall in investment rates.

6.0 IMPLICATIONS

6.1 Legal: None. Any borrowing or lending is done under the Council's legal powers.

Finance: Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £836,000. The Council utilises Treasury Management as part of the overall Financial Strategy and Officers will continue to investigate borrowing and investment opportunities to bring financial benefits to the Council, all within the Treasury Management Policy.

Human Resources: None.

Equalities: None.

7.0 CONSULTATIONS

7.1 This report has been produced based on advice from the Council's treasury advisers (Sector Treasury Services Limited).

8.0 LIST OF BACKGROUND PAPERS

8.1 CIPFA - Code of Practice on Treasury Management 2001
Inverclyde Council – Treasury Management Strategy 2008/09
Inverclyde Council – Treasury Management Strategy 2009/10.

TREASURY MANAGEMENT
GLOSSARY OF TERMS

Affordable Capital Expenditure Limit
The amount that the Council can afford to allocate to capital expenditure in accordance with the requirements of the Local Government in Scotland Act 2003 and supporting regulations.

Authorised Limit for External Debt
This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bank of England
The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or "MPC").

Bank Rate
The interest rate for the UK as set each month by the Monetary Policy Committee ("MPC") of the Bank of England. This was previously referred to as the "Base Rate".

Capital Expenditure
Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the annual Statement of Recommended Practice (SORP) and for which the Council are able to borrow.

Capital Financing Requirement
This is a Prudential Indicator that can be derived from the information in the Council's Balance Sheet. It generally represents the underlying need to borrow for capital expenditure.

CIPFA
CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Consumer Prices Index
The Consumer Prices Index ("CPI") is a means of measuring inflation (as is the Retail Prices Index or "RPI"). The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try to keep CPI at or close to the target set by the Government (currently the target is 2%). The calculation of the CPI includes many items of normal household expenditure but the calculation excludes some items such as mortgage interest payments and Council Tax.

Counterparty
Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the "Counterparty".

Credit Ratings
Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

European Central Bank
Sometimes referred to as "the ECB", the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

European Investment Bank
Sometimes referred to as “the EIB”, this is the European Union's long-term lending institution from whom Strathclyde Regional Council took out some loans before local government reorganisation in 1996. These loans are now administered by Glasgow City Council to whom the Council makes payments of principal and interest.

Eurozone
The name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 16 countries: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Fed Rate
The interest rate for the US. Rates for the US are set by the Federal Reserve (the central bank for the US and the equivalent of the Bank of England).

Federal Reserve
Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments is fixed and does not change.

Flat Yield Curve
A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Gilt Yields
A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts
Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on base rate expectations, and on market conditions.

Gross Domestic Product
Gross Domestic Product (“GDP”) is a measure of the output of goods and services from an economy.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

Inflation
Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index (“CPI”) or the Retail Prices Index (“RPI”).

Inverted Yield Curve
An inverted or negative yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

LIBID
This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR
This is the London Inter Bank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

LOBO
This is a form of loan that the Council has with some lenders. The term is short for the phrase “Lender Option/Borrower Option”.

MPC
The MPC or Monetary Policy Committee is a committee of the Bank of England that meets each month (in a meeting over 2 days) to set the Bank Rate for the UK.

Negative Yield Curve
A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

Net Borrowing Requirement
This is the difference between the Council’s net external borrowing and its capital financing requirement. Under the Prudential Code the Council’s net external borrowing should not, except in the short term, exceed its capital financing requirement. The Net Borrowing Requirement should therefore normally be a negative figure.

Operational Boundary
This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Positive Yield Curve
A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).

Prudential Code
Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators.

Prudential Indicators
Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB
The Public Works Loans Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Rates
The interest rates chargeable by the Public Works Loans Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the close of business on the preceding business day.

Quantitative Easing
The creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

Ratings
Ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an indication of the financial or operational strength of entities including financial institutions and even countries. Ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

Repo Rate
This is another name for the Bank Rate as set by the Monetary Policy Committee.

