CABINET
7 JULY 2009

ITEM NO. ....

TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL INDICATORS 2008/09

Responsible Cabinet Member – Councillor Chris McEwan, Efficiency and Resources Portfolio

Responsible Director - Paul Wildsmith, Director of Corporate Services

SUMMARY REPORT

Purpose of the Report

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and covers treasury activity for 2008/09. The report also seeks approval of the Prudential Indicators results for 2008/09 in accordance with the Prudential Code. In addition the report requests further revision to the Investment Strategy for 2009/10.

Summary

2. The financial year 2008/09 presented exceptional circumstances with regard to treasury management. The downturn in the economy, coupled with increased counterparty credit risk presented the Council with additional issues not normally encountered. For Darlington Council the main implications of these exceptional circumstances have been :-

    (a) Deteriorating investment returns, resulting in reduced investment income from that originally budgeted.
    (b) Increase in counterparty risk (the institutions that we invest with). This had two impacts, reduced counterparties that the Council could use and also change in the management of the function by running a net book (ie using investments to fund expenditure thereby reducing debt) and in 2009/10 actually using returning investments to repay debt.

3. Two further changes to the Investment Strategy are proposed to help to improve performance and manage risks, adding the Council's bank to the counterparty list and increasing the limits for money Market funds.

4. During 2008/09 the Council complied with its legislative and regulatory requirements and no investments are at risk with the Icelandic banks. The Director of Corporate services also confirms that borrowing was only undertaken for capital purposes and the Statutory borrowing limit, the Authorised limit was not breached.

5. At 31 March 2009, the Council's external debt was £104.242M (£101.242M at 31 March 2008) with an average interest rate of 4.27%. Investments totalled £39.900M (£43.460M at 31 March 2008) earning interest of 5.23% on short term investments and 5.72% on long term.

6. Financing costs have been reduced during the year and a saving of £220,000 achieved from the revised MTFP as reported elsewhere on this agenda as a result of a number of actions taken throughout the year to manage the financing costs in the changing economic climate.

Recommendation

7. It is recommended that :-

   (a) The outturn 2008/09 Prudential Indicators within this report and those in Appendix 1 be noted.

   (b) The Treasury Management Annual Report for 2008/09 be noted.

   (c) The Councils own bank (currently Nat West) be added to the Counterparty list with a cash limit of £3M and a time limit of 3 months.

   (d) A further two Money Market Funds be added to the counterparty list with a maximum investment of £5M each but with an overall limit of investments in Money Market Funds of £20M.

   (e) This report be forwarded to Council, in order for the prudential Indicators for 2008/09 to be approved.

Reasons

8. The recommendations are supported by the following reasons :-

   (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.

   (b) To inform members of the Performance of the Treasury Management function.

   (c) To comply with the requirements of the Local Government Act 2003.

Paul Wildsmith
Director of Corporate Services

Background Papers
1. Accounting Records
2. Annual Investment Strategy 2008/09
3. Prudential Indicators and Treasury Management Strategy Report 2008/09

Elaine Hufford : Extension 2447

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Sustainability	There are no issues relating to environmental impact
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is a key decision and as such has been reported on the forward plan
Urgent Decision	For the purpose of 'call-in' procedure this does not represent an urgent matter
One Darlington: Perfectly Placed	The proposals in the report support delivery of the Sustainable Community Strategy through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that has enabled officers to take advantage of changing interest rates to benefit the Revenue MTFP. Proposals to amend the counterparty list and increase limits for money Market Funds are made to increase efficiency, consistent with managing risks.

MAIN REPORT

Information and Analysis

9. This report summarises:

   (a) capital expenditure and financing for 2008/09;
   (b) overall borrowing need;
   (c) treasury position at 31 March 2009;
   (d) prudential indicators and compliance issues;
   (e) the economic background for 2008/09;
   (f) The Treasury Management Strategy agreed for 2008/09;
   (g) Treasury Management activity during 2008/09;
   (h) performance and risk.
   (i) Revised Investment Strategy 2008/09

The Council's Capital Expenditure and Financing 2008/09

10. The Council undertakes capital expenditure on long term assets, which is financed either:

    (a) immediately through capital receipts, capital grants, contributions and from revenue.; or
    (b) by borrowing .

