



Glasgow City Council

Report to the Finance and Audit Scrutiny Committee

Report by the Executive Director of Financial Services

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Item 7

2nd December 2009

TREASURY MANAGEMENT ANNUAL REPORT 2008/09 AND 2009/10 UPDATE

Purpose of Report:

To advise members of the outturn Treasury Management position for 2008/09 and provide an update on 2009/10.

Recommendations:

The Committee is invited to note

- (a) the Treasury Management Annual Report for 2008/09, and
- (b) the Treasury Management Update for 2009/10.

Ward No(s):

Citywide:

Local member(s) advised: Yes No Consulted: Yes No

FINANCE AND AUDIT SCRUTINY COMMITTEE

TREASURY MANAGEMENT ANNUAL REPORT 2008/09 AND 2009/10 UPDATE

INTRODUCTION

1. The Treasury Management Policy Statement approved by the Policy and Resources Committee on 27th March 2002 included the requirement to regularly report to committee on the review of treasury management activity.

REVIEW OF TREASURY MANAGEMENT ACTIVITY 2008/09

2. Committee previously considered an interim report for the year in January 2009. This report considers the overall performance for the year.

Summary Position

3. A summary of the Council's debt portfolio and investment position as at 31st March 2009 is outlined in Appendix 1.

The Economy and Interest Rates

4. The major economic events of the financial year and the impact they had on interest rates was without precedent. The financial crisis had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England. Investment income returns have been badly hit but lower borrowing rates in short to medium periods has benefited Glasgow City Council.
5. When the Treasury Strategy for 2008/09 was approved, it was anticipated that the Bank Rate would be stable in 2008-09 at 5.25%. This was based on the Monetary Policy Committee (MPC) balancing the opposing risks of rising inflationary pressures on one hand, and the impact of the credit crunch on the economy and the knock on impact on world economic growth rates on the other hand.
6. On 1st April 2008 Bank Rate was 5% and the Bank of England was focused on addressing inflation, which was sitting above the 2% CPI target. Lehman Brothers, a US investment bank, filed for bankruptcy on 15 September 2008. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. Shortly thereafter the Icelandic government took control of their banks and the UK government provided £37bn to three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. In the meantime, the MPC had reduced interest rates by 0.5% to 4.5% on 9th October. Market focus shifted from inflation concerns to concerns about recession, depression and deflation.
7. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5% to 3%, and as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates further by 1% in December, 0.5% in January, 0.5% in February and 0.5% in March, closing the year at 0.5%, a record low.
8. The market assumption, when the Treasury Strategy for 2008/09 was approved, was that long-term interest rates (50 years) would remain static at around 4.45% for the whole year. The Public Works Loans Board (PWL) 45-50 year rate was generally within a band of 4.3 - 4.6% until mid October when there was a spike up to 4.84%, followed by a plunge down to 3.86% in early December. Further spikes of 4.84% and 4.72% occurred in late January and early February, before closing the year at 4.58%. It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year.

Borrowing Strategy

9. The forecast when the 2008/09 strategy was approved was that short-term interest rates would be higher than long-term rates throughout 2008/09. Against this background, the Council planned to undertake the majority of its long-term borrowing activity at the back end of the financial year. However, as little variation was expected in average quarterly rates during the year, it was possible that attractive rates could be available at any time. The Executive Director of Financial Services would continue to monitor the interest rate market and adopt a pragmatic approach to changing circumstances as opportunities arose. New PWLB borrowing of £95.7m was secured in 2008/09 at an average interest rate of 2.62%.
10. During 2008/09 the Council restructured a total of £116m PWLB loans. Loans with interest rates as high as 9.75% were repaid and replaced with new PWLB loans with an average interest rate of 2.96%. Appendix 2 provides details of the PWLB loans restructured in 2008/09, while Appendix 3 provides details of the replacement loans taken. This resulted in annual interest savings of £3.4m.

