
**TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL
INDICATORS 2007/08**

Responsible Cabinet Member – Councillor Stephen Harker, Resources Portfolio

Responsible Director - Paul Wildsmith, Director of Corporate Services

SUMMARY REPORT

Purpose of the Report

1. The 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 the treasury activity for 2007/08. The report also seeks approval of the Prudential Indicator results for 2007/08 in accordance with the requirement of the Prudential Code.

Summary

2. During 2007/08 the Council complied with its legislative and regulatory requirements. 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.
3. At 31 March 2008, the Council's external debt was £101.242M (£95.242M at 31 March 2007) with an average interest rate of 4.43%. Investments totalled £43.460M (£43.466M at 31 March 2007) earning interest of 5.85% on short term investments and 5.6% on long term.

Recommendation

4. It is recommended that :-
 - (a) The outturn 2007/08 Prudential Indicators within this report and those in **Appendix 1** be noted;
 - (b) The Treasury Management Annual Report for 2007/08 be noted.
 - (c) This report be forwarded to Council, in order for the outturn Prudential Indicators for 2007/08 to be approved.

Reasons

5. 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 2007/08
3. Prudential Indicators and Treasury Management strategy Report 2007/08

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 affect all wards
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 the '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 Council's resources

MAIN REPORT

Information and Analysis

6. This report summarises:
- (a) capital expenditure and financing for 2007/08;
 - (b) overall borrowing need;
 - (c) treasury position at 31 March 2008;
 - (d) prudential indicators and compliance issues;
 - (e) the economic background for 2007/08;
 - (f) the Treasury Management Strategy agreed for 2007/08;
 - (g) Treasury Management activity during 2007/08;
 - (h) performance and risk.

The Council's Capital Expenditure and Financing 2007/08

7. 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 .
8. 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.
9. The Capital Expenditure forms one of the prudential indicators. 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 £8.133m less than planned, resulting in £2.964m less borrowing being required.

Table 1

	2006/07	2007/08		
	Outturn £m	Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	29.173	37.395	29.870	-7.525
HRA Capital Expenditure	12.030	12.057	11.449	-0.608
Total Capital Expenditure	41.203	49.452	41.319	-8.133
Resourced by:				
Capital Receipts	4.377	7.778	0.757	-7.021
Capital Grants	16.675	25.983	26.859	+0.876
Capital Contributions	0.602	0.724	1.191	+0.467
Revenue	3.275	2.274	2.783	+0.509
Borrowing needed to finance 2007/08 expenditure	16.274	12.693	9.729	-2.964

The Council's Overall Borrowing Need

10. 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 2007/08 and prior years net capital expenditure which has not yet been paid for by revenue or other resources.
11. The General Fund element of the CFR is reduced each year by a statutory revenue charge called the Minimum Revenue Provision (MRP). The total CFR can also be reduced each year through a Voluntary Revenue Provision (VRP).
12. The VRP in Darlington Borough Council's accounts is made by:
 - (a) departments as part of the annual charge to their revenue accounts for Departmental Unsupported Borrowing.
 - (b) a corporate VRP, the decision to utilise £2.000M of Capital Receipts to repay debt in order to make future savings in the revenue account.
13. The Council's CFR for the year is shown below, and represents a key prudential indicator. The CFR outturn for 2007/08 is £1.202m below the approved indicator, which is satisfactory.

Table 2

Capital Financing Requirement	2006/07	2007/08		
	Outturn £m	Approved Indicator £m	31 March Actual £m	Variance £m
Opening Balance	79.915	93.490	93.469	-0.029
Add Unfinanced Capital Expenditure	16.274	12.693	9.729	-2.964
Less MRP / VRP	2.699	-6.837	-5.043	+1.794
Less Deferred Capital Receipts	-0.018		-0.011	-0.011
Closing balance	93.472	99.346	98.144	-1.202

Treasury Position at 31 March 2008

14. 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).
15. The accounting 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 recorded in the accounts in accordance with national Financial Reporting Standards. The figures in this report are based on amounts borrowed and invested and so may differ from those in the final accounts.