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cashflow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.

12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £13.154M less than planned, resulting in £5.410M less borrowing being required.

Table 1 – Capital Expenditure and Financing

	2007/08	2008/09		
	Outturn £m	Revised Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	29.870	49.904	39.516	-10.388
HRA Capital Expenditure	11.449	12.484	9.718	-2.766
Total Capital Expenditure	**41.319**	**62.388**	**49.234**	**-13.154**
Resourced by:				
Capital Receipts	0.757	2.492	0.895	-1.597
Capital Grants	26.859	37.550	32.466	-5.084
Capital Contributions	1.191	3.322	1.861	-1.461
Revenue	2.783	2.822	3.220	0.398
Borrowing needed to finance 2008/09 expenditure	**9.729**	**16.202**	**10.792**	**-5.410**

The Council's Underlying Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. It represents 2008/09 and prior years net capital expenditure which has not yet been paid for by revenue or other resources.

14. The General Fund element of the CFR is reduced each year by a statutory charge to the revenue accounts called the Minimum Revenue Provision (MRP). The total CFR can also be reduced each year through a Voluntary Revenue Provision (VRP).

15. The VRP in Darlington Borough Council's accounts is made by, the decision to utilise £1.000M of Capital Receipts to repay debt in order to make future savings in the revenue account. This repayment during 2008/09 resulted in savings to revenue of £215,000 for 2008/09, £620,000 over the life of the Revenue MTFP and a further £300,000 beyond that, to 2018/19

16. The Council's CFR for the year is shown below, and represents a key prudential indicator. The CFR outturn for 2008/09 is £6.256M below the approved indicator, which is satisfactory.

Table 2 - Capital Financing Requirement

	2007/08	2008/09		
	Outturn £m	Approved Indicator £m	31 March Actual £m	Variance £m
Opening Balance	93.469	98.144	98.146	0.002
Add Capital Expenditure financed by borrowing	9.729	16.202	10.792	-5.410
Less MRP / VRP	-5.043	-2.986	-3.832	-0.846
Less Deferred Capital Receipts	-0.009			
Closing balance	**98.146**	**111.360**	**105.106**	**6.254**

Treasury Position at 31 March 2009

17. Whilst the measure of the Council's underlying need to borrow is the CFR, the Director of Corporate Services can manage the Council's actual borrowing position by: -

    (a) borrowing to the CFR level; or
    (b) choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or
    (c) borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).

18. The financial reporting practice that the Council is required to follow (the Statement of Recommended Practice (SORP)), changed in 2007/08. Financial instruments(borrowing and investments etc.) must now be reported in the Statement of Accounts in accordance with national Financial Reporting Standards. The figures in this report are based on actual amounts borrowed and invested and so will differ from those in the Statement of Accounts.

19. The Council's total debt outstanding at 31 March 2009 was £104.242M. The aim was to manage it to the Council's revised CFR position £111.360M. This meant when compared to our actual CFR £105.106M that the Council was "under borrowed" by £0.864M, this "under borrowed" amount was financed by internal borrowing ie the amount invested externally was reduced to cover this The treasury position at the 31 March 2009, including investments compared with the previous year was:

Table 3 – Summary of Borrowing and Investments

Treasury Position	**31 March 2008**		**31 March 2009**	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
Fixed Rate Debt Market and Public Works Loan Board (PWLB)	101.242	4.43	104.242	4.27
Total Debt	**101.242**	**4.43**	**104.242**	**4.27**
Cashflow Investments	18.710	5.85	24.150	5.25%
Capital Investments	24.750	5.60	15.750	5.72%
Total Investments	**43.460**		**39.900**	
Net borrowing position	**57.782**		**64.342**	

Prudential Indicators and Compliance Issues

20. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:

21. **Net Borrowing and the CFR –** Over the medium term the Council's external borrowing, net of investments, must only be for capital purposes. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2008/09 plus the expected changes to the CFR over 2009/10 and 2010/11. Table 4 highlights the Council's net borrowing position against CFR. The Council has complied with this prudential indicator.