Investment Strategy

11. The Council manages day-to-day cashflow requirements by investing with banks and other financial institutions on its approved lending list, the 'counterparty investment list', up to the approved investment limit of £15m with any one institution. The counterparty investment list has been updated as part of the regular review of the credit ratings of the banks and other financial institutions with which the Council invests its surplus funds. Investments are made for a range of periods from overnight to a maximum of 364 days, dependent on the Council's cashflows and the interest rates on offer. The investment limit of £15m was approved several years ago as part of the approved treasury management policy. No institutions in which investments were made had any difficulty in repaying investments and accrued interest in full during the year.
12. In addition to internally managed investments, the Council also holds externally managed investments in respect of the Insurance Fund, and on behalf of the Common Good and Sundry Trust Funds. As at 31 March 2009, the Council held investments of £28.5m with investment brokers Ruffer Limited Liability Partnership in respect of the Insurance Fund (£16.9m) and Common Good Fund (£11.6m), and £8.1m with Standard Life Investments in respect of Sundry Trust Funds.

Performance Indicators

13. The headline performance indicator for Treasury Management is the average cost of servicing loans as reflected in the Loans Fund Interest Rate. In the 2007/08 Annual and 2008/09 Update Report, the forecast interest rate for 2008/09 was 5.8%. The final outturn rate achieved for 2008/09 was an improvement on expectations at 5.7%.
14. The rate of return on externally managed investments can be compared to appropriate industry benchmarks. Both investment fund managers out-performed their respective benchmarks in 2008/09. The rate of return in respect of investments managed by Ruffer Limited Liability Partnership was 12.66% compared to a benchmark of 7.34%. Investments managed by Standard Life Investments achieved a rate of return of -7.92% compared to a benchmark of -20.39%.
15. It is worth noting that the Council withdrew its investment with Standard Life in respect of the Capital Fund in February 2009, in order to safeguard these resources against further exposure to changing market conditions since these resources will be required in the short to medium term. These resources are now being managed internally, with capital preservation being the key priority.

Compliance with Treasury Limits

16. The Local Government in Scotland Act 2003 requires the Council to set Prudential Indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable. During 2008/09, the Council operated within the treasury limits set for the management of the Treasury function. The 2008/09 Prudential Indicators final outturn position is outlined in Appendix 4.

Operating Leases

17. A summary of the operating leases entered into during 2008/09 is outlined in Appendix 5.

TREASURY MANAGEMENT UPDATE 2009/10

18. This report provides an interim analysis of the Council's treasury management activities to 30th September 2009 and covers:

- Summary Position
- Interest Rates
- Borrowing Strategy
- Investment Strategy
- Performance Indicators
- Adherence to Treasury Limits
- Counterparty Investment List Update and
- Operating Leases

Summary Position

19. A summary of the Council's debt portfolio and investment position as at 30 September 2009 is outlined in Appendix 6.

Interest Rates

20. In approving its strategy for 2009/10, the committee noted the market assumptions of long term interest rates in the range of 3.9% to 3.95% and short term interest rates at a stable 0.5%. The current position is as follows:

(a) Long Term

The 50 year PWLB rate started the year at 4.57% and was 4.25% as at 30 September 2009. The rate is expected to reach 4.55% by 31st March 2010.

b) Short Term

Short term rates started the year and have remained stable at 0.5% as at 30 September 2009. Forecasters are not anticipating any change to the rate by 31st March 2010.

Borrowing Strategy

21. The Executive Director of Financial Services will continue to monitor the interest rate market and adopt a pragmatic approach to changing circumstances as opportunities arise.
22. The PWLB are the main source of capital funding to local authorities, offering loans at interest rates set by reference to Government borrowing rates in the gilt markets. In addition to these rates, the flexibility and transparency in the terms under which loans were advanced have been attractive to local authorities, allowing a reduction in risk in managing our debt portfolio.
23. In 2009/10 to date, new PWLB borrowing of £21.1m has been secured at an average interest rate of 3.91%. This is in line with the Council's Capital Forecast model and delivery of the approved Investment Programme, and reflects the use of internal resources.
24. The Council's reserve and fund balances may be utilised to limit the new external borrowing requirement, as an alternative to investing these resources. Reducing investment balances rather than increasing external borrowing will both reduce interest payable, as short term rates on investments are likely to be lower than rates paid on external borrowing, and limit exposure to investment risk. In 2009/2010 to date, this strategy has facilitated the early repayment of PWLB debt totalling £75m, with an average interest rate of 4.32%. This has generated a non-recurring discount of £0.5m and ongoing annual revenue savings of £3.2m.
25. The introduction of different PWLB rates in November 2007 for new borrowing, as opposed to early repayment of debt, has meant that loan debt restructuring is now less attractive than before. Nevertheless, opportunities for restructuring still remain.
26. In order to minimise interest charges, the Council has actively monitored potential restructuring opportunities in order to generate cash savings at a minimum risk and improve the balance of the loan debt maturity profile. In 2009/10 to date, the Council has repaid £53.9m of PWLB loans, with an average interest rate of 4.4%. These loans were replaced with new PWLB loans totalling £53.9m, with an average interest rate of 2.9%. This restructuring has resulted in annual net savings of £0.8m.
27. Pro-active debt management, therefore, will continue to be very important to the Council in procuring financial savings and delivering our financial strategies, as can be seen from the examples detailed above.