16. The Council's total debt outstanding at 31 March 2008 was £101.242M. The aim was to manage it to the Council's revised CFR position £99.346M. This meant when compared to our actual CFR that the Council was "over borrowed" by £3.087M, this "over borrowed" amount was in turn invested at a higher rate of interest than our debt interest rate. The treasury position at the 31 March 2008, including investments compared with the previous year was:

Table 3

Treasury Position	31 March 2007		31 March 2008	
	Principal £m	Average Rate %	Principal £m	Average Rate %
Fixed Rate Debt Market and Public Works Loan Board (PWLB)	95.242	4.40%	101.242	4.43
Total Debt	95.242	4.40	101.242	4.427
Cashflow Investments	20.716	4.82	18.710	5.85
Capital Investments	22.750	4.92	24.750	5.60
Total Investments	43.466		43.460	
Net borrowing position	51.776		57.782	

Prudential Indicators and Compliance Issues

17. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:
18. **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 2006/07 plus the expected changes to the CFR over 2007/08 and 2008/09. 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 2006 Actual £m	31 March 2007 Approved Indicator £m	31 March 2008 Actual £m
Net Borrowing Position	51.776	51.606	57.782
CFR	93.490	99.346	98.144

19. **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 2007/08 the Council has maintained gross borrowing within its Authorised Limit.
20. **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.
21. **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

	Actual 2006/07 £m	Approved Limit/ Estimate 2007/08 £m	Actual 2007/08 £m	Amount Below Limit/ Estimate £m
Approved Indicator – Authorised Limit	112.380	116.548	101.285	15.263
Approved Indicator – Operational Boundary	97.722			
Maximum gross borrowing position	95.242	101.346	101.285	0.061
Average gross borrowing position	89.367	98.294	98.264	0.030
Minimum gross borrowing position	86.603	95.242	95.242	0
Financing costs as a percentage of net revenue expenditure	2.04%	1.89%	1.83%	0.06%

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

Economic Background for 2007/08

22. A summary of the general economic conditions that have prevailed through 2007-08 provided by Butlers, the Council's treasury management advisors is attached at **Appendix 2**.

Summary of the Treasury Management Strategy agreed for 2007/08

23. The revised Strategy agreed by Council on 31 January 2008 anticipated that during 2007/08 the Council would need to borrow £12.693M to finance part of its capital programme.
24. 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.
25. 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 31 January 2008 and estimated long term investments of £15M were included for the three years 2007/08, 2008/09 and 2009/10 .

Treasury Management Activity during 2007/08

Debt Position

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

Table 9

Lender	Principal	Type	Interest Rate	Maturity	Average for 2006/07
PWLB	£2.000M	Fixed interest rate	4.26	3-3.5 years	5.11
PWLB	£2.000M	Fixed Interest rate	4.33	3 years	5.11
PWLB	£2.000M	Fixed Interest rate	4.04	4-4.5years	5.11

27. This compares with a budget assumption of borrowing at an interest rate of 4.5%
28. **Rescheduling** – Throughout the year a number of opportunities were taken to repay loans without any breakage (penalty) costs. The Council repaid 8 loans amounting to £15.389M of debt at an average rate of 4.91%. These loans were replaced with £15.389M of debt at 4.67%. As a result annual savings of £0.030M will be made to the General Rate Fund after taking into account savings on the HRA.
29. **Repayment** - No loans were due for repayment during 2007/08.
30. **Change of Policy** – In November 2007 the PWLB changed its structure of interest rates so that any repayment of PWLB debt will have a penal repayment rate applied. As such the cost of repayments will be higher in future and result in less opportunities to reschedule debt.
31. **Summary of Debt Transactions** – The overall position of the debt activity resulted in an average interest rate of 4.43% compared with 4.40% for 2006/07. The average for 2006/07 of 4.40% included a one-off reduction in interest relating to a previous provision no longer required. Without this exceptional adjustment the average rate for 2006/07 would have been 4.59%.

Investment Position

32. **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 8 March 2007. The investment activity during the year conformed to the approved Strategy and the Council had no liquidity difficulties.
33. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds as detailed below:
- (a) **Temporary Surplus Cash Balances** – the table below shows the activity against budget for 2007/08.