Table 4 – Net Borrowing Compared with CFR

	31 March 2008 Actual £m	31 March 2009 Approved Indicator £m	31 March 2009 Actual £m
Net Borrowing Position	**57.782**	**63.445**	**64.342**
CFR	**98.144**	**111.360**	**105.106**

22. **The Authorised Limit –** The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level. Table 5 demonstrates that during 2008/09 the Council has maintained gross borrowing within its Authorised Limit.

23. **The Operation Boundary –** The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are both acceptable, subject to the Authorised Limit not being breached.

24. **Actual financing costs as a proportion of net revenue expenditure -** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue expenditure.

Table 5 – Key Prudential Indicators

	Actual 2007/09 £m	Approved Limit/ Estimate 2008/09 £m	Actual 2008/09 £m	Amount Below Limit/ Estimate £m
Approved Indicator – Authorised Limit	**101.285**	**124.638**	**124.638**	
Approved Indicator – Operational Boundary		**113.360**	**113.360**	
Maximum gross borrowing position	**101.285**	**113.360**	**107.261**	**6.099**
Average gross borrowing position	**98.264**	**107.301**	**104.986**	**2.315**
Minimum gross borrowing position	**95.242**	**101.242**	**101.242**	**0.00**
Financing costs as a percentage of net revenue expenditure	**1.83%**	**1.60%**	**1.50%**	

A further six prudential indicators are detailed in **Appendix 1**.

Economic Background for 2008/09

25. A summary of the general economic conditions that have prevailed through 2008-09 provided by Butlers, the Council's treasury management advisors is attached at **Appendix 2.**

Summary of the Treasury Management Strategy agreed for 2008/09

26. The revised Strategy agreed by Council on 29 January 2009 anticipated that during 2008/09 the Council would need to borrow £16.202M to finance part of its capital programme.

27. The Annual Investment Strategy stated that the use of Specified (usually less than 1 year) and non-specified (usually more than 1 year) investments will be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

28. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) was included in the report on the Prudential Indicators update approved by Council on 29 January 2009 and estimated long term investments of £15M were included for the three years 2008/09, 2009/10 and 2010/09 .

Treasury Management Activity during 2008/09

Debt Position

29. **Borrowing –** Loans taken out during the year to finance the expected net capital spend were: -

Table 9 – Borrowing 2008-09

Lender	Principal	Type	Interest Rate	Maturity	Average for 2008/09
Market	**£3.000M**	**Fixed interest for first six years**	**3.94%**	**70 years**	**4.45%**
This loan is fixed for the first six years thereafter annually the rate can change at the lenders option, however if this new rate is not favourable the loan can be repaid at no additional cost.					

30. The average rate of 4.45% compares with a budget assumption of borrowing at an interest rate of 4.5%

31. **Rescheduling –** Due to the economic outlook throughout 2008/09 the profile of loan rates changed, short term loans became considerably cheaper than longer term rates. These changes to the yield curve provided the Council with opportunities to make considerable savings over three years for the Revenue MTFP. In January a number of longer term loans were replaced with short term loans. The Council repaid 12 loans amounting to £29.974M, savings gained by any restructure are split between the Housing Revenue Account and the General Fund the table below summarises savings made to the General Fund for these transactions.

Table 10

	Loans repaid				Replacement Loans			
Date	**Amount £M**	**Duration of loans Years**	**Interest Rate**	**Discount received to General Fund £M**	**Amount £M**	**Duration of Loan Years**	**Interest Rate**	**Interest Savings to General Fund £M**
21/01/09	13.474	36.41	4.06%	0.240	13.474	1	1.17%	0.272
23/01/09	5.500	24.05	4.35%	0.011	5.500	2	1.61%	0.211
28/01/09	11.000	32.60	4.32%	0.317	6.250	2	1.55%	0.242
					4.750	3	2.11%	0.220
Total Savings				**0.568**				**0.945**

32. In the current year Officers have worked proactively in securing competitive borrowing from the market to ensure that as these new loans become repayable there will be further loans in place to protect these new borrowing rates achieved going forward.

33. **Repayment -** No loans were due for repayment during 2008/09.

34. **Summary of Debt Transactions –** The overall position of the debt activity resulted in an average interest rate of 4.27% compared with 4.43% for 2007/08.