Investment Strategy

28. In light of the current economic climate, including the collapse of Icelandic banks, the Council has strengthened its strategy in respect of investments. The key priority of the strategy is to preserve the principal investment, minimising the risk of any loss on the principal sum invested. The Council will also aim to achieve the optimum return on its investments within an agreed risk framework and liquidity requirements.
29. The Council will continue to manage day-to-day cashflow requirements by investing with institutions on its approved counterparty investment list. The counterparty investment list will continue to be updated as part of the regular review of the credit ratings of the banks and other financial institutions with which the Council invests its surplus funds. The current counterparty investment list is outlined in Appendix 7. Given that investment rates are to remain at a historically low level throughout the year and with uncertainty in the banking sector is still prevalent, the Council will keep investments short dated throughout 2009/10. The limit of investments will reflect the level of available Council reserve balances, subject to paragraph 24 above, together with provision for managing the Council's day-to-day cashflow requirements.
30. In addition to internally managed investments, externally managed investments are currently held in respect of the Insurance Fund and on behalf of the Common Good Fund and Sundry Trusts. Investments in respect of the Insurance Fund and Common Good Fund are currently held with investment brokers Ruffer Limited Liability Partnership, while investments in respect

of Sundry Trusts are held with Standard Life Investments. Although these investments will be impacted upon by the recent downturn in the value of shares and equities, given that these funds are all invested on a longer term basis, there are currently no changes proposed to the management of these resources.

31. The Executive Director of Financial Services will continue to monitor the economic environment and adopt a pragmatic approach to changing circumstances. A balanced view of risk against return will be taken in respect of all investments. It is anticipated that return on investments will be limited in 2009/10 as a result of Bank Rate forecasts and the over-riding principal of risk aversion.

Performance Indicators

32. The estimated pooled interest rate for 2009/10, as outlined in the 2009/10 strategy, is 5.7%. However, as a result of the borrowing and investment strategy outlined above and significant decreases in Base Rate, it is forecast that the 2009/10 rate will be 4.6% for the full financial year.
33. The rate of return on externally managed investments can be compared to appropriate industry benchmarks. In 2009/10 to date, both investment fund managers out-performed their respective benchmarks. The rate of return in respect of investments managed by Ruffer Limited Liability Partnership was 11.34% compared to a benchmark of 1.04%. Investments managed by Standard Life Investments achieved a rate of return of 26.81% compared to a benchmark of 17.86%.

Adherence to Treasury Limits

34. In 2009/10 to date, the Council has adhered to the limits set for the management of the Treasury function.

Operating Leases

35. A summary of the operating leases entered into in 2009/10 to 30 September 2009 is outlined in Appendix 8.

FINANCIAL ISSUES

36. The impact on the pooled interest rate detailed above will be utilized in the management of the Council's overall budget.

PERSONNEL ISSUES

37. There are no personnel implications.

LEGAL ISSUES

38. There are no legal implications.

SERVICE PLAN ISSUES

39. These matters currently form part of the operational activities of the department and there are no specific service plan issues to be considered.

ENVIRONMENTAL CONSIDERATIONS

40. There are no environmental considerations.

RECOMMENDATIONS

41. The Finance and Audit Scrutiny Committee is invited to note

- (a) the Treasury Management Annual Report for 2008/09, and
- (b) the Treasury Management Update for 2009/10.