Retail Prices Index
The Retail Prices Index ("RPI") is a means of measuring inflation (as is the Consumer Prices Index or "CPI"). The calculation of the RPI includes most of the same items as the CPI as well as some items not included in the CPI such as mortgage interest payments and Council Tax whilst excluding items that are in the CPI such as charges for financial services.

Sector
Sector Treasury Services Limited who are the Council's treasury management advisers.

Treasury Management in the Public Services: Code of Practice
This is a code of practice for Council treasury management activities that is produced by CIPFA.

Treasury Management Practices (TMPs)
This is a Council document that sets out Council policies and procedures for treasury management as required by the CIPFA "Treasury Management in the Public Services: Code of Practice". The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Variable Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments varies on an agreed basis.

Yield
The yield is the effective rate of return on an investment.

Yield Curve
A graph showing the yield on investments plotted against the maturity period for investments:

- A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).
- A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).
- A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Finance Services
Inverclyde Council
August 2009.

Appendix 2

THE ECONOMY IN 2008/09
KEY DATES AND EVENTS

8/9/2008
- Nationwide takes over Cheshire and Derbyshire Building Societies.

15/9/2008
- Lehman Brothers filed for bankruptcy.

16/9/2008
- US Government nationalises AIG (a major global insurance company based in US).

17/9/2008
- Lloyds TSB in advanced talks with HBOS to save it by merger after major collapse in HBOS share value.

19/9/2008
- US Government announces TARP (Troubled Assets Relief Programme) of $700bn.

22/9/2008
- Last two US investment banks Goldman Sachs and Morgan Stanley give up investment bank status.

25/9/2008
- Washington Mutual (fourth biggest US retail bank) fails. Biggest bank to fail in US history.

29/9/2008
- UK: Bradford and Bingley nationalised.
- US: Wachovia sixth largest bank fails.
- Germany: Hypo Real Estate (owner of Depfa Bank based in Ireland) bailed out by consortium of German banks.
- Fortis: bailed out by Belgium, Netherlands and Luxembourg Governments.
- Iceland: Glitnir - third largest Icelandic bank - 75% nationalisation.
- US: Congress refuses to approve TARP

30/9/2008
- Ireland announces guarantee on all Irish bank deposits to 28/9/2010. Other EU countries concerned at lack of level playing field for banks across EU.
- Icelandic Banks Landsbanki, Heritable and Kaupthing, Singer & Friedlander have short term credit ratings downgraded from F1 to F3, and Glitnir from F2 to F3.

3/10/2008
- The UK Financial Services Authority (FSA) increases savings guarantee on all deposits from £35,000 to £50,000.

7/10/2008
- Icelandic Government takes over banks.

8/10/2008

- Coordinated emergency 0.5% Bank Rate cuts by UK, ECB, US, Canada, Sweden and Switzerland.
- UK £500bn bank bailout package announced in principle. 8 named banks covered by bank recapitalisation scheme - they are to increase their tier 1 capital by £25bn in aggregate. £25bn available in exchange for preference shares or PIBS, £25bn in exchange for ordinary shares, preference shares or permanent interest bearing shares, £250bn to guarantee debt issuance by 8 banks, plus £200bn to be made available under Special Liquidity Scheme in short lending support. Bank of England to announce next week a permanent regime to underpin banking system liquidity including a discount window facility.

13/10/2008

- £37bn cash injection into RBS, HBOS and Lloyds TSB - £28bn as ordinary shares and £9bn as preference shares @ 12%. RBS takes up £15bn as ordinary shares, £5bn as preference shares = 63% nationalisation. HBOS £11.5bn, Lloyds £5.5bn = 43% of combined group. Barclays to raise £6.5bn from investors.
- Germany, France and Spain announce €1 trillion package to support banks through state guarantees and bank recapitalisation.

22/10/2008

- Barnsley Building Society forced to seek a rescue merger with Yorkshire Building Society after facing up to £10m in losses on cash it had deposited with Icelandic banks Kaupthing Singer & Friedlander and Heritable.