Table 10

	Approved Revised Budget 2007/08	Actual 2007/08
Monthly Average level of Investments	£22.955m	£24.700m
Average Rate of Return on Investment	5.65%	5.85%
Interest Earned	£1.297m	£1.445m

(b) Capital Receipts and Funds**Table 11**

	Approved Revised Budget 2007/08	Actual 2007/08
Monthly Average level of Investments	£24.750M	£24.330m
Average Rate of Return on Investment	5.54%	5.6%
Interest Earned	£1.372M	£1.363M

Performance and Risk**Performance Indicators set for 2007/08**

34. 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 12 – Performance Compared With Indicators

Borrowing	Average overall rate paid compared to previous years	2006/07 4.40%	2007/08 4.43%
Investments		Average comparative rates	DBC
Short term	Cash flow investment rate returned against comparative average rate	5.59%	5.85%
Long term	Capital investment rate returned against comparative average rates	5.81%	5.60%
Basket of comparative rates used to compare DBC performance: -			
Comparative Rates		Short Term Investments	Long Term Investments
Local Authority 2 day rate		5.59	
Local Authority 7 day rate		5.59	
Local Authority 6 month rate			5.95
Local Authority 12 month rate			5.91
London Inter Bank Bid (LIBID) 7 day rate		5.58	5.58
Average		5.59	5.81

35. As can be seen from the table, the actual investment rate achieved for short term investments exceeds the average of comparative rates for the short term investments. As predicted in the half yearly report, the longer term investments have not achieved the target to be above the comparative rates. The reason for this is that interest rates are rising and some longer term investments were placed on a fixed rate when interest rates were generally lower.

Risk

36. 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 2007/08);
 - (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 CIPFA 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 8th November 2007.
37. The Council's 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.
38. 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 continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are all fixed, utilising long-term loans.
39. Shorter term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Conclusion

40. The Council's treasury management activity during 2007/08 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 £0.065m achieved from the revised budget approved by Council on 31st January 2008 as a result of increased cashflow interest.

Outcome of Consultation

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

Additional Prudential Indicators not reported in the body of the report

		2006/07 Actual	2007/08 Approved Indicator	2007/08
1	Incremental impact of capital investment decisions on the Band D Council tax	£1.97	Nil	Nil
2	Incremental impact of capital investment decisions on the housing rent levels	Nil	Nil	Nil
3	Upper limits on fixed interest rates (<i>against maximum position</i>)	100%	100%	100%
4	Upper limits on variable interest rates (<i>against maximum position</i>)	0%	40%	9.4%
5	Maturity structure of fixed rate borrowing (<i>against maximum position</i>)			
	Under 12 months	0%	25%	0%
	12 months to 2 years	0%	40%	0%
	2 years to 5 years	0%	60%	5.94%
	5 years to 10 years	0%	80%	0%
	10 years and above	100%	100%	94.06%
6	Maximum Principal funds invested greater than 364 days	£8m	£15m	£10m

Economic Background for 2007/08 – Butlers, Treasury Management Advisors

1. The rising trend in UK interest rates continued in the first half of 2007/08. The UK economic backdrop continued to present challenges for the Bank of England's Monetary Policy Committee, notably in the early summer. Consumer Price Index (CPI) inflation breached the 3% upper limit of the Government's target range in April (reported in May). Consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices.
2. Official Bank Rate was raised to 5.5% in May and 5.75% in July in response to expectations of rising inflation. In addition, the Bank of England's May and August Inflation Reports hinted that more increases might be necessary.

Table A - Official, Market and PWLB Interest Rates

End Qtr	Bank Rate	London Inter-bank Offer Rates (LIBOR)			PWLB Rates		
		3mth	6mth	1yr	5yr	20yr	50yr
2007 Mar	5.25	5.6	5.8	5.9	5.35	4.80	4.45
Jun	5.50	6.0	6.1	6.3	5.80	5.20	4.80
Sep	5.75	6.3	6.3	6.2	5.25	5.00	4.75
Dec	5.50	6.0	6.0	5.8	4.64	4.63	4.47
2008 Mar	5.25	6.0	6.0	5.8	4.14	4.70	4.43

3. The money market became volatile in late August as the tightening of credit conditions, triggered initially by the failure of a selection of US mortgage lending institutions, undermined investor confidence. LIBOR rates rose to well over 6.5% as financial organisations' reluctance to lend money to each other sparked a severe shortage of funds in the market. In the UK, the crisis came to a head with the Northern Rock Bank (September) and while the danger of potential meltdown was defused by the Government's decision to guarantee all deposits with this institution, this did not prevent a prolonged tightening of credit conditions.
4. Central banks in many countries strove to boost market liquidity via the injection of funds into the banking system and there were signs that this might be working in January. But a series of disappointing financial results and a persistent undercurrent of mistrust ensured a wide margin between official and market rates continued to year end.
5. The credit crisis provoked a significant change in the Bank of England's assessment of UK economic prospects over the medium term. It was clearly concerned that the tightening of liquidity and the consequent rise in borrowing rates across the entire economy could lead to a rapid slowdown in activity. This would help to contain inflation pressures. Bank Rate was cut by 0.25% on two occasions, December and February, to end the year at 5.25%.
6. Long-term rates (gilt yields & PWLB rates) were erratic. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into the new year as concerns persisted that international interest rates would need to rise further to combat mounting inflation pressures.