Investment Position

35. **Investment Policy –** the Council's investment policy is governed by the Department of Communities and Local Government Guidance which has been implemented in the annual investment strategy approved by Council on 28 February 2008 this was subsequently reviewed in November 2008 in light of the financial crisis in the worldwide banking system. This review formalised a number of procedures currently carried out by officers and reduced the counterparty list further by restricting the list to UK Banks and Building Societies but keeping the ratings criteria the same.

36. In addition the amount able to be invested in the Government via the Debt Management Office became unlimited and nationalised institutions such as Northern Rock were added to the counterparty list with an investment time limit of 3months in line with the Government's guarantee.

37. Due to the increased counterparty risk, because of the financial crisi,s incoming investments were used to pay for ongoing expenditure rather than take out further loans to cover capital expenditure. This resulted in the average amount of money invested was reduced from the previous year.

38. The investment activity during the year conformed to the approved and revised Strategy and the Council had no liquidity difficulties.

39. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds as detailed below: -

Table 11 - Temporary Surplus Cash Balances

	Approved Revised Budget 2008/09	Actual 2008/09
Monthly Average level of Investments	**£24.00M**	**£22.02M**
Average Rate of Return on Investment	**5.25%**	**5.23%**
Interest Earned	**£1.260**	**£1.156**

Table 12 - Capital Receipts and Funds

	Approved revised Budget 2008/09	Actual 2008/09
Monthly Average level of Investments	**£25.60M**	**£23.41m**
Average Rate of Return on Investment	**5.25%**	**5.72%**
Interest Earned	**£1.344M**	**£1.342M**

40. In addition to the above further investment income was due from Durham County Council relating to the Council's holding in Newcastle International Airport Ltd (NIAL), which was transferred from Durham County Council towards the end of 2003/04. NIAL declared a dividend for 2008 and £25,000 is due for Darlington's share, a further £53,000 is due for interest on loans relating to 2007/08 and 2008/09.

41. To achieve further savings and reduce counterparty risk further during 2009-10 the Council has repaid debt of £23.408M. This will reduce financing costs as the difference between average debt and investment returns is circa 3.5%. This will produce savings of £68,250 per month for the period that the Council remains under borrowed; officers will work proactively to determine the correct time to enter the borrowing market again, taking into account both investment returns and prevailing borrowing rates. This timing cannot be predetermined although expectations are that these conditions will remain in place for at least 12 months. In addition to the savings on interest there was a small discount received for the repayment of the debt, which will be shared between the Housing Revenue Account and the General Fund.

Performance and Risk

Performance Indicators set for 2008/09

42. Performance indicators relating to interest rates for borrowing and investments were set for this service. These are distinct historic performance indicators, as opposed to the Prudential Indicators, which are predominantly forward looking. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

Table 13 – Performance Compared With Indicators

Borrowing	Average overall rate paid compared to previous years	**2007/08** 4.43%	**2008/09** 4.27%
Investments		**Average comparative rates**	**DBC**
Short term	Cash flow investment rate returned against comparative average rate	3.67%	5.23%
Long term	Capital investment rate returned against comparative average rates	4.33%	5.72%

Basket of comparative rates used to compare DBC performance: -	**Short Term Investments**	**Long Term Investments**
Comparative Rates		
Local Authority 2 day rate	3.64%	
Local Authority 7 day rate	3.64%	
Local Authority 6 month rate		4.58%
Local Authority 12 month rate		4.69%
London Inter Bank Bid (LIBID) 7 day rate	3.72%	3.72%
Average	**3.67%**	**4.33%**

43. As can be seen from the table, the actual investment rate achieved for short term investments exceeds the average of comparative rates for both short term and longer term investments.

Risk

44. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:-

(a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

(b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2008/09);

(c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

(d) The SI requires the Council to undertake any borrowing activity with regard to the CIFPA Prudential Code for Capital Finance in Local Authorities;

(e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services;

(f) Under the Act the Department for Communities and Local Government has issued Investment Guidance to structure and regulate the Council's investment activities;

(g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8^{th} November 2007.

45. The Councils Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

46. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed the debt and investments over the year. The Council has taken advantage of the change in the yield curve on both borrowing and investing to secure reduced financing costs for the Revenue MTFP.