CORPORATE RISK REGISTER WORKING GROUP MEMBERSHIP 2009/2010

Service	Name	Post
Financial Services	Tom McCabe	Head of Service Development
Chief Executive / Corporate Services	Iain Scott	Assistant Director
Chief Executive / Corporate Services	John Watson	Senior Health and Safety Officer
Development & Regeneration Services	Gerry Gormal	Assistant Director
Education Services	Jim Wilson	Head of Performance & Review
Land & Environmental Services	David McClelland	Head of Service Development
Social Work Services	John Donaldson	Head of Immigration & Emergency Services
Culture & Sport Glasgow	Susan Deighan	Strategic Planning & Corporate Services
Cordia	Andy Clark	Finance Director

The following substitutions were made for the workshop held 23rd July 2009

Service	Name	Post
Culture & Sport Glasgow	Joe Larkin	Assistant Business Support Manager
Cordia	Fiona Wade	Financial Accountant
Education Services	Alasdair Henderson	Manager, Children & Young People Support

The following sent their apologies and were consulted to gain their input.

Service	Name	Post
Chief Executive / Corporate Services	Iain Scott	Assistant Director
Development & Regeneration Services	Gerry Gormal	Assistant Director
Land & Environmental Services	David McClelland	Head of Service Development

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PWLB Loans Restructured 2008/09

Loan Ref.	Amount £	Interest Rate
466953	3,059,999.73	9.750%
465161	1,380,132.69	9.500%
465027	14,222,749.70	9.500%
466623	14,222,749.70	9.375%
467697	1,380,132.69	9.875%
492759	25,000,000.00	4.250%
492836	20,000,000.00	4.250%
493351	26,000,000.00	4.600%
493908	7,000,000.00	4.550%
493913	4,000,000.00	4.550%
Total	116,265,764.51	5.900%

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Replacement Loans 2008/09

Loan Details	Reference	Maturity Date	Interest Dates	Amount £	Interest Rate
<u>PWLB Loans</u>					
New Loans 23/10/08					
50 Year maturity at 4.47%	494958	22/10/2058	22 Apr and 22 Oct	14,265,765	4.47%
New Loans 2/12/08					
50 year maturity at 4.12%	495097	01/12/2058	1 Jun and 1 Dec	20,000,000	4.12%
New Loans 2/02/09					
3 year maturity at 2.10%	495277	01/02/2012	1 Feb and 1 Aug	27,000,000	2.10%
3.5 year maturity at 2.35%	495278	01/08/2012	1 Feb and 1 Aug	27,000,000	2.35%
4.5 year maturity at 2.77%	495279	01/08/2013	1 Feb and 1 Aug	28,000,000	2.77%
Total Replacement Loans				116,265,765	2.96%

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2008/09 Prudential Indicators Final Outturn

		2008/09 Actual
Affordability Indicators		
1) Actual Ratio of Financing Costs to Net Revenue Stream		5.48%
2) Actual Incremental Impact of Capital Investment Decisions on the Council Tax		None
Prudential Indicators		
3) Actual Net Borrowing Less the Capital Financing Requirement		-£51m
4) Actual Capital Expenditure for 2008/09		£212m
5) Actual Capital Financing Requirement as at 31/03/09		£1,444m
External Debt		
6) Authorised Limit	£1,700m	Within Limit
7) Operational Boundary	£1,600m	Within Limit
Treasury Management		
8) CIPFA Code of Practice for Treasury Management		Adopted
9) Upper Limit on Fixed Interest Rate Exposures	90%	Within Limit
10) Upper Limit on Variable Interest Rate Exposures	40%	Within Limit
11) Maturity Structure of Borrowing		
a) Under 12 months		18.50%
b) 12 months and within 24 months		2.19%
c) 24 months and within 5 years		7.62%
d) 5 years and within 10 years		8.81%
e) 10 years and above		62.88%

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Summary New Operating Leases 2008/09

Service Department	Number of Agreements	Original Capital Value £	Revenue Rental per annum £	Lease Terms
Land and Environmental Services	34	12,670,980.62	2,419,470.99	2, 3, 4, 5, 6 & 7 years
Total	34	12,670,980.62	2,419,470.99	

Vehicles and plant were leased during the period.

The lessors used were Societe Generale Equipment Finance, Siemens Financial Services JCB Finance Limited and Asset Advantage Limited.

All contracts were awarded after a full tendering process in compliance with the procedures for public procurement in respect of the local authorities' tendering requirements.