19/1/2009

Bank support package 2

- RBS swaps £5bn preference shares for ordinary shares – now 70% nationalised.
- £250bn Government guarantees (insurance scheme) for toxic assets clogging up bank balance sheets; insurance scheme putting a floor on the amount that banks can lose on them (will help to free up capital).
- £100bn Government guarantees for new bonds issued by banks to back fresh loans to consumers, homebuyers and businesses – aim to reopen the asset backed security market.
- Extension of £250bn credit guarantee scheme October 2008 extended to end of 2009.
- £50bn asset purchase facility to buy corporate bonds, commercial paper and other company debts.
- Northern Rock to start lending to customers again and to stop repaying its loan from the Government (subject to EU approval). Northern Rock to be split into good bank (with new input of capital from the Government) and bad bank.
- FSA announced that capital buffers built in during the recapitalisations of banks can be allowed to run down during the downturn on the basis that they will strengthen again once the business cycle turns.
- Bank of England's Special Liquidity Scheme due to close in January but will be replaced by the Bank of England's discount window to ensure banks have permanent access to long term liquidity.
- Bank of England given the go ahead to embark on quantitative easing through purchasing assets from banks whose liquidity is currently impaired.

13/2/2009

- Asset purchase scheme starts buying commercial paper.

26/2/2009

- Asset Protection Scheme (APS) published – insurance of toxic assets.
- RBS lost £24bn in 2008. Government support increases from £20bn to £45bn. The surprise need for additional capital was necessary to facilitate RBS's participation in the Government's Asset Protection Scheme - under which the Treasury will guarantee the bank against losses on £325bn of its problem assets. The Government will inject an immediate £13bn into RBS in return for non-voting ‘B’ shares. It will then make an additional £6bn available at the request of the bank. RBS will pay £6.5bn in fees to take part in the APS in the form of ‘B’ shares, taking the total to up to £25.5bn. The need for additional capital was because of RBS's agreement to shoulder the first £19.5bn of losses on assets put into the APS. Losses larger than that will be shared 90% by the Government and 10% by RBS.

5/3/2009

- Quantitative Easing: twice weekly buying to start 11 March.

9/3/2009

- Lloyds Banking Group (LBG) puts £260bn into Asset Protection Scheme = £216bn from HBOS and higher than expected £44bn from Lloyds TSB. Following the preference share conversion, LBG will be 65%-owned by the UK Government (assuming no take-up by existing shareholders) and this figure would rise to 77% assuming the Government exercised an option to convert the £15.6bn 'B' shares issued to it as the fee for participation in the APS. Upon completion of the APS transaction LBG's core Tier 1 capital ratio will increase sharply to around 14.5%, leaving it well-equipped to meet the mortgage and small business lending targets agreed with the UK Government.

25/3/2009

- Governor of the Bank of England advises against any further fiscal expansion in upcoming budget – no more debt issuance affordable; leave it to Bank of England to do Quantitative Easing now.
- Government gilt auction fails; £1.75bn 2049 conventional – first failure since 2002.

30/3/2009

- Dunfermline Building Society taken over by Nationwide.
- Irish AAA sovereign rating downgraded by Standard & Poor’s to AA+ as debt to GDP ratio is expected to exceed 70% and will be difficult to get down again below that level.

Finance Services
Inverclyde Council
August 2009.

Appendix 3

PRUDENTIAL INDICATORS

	2007/08	2008/09
	Actual	**Actual**
Capital Expenditure (Indicator 5)	£000	£000
Non – HRA	39,994	24,490
HRA #	7,576	0
TOTAL	47,570	24,490
Ratio of financing costs to net revenue stream (Indicator 1)		
Non – HRA	10.35%	8.18%
HRA #	40.68%	0.00%
Net borrowing requirement (Indicator 4)	£000	£000
As At 31 March	-37,962	-40,024
Capital Financing Requirement as at 31 March (Indicator 6)	£000	£000
Non – HRA	176,130	184,135
HRA #	0	0
TOTAL	176,130	184,135
Upper limit for total principal sums invested for over 364 days (Indicator 14)	£0	£0
# - The Council undertook Housing Stock Transfer during 2007/08.		