Review of Investment Strategy

47. The current criteria for our counterparty list has lead to the number of banks listed being drastically reduced over the past year, more recently this has included Nat West of the Royal Bank of Scotland Group.

48. Whilst we have no specific investments with the bank our daily transactions are conducted through the bank, the bank does hold large quantities of money throughout the day whilst awaiting transfer to different accounts or payments to creditors etc. Occasionally payments come in late in the day and are unable to be transferred to other institutions.

49. Officers are requesting that the Councils own bank (at this point in time Nat West) be added to the counterparty list for investments up to a maximum of £3M with a time limit of 3 months. This will enable officers to set up a call account (investments requiring no notice to withdraw funds) to maximise deposits which cannot be invested elsewhere.

50. **Risk –** Nat West part of the Royal Bank of Scotland is one of the Governments Eligible institutions under the terms of the Bank of England's Credit Guarantee Scheme. Under this scheme eligible institutions can utilise government subscriptions as a means of raising capital effectively the bank will be partly government owned, the government currently has a 70% share of the bank.

51. It is recommended that the Councils own bank be added to the counterparty list for investments of up to £3M for a maximum of 3months

Money Market Funds

52. In the past six months money market funds have been used extensively for our cashflow investments. There are 3 currently in place and on occasions we have had to invest money in the Governments Debt Management at lower rates than Money Market fund would have provided. Officers wish to increase the number of Money Market funds available for use whilst limiting the amount of money invested via this route to £20M.

53. **Risk** - By using Money Market funds the risk of losing our entire capital sum with one fund is non existent, however the risk of losing part of the fund is greater than if the investment were with a single institution because within the fund risks are being spread. Monies can be withdrawn from Money Market funds without notice ie same day.

54. It is recommended that a further two money market funds be added to the counterparty list with an investment level of £5M with the overall investment maximum of £20M in money market funds.

Conclusion

55. The Council's treasury management activity during 200/098 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £220,000 achieved from the revised MTFP as reported elsewhere on this agenda as a result of a number of actions taken throughout the year to manage the financing costs in the changing economic climate.

Outcome of Consultation

56. No formal consultation has been undertaken regarding this report.

APPENDIX 1

Additional Prudential Indicators not reported in the body of the report

		2007/08 Actual	2008/09 Approved Indicator	2008/09
1	**Incremental impact of capital investment decisions on the Band D Council tax**	**Nil**	**£1.80**	**£2.44**
2	**Incremental impact of capital investment decisions on the housing rent levels**	**Nil**	**Nil**	**Nil**
3	**Upper limits on fixed interest rates (*against maximum position*)**	**100%**	**100%**	**100%**
4	**Upper limits on variable interest rates (*against maximum position*)**	**9.4%**	**40%**	**12.8%**
5	**Maturity structure of fixed rate borrowing (*against maximum position*)**			
	Under 12 months	**0%**	**25%**	**12.9%**
	12 months to 2 years	**0%**	**40%**	**13.2%**
	2 years to 5 years	**5.94%**	**60%**	**8.40%**
	5 years to 10 years	**0%**	**80%**	**0%**
	10 years and above	**94.06%**	**100%**	**65.5%**
6	**Maximum Principal funds invested greater than 364 days**	**£10M**	**£15M**	**£12M**

APPENDIX 2

Economic Background for 2008/09

1. The 2008/09 financial year has featured one of the most testing and difficult economic and investment environments since the 1930s. It has featured a number of very significant changes in the performance of the UK as well as global economy. And beneath all of this has been the undercurrent of uncertainty and mistrust in the financial markets. This was not an easy backdrop in which to manage an investment portfolio.

2. The year opened on an uncertain note. The ongoing effects of the "credit crunch" which had started in 2007, prompted a bout of monetary policy easing in early April when the Bank of England cut its Bank Rate by 0.25% to 5%.

3. But inflation was rising sharply, courtesy of the strength of global commodity and food prices and the very steep rise in oil prices. The CPI inflation measure breached the 3% upper limit of the Governments' target range in April. The Bank was concerned that these external cost pressures could eventually transform into a domestic wage/price spiral and kick start a bout of damaging inflation.