7. Gilt yields peaked in late June and started to fall in the summer months. The movement to safe investments triggered by the financial crisis placed strong downward pressure upon gilt-edged yields in August/September notably at the short end of the maturity range and the rally in this part of the market gained momentum as the year drew on.
8. Progress to lower levels was erratic and limited in the early months of 2008, but the general trend in yields was downwards. The most notable development was the reversion of the yield curve to a strongly-positive incline.

Table B – Bank of England Base Rate Compared With Market Rates

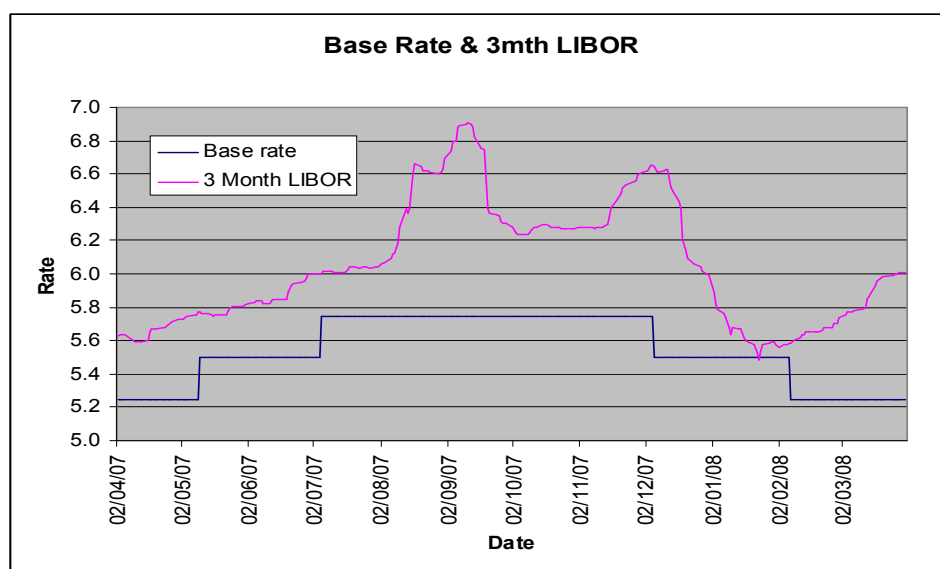
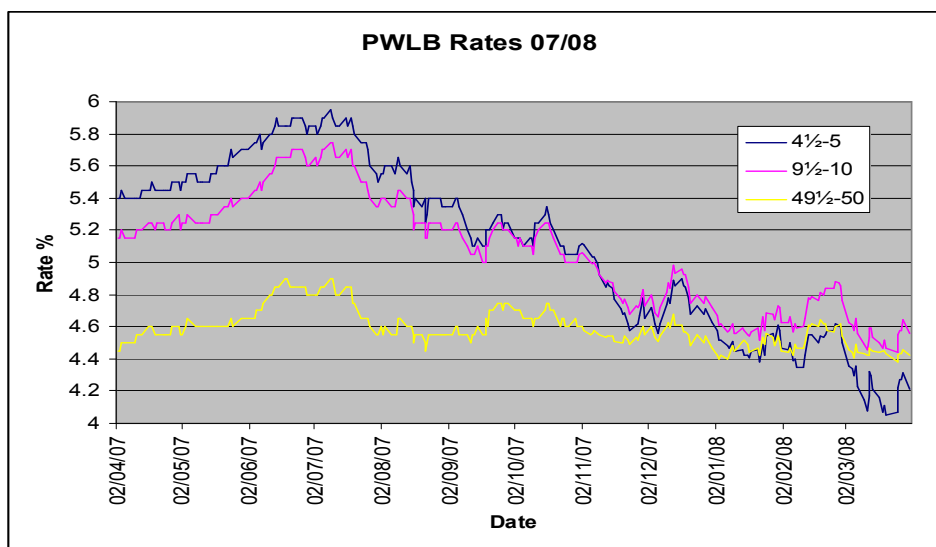


Table C – Public Works Loan Board Long Term Rates



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