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Summary Debt and Investment Position as at 30 September 2009

	Amount as at 30/9/09 £ 000s	Annual Average Interest Rate	% Share Total Debt	Amount as at 31/3/09 £ 000s	Annual Average Interest Rate	% Share Total Debt
Debt						
Public Works Loan Board	832,074	5.49%	61.6%	885,968	5.52%	58.70%
Temporary Loans	70,774	0.63%	5.2%	173,332	3.50%	11.50%
Market Loans & Local Bonds	449,008	4.42%	33.2%	449,008	4.35%	29.70%
European Investment Bank*	0	0.00%	0.0%	1,667	8.05%	0.10%
Stock	9	3.50%	0.0%	9	3.50%	0.00%
Total Debt	1,351,865	4.88%	100.0%	1,509,984	4.94%	100.0%
Investments						
Internally Managed Investments	127,360	0.83%		27,597	4.80%	
Externally Managed Investments:						
Ruffer LLP	32,578	11.34%		28,542	12.66%	
Standard Life Investments	10,323	26.81%		8,117	-7.92%	
Total Investments	170,261	4.42%		64,256	6.68%	

***Note**

European Investment Bank loans were repaid in full at 30 June 2009.

Counterparty Investment List

Institution	Country	Long Term Rating	Short Term rating	Support Rating
Abbey National plc **	GBR	AA-	F1+	1
ABN AMRO Bank N.V.	NLD	AA-	F1+	1
Alliance & Leicester	GBR	AA-	F1+	1
Australia & New Zealand Banking Group	AUS	AA-	F1+	1
Banco Bilbao Vizcaya Argentaria (BBVA)	ESP	AA-	F1+	1
Banco Popular Espanol	ESP	AA-	F1+	2
Banco Santander Central Hispano	ESP	AA	F1+	1
Banco Santander Totta SA	POR	AA	F1+	1
Bank Netherlandse Gemeenten	NLD	AAA	F1+	1
Bank of Montreal	CAN	AA-	F1+	1
Bank of Nova Scotia	CAN	AA-	F1+	1
Halifax/Bank of Scotland Plc	GBR	AA	F1+	1
Barclays Bank plc	GBR	AA-	F1+	1
BNP Paribas	FRA	AA	F1+	1
Caixa Geral de Depositos	PRT	AA-	F1+	1
CALYON	FRA	AA	F1+	1
Canadian Imperial Bank of Commerce	CAN	AA-	F1+	1
Clearstream Banking	LUX	AA+	F1+	1
Clydesdale Bank **	UK	AA-	F1+	1
Commonwealth Bank of Australia	AUS	AA	F1+	1
Ahorros	ESP	AA-	F1+	2
Credit Agricole	FRA	AA	F1+	1
Credit Industriel et Commercial(CIC)	FRA	AA-	F1+	1
Credit Suisse	GBR	AA-	F1+	1
Deutsche Bank AG	DEU	AA-	F1+	1
Corporation	HKG	AA	F1+	1
HSBC Bank plc	GBR	AA	F1+	1
HSBC Bank USA	USA	AA	F1+	1
Intesa Sanpaola	ITA	AA-	F1+	1
Landwirtschaftliche Rentenbank	DEU	AAA	F1+	1
Lloyds TSB Bank	GBR	AA-	F1+	1
National Australia Bank **	AUS	AA	F1+	1
National Westminster Bank	GBR	AA-	F1+	1
Nationwide Building Society	GBR	AA-	F1+	2
Noredea Bank AB	SWE	AA-	F1+	1
Nordea Bank Finland plc	FIN	AA-	F1+	1
Northern Trust Company	USA	AA-	F1+	3
Rabobank International	NLD	AA+	F1+	1
Royal Bank of Canada	CAN	AA	F1+	1
Royal Bank of Scotland plc (The)	GBR	AA	F1+	1
Svenska Handelsbanken	SWE	AA-	F1+	1
Toronto-Dominion Bank	CAN	AA-	F1+	1
Westpac Banking Corporation	AUS	AA-	F1+	1

Glasgow City Council**Summary New Operating Leases 2009/10 to 30 September 2009**

Service Department	Number of Agreements	Original Capital Value £	Revenue Rental per annum £	Lease Terms
Land and Environmental Services	9	4,519,725.61	870,954.70	3, 4, 5 & 7 years
Total	9	4,519,725.61	870,954.70	

Vehicles and plant were leased during the period.

The lessors used were Siemens Financial Services, Societe Generale Equipment Finance and JCB Finance Limited.

All contracts were awarded after a full tendering process in compliance with the procedures for public procurement in respect of the local authorities' tendering requirements.