4. Rates were left on hold through the summer months and there seemed to be some signs of a gradual return to slightly more normal conditions in the money markets. But this was not to last. Mid-September saw a "sea change" in financial markets and economic policies. The collapse of US investment bank, Lehman Brothers, dealt a devastating blow to the markets. Liquidity dried up almost completely making it extremely difficult for banks to function normally. These developments culminated in the failure of the entire Icelandic banking system in early October.

5. The failure of the Icelandic banking system had a major impact on local authority investments. A number of local authorities had deposits with Icelandic institutions and these investments are still at risk. At this point in time recovery rates have not been fully disclosed by the respective institutions, although early indicators suggest a good, albeit not 100% recovery.

6. The crisis in the financial markets deepened and threatened a complete 'melt-down' of the world financial system. This, together with evidence that economies had entered recession prompted a number of significant policy changes. In the UK these featured the following:

   (a) a major rescue package totalling as much as £400bn to recapitalise the banking system

   (b) a series of interest rate cuts down to 2% in early December

   (c) a fiscal expansion package, including a 2.5% cut in VAT.

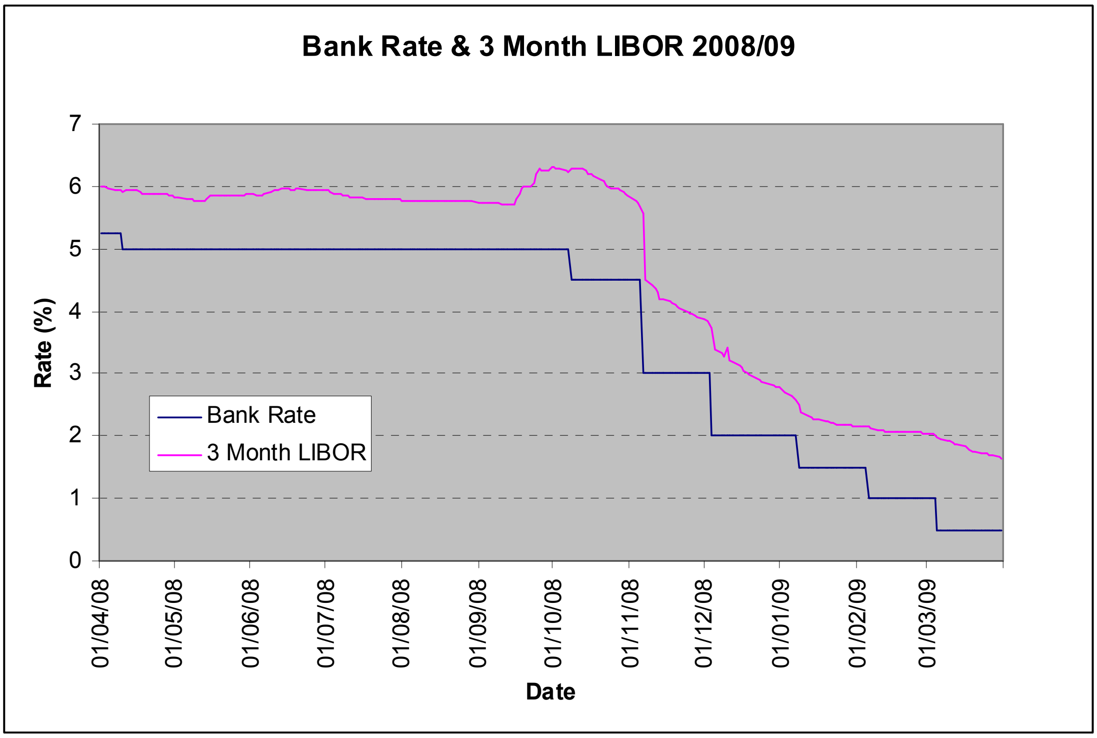
7. The New Year failed to herald a change in the fortunes of the banking sector. Central banks continued to ease monetary policies in an attempt to reduce borrowing rates and hence alleviate some of the cost pressures being experienced by financial institutions and, more to the point, the corporate and household sectors.