Table 1
Prudential Indicators

	Estimate For 2009/10 £million	Actual For 2009/10 Quarter 1 £million	Within Limits
PI 7 - Authorised Limit for External Debt	222.911	189.907	Yes
PI 8 - Operational Limit for External Debt	212.960	189.907	Yes
PI 10 - Compliance with CIPFA code			Yes
	%	%	
PI 11 - Upper limit on fixed interest exposure	130.00%	92.57%	Yes
PI 12 - Upper limit on variable rate exposure	30.00%	7.43%	Yes

PI 13 Borrowing fixed rate maturing in each period	Upper	Lower	Actual	Within Limits
Under 12 months	30%	0%	11.834%	Yes
1 - 2 years	30%	0%	0.003%	Yes
2 - 5 years	30%	0%	6.951%	Yes
5 - 10 years	45%	0%	2.132%	Yes
10 years and above	100%	55%	79.080%	Yes
			100.000%	

	Limit For 2009/10 £	Maximum In Quarter 1 £	Within Limit
PI 14 - Upper limit on sums invested for periods longer than 364 days	20,000,000	0	Yes

Table 2
Council Policy Limits

	Limit per Council Policy	Actual For 2009/10 Quarter 1	Within Limit
Maximum proportion of borrowing at variable interest rat	35%	33.240%	Yes
Maximum proportion of debt restructuring in any one year	30%	8.216%	Yes
Maximum proportion of debt repayable in any one year	20%	21.063%	No

Appendix 4

Table 1
Debt Outstanding - Analysis By Time

	£ Million	Average Interest Rate	Proportion of Debt
Borrowings up to 1 year			
Public Works Loan Board Loans	15.003	0.89%	7.900%
European Investment Bank Loans	0.000	0.00%	0.000%
Temporary Loans	21.225	0.55%	11.177%
	36.228	**0.69%**	**19.077%**
Borrowings over 1 year			
Public Works Loan Board Loans	50.779	4.50%	26.739%
European Investment Bank Loans	0.000	0.00%	0.000%
Money Market Loans	102.900	4.47%	54.184%
	153.679	**4.48%**	**80.923%**
Total Debt Outstanding 30th June 2009	**189.907**	**3.76%**	**100.000%**

Table 2
Debt Outstanding - Analysis By Fixed/Variable

	£ Million	Average Interest Rate	Proportion of Debt
Variable Rate Loans			
Public Works Loan Board Loans	0.000	0.00%	0.000%
European Investment Bank Loans	0.000	0.00%	0.000%
Temporary Loans	21.225	0.55%	11.177%
Market Loans *	41.900	4.57%	22.063%
	63.125	**3.22%**	**33.240%**
Fixed Rate Loans			
Public Works Loan Board Loans	65.782	3.68%	34.639%
Market Loans *	61.000	4.40%	32.121%
	126.782	**4.02%**	**66.760%**
Total Debt Outstanding 30th June 2009	**189.907**	**3.76%**	**100.000%**

* - Market Loans are shown as variable when they have less than 1 year to go until their next call date.

Appendix 6

Table 1

Investments and Deposit Accounts Balances As At 30th June 2009

	Annual Rate	Amount	Deposit Type	Maturity Date
Investments		£		
Bank of Scotland	6.75%	10,000,000	Fixed	02-Jul-09
Bank of Scotland	6.42%	10,000,000	Fixed	13-Aug-09
Bank of Scotland	4.00%	10,000,000	Fixed	07-Dec-09
Bank of Scotland	3.26%	5,000,000	Fixed	06-Jan-10
		35,000,000		
Deposit Accounts				
Bank of Scotland	0.50%	9,900,900	Call	
Abbey #	0.60%	8,000,182	Call	
Bank of Scotland ##	0.51%	42,323	7-Day Notice	
		17,943,405		

* - Investment entered into since last quarterly report.
# - Account has tiered rates. Rate shown is for the balance in the account.
'## - The rate on this account varies on a weekly basis.