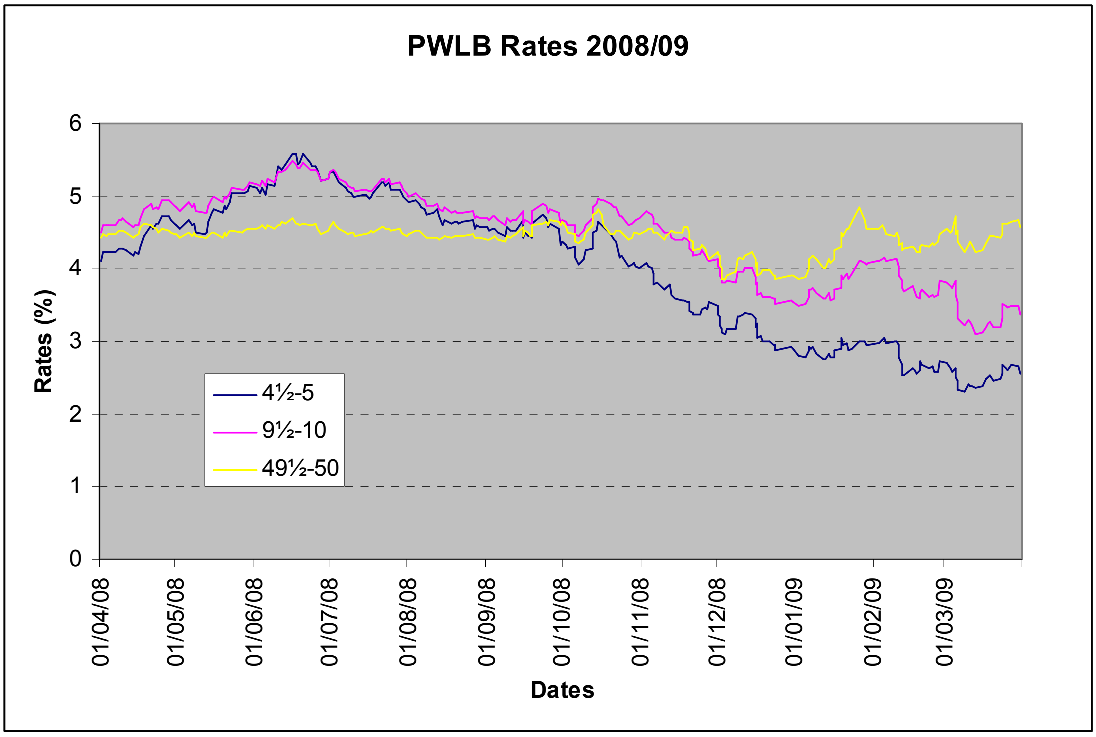
8. With official interest rates in the US already at close to zero at end-2008, the Bank of England was at the forefront of policy easing. Bank Rate was cut in successive monthly moves from 2% at the outset of the year to the historically low level of 0.5% in March. Thereafter, the Bank resorted to the quantitative easing of monetary policy via a mechanism of buying securities from investment institutions in exchange for cash. This commenced in early March and is expected ultimately to amount to £150bn.

9. Aside from Bank of England assistance, the central government launched the second phase of its support operations for the banking industry during the second half of January. This failed to allay fears that even more aid might have to be extended to the banking industry before the crisis is over. During the course of the quarter, two major banks, RBS and Lloyds Group, needed substantial cash injections; action that led the public sector to assume near-full ownership. In addition to this, the Dunfermline Building Society was rescued from bankruptcy.

10. The problems of the financial markets since late 2007 had clearly spread to other parts of the economy. Economic data confirmed that the UK was in deep recession and the latest Bank of England Inflation Report (published in mid-February) registered a marked change in official forecasts for 2009 and 2010. Economic activity was expected to decline sharply (GDP was forecast to contract by more than 4% in 2009) and inflation was projected to fall into negative territory

11. The generally uncertain backdrop to the UK and the financial markets prevented a marked easing in overall money market liquidity. While the situation did show some signs of improving as the financial year drew to a close, the margin between official interest rates and those quoted in the inter-bank market for periods longer that 1-month remained very wide.





Glossary of Terms

Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cashflow
Capital Financing Requirement	The authority's underlying need to borrow for capital purposes
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.