

Treasury Management Activities, Prudential and Financial Health Indicators 2009/10

1. Summary

1.1. This Appendix:

- contains an annual report on the exercise of Treasury Management functions in accordance with the County Council's Treasury Management Policy Statement
- sets out the County Council's prudential indicators for the year in accordance with the relevant Code of Practice, together with a number of other financial health indicators.

2. Capital expenditure and capital financing requirement in 2009/10

- 2.1. The capital financing requirement represents capital expenditure other than that met directly from capital receipts, the revenue budget, capital grants or contributions. This can be financed from external borrowing or by borrowing from internal balances. The variation from year to year in the capital financing requirement represents the impact of new capital expenditure financed by borrowing offset by the provision made in the revenue budget and the use of capital receipts to repay debt. The actual capital financing requirements at 31 March 2009 and 2010 and estimates for 31 March 2011, 2012, and 2013 are set out in the table below.

Table 1: Capital financing requirement

At 31 March	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m
Supported borrowing:					
County Council	485.4	496.6	532.7	533.7	515.8
Other bodies	40.8	38.9	37.3	35.6	34.0
Street Lighting PFI	0.0	0.0	7.3	27.0	54.8
Waste management contract	88.7	85.5	82.0	78.3	74.3
	614.9	621.0	659.3	674.6	678.9
Unsupported borrowing	97.8	93.9	84.0	55.1	45.6
Total	712.7	714.9	743.3	729.7	724.5
Estimates approved in February	624.0	653.5	684.2	673.4	671.3

The capital financing requirement at 31 March 2010 of £714.9m is above the revised estimate approved in February of £653.5m following the inclusion of the Waste Management contract assets on the balance sheet, which has only partially been offset by slippage in the schemes to be financed from borrowing. The unsupported borrowing included in the capital financing requirement relates to the following projects:

Table 2: Capital financing requirement from unsupported borrowing

At 31 March	2009	2010	2010	2011	2012	2013
	Actual	Estimate	Actual	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Schemes to be financed from savings in the revenue budget	42.3	43.9	42.9	41.6	40.8	37.5
Temporary borrowing on specific projects to be repaid from capital receipts / developer contributions	54.4	50.1	49.9	41.3	13.2	6.7
Trading unit capital investment financed from future charges	1.1	2.0	1.1	1.1	1.1	1.0
General temporary borrowing to meet short term capital resource shortfalls	0.0	0.0	0.0	0.0	0.0	0.4
Total	97.8	96.0	93.9	84.0	55.1	45.6

- 2.2. The explanation of the increase in the capital financing requirement is as follows in Table 3 below:

Table 3: Increase in capital financing requirement

	£m
New capital expenditure financed by loan. Total capital payments in 2009/10 amounted to £167.6m, of which £129.9m was financed from Government grant, revenue contributions, reserves, usable capital receipts and external contributions, leaving £37.7m to be financed from loan.	37.7
The sums set aside in the revenue budget for the normal repayment of debt, in accordance with the County Council's policy for making a minimum revenue provision	-23.8
Repayments of unsupported borrowing from capital receipts and other sources	-6.6
Increase in net capital financing requirement	7.3
Reduction in transferred debt	-1.9
Reduction in Waste Management contract liability	-3.2
Increase in capital financing requirement	2.2

- 2.3. The capital expenditure prudential indicators are set out in Table 4 below, which shows the actual capital expenditure incurred in 2008/09 and 2009/10, and estimated capital expenditure in the years to March 2013:

Table 4: Capital expenditure

2008/09 Actual £m	2009/10 Estimate £m	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
193.6	185.6	167.6	210.3	161.0	117.1

- 2.4. The actual capital expenditure in 2009/10 of £167.6m is £16.0m lower than the adjusted revised estimate of £183.6m. The estimated capital expenditure for 2010/11 and beyond will be subject to revision during the year, to reflect the slippage of payments from 2009/10.

3. External borrowing requirement in 2009/10

- 3.1. Changes in the availability of internal resources have resulted in a reduction to the net external borrowing requirement by £4.2m, as set out in Table 5:

Table 5: Net external borrowing requirement

	£m	£m
Net increase in capital financing requirement		2.2
Decrease in earmarked reserves and provisions	5.7	
Increase in revenue account balance	-2.4	
Increase in other internal resources	-9.7	
		<u>-6.4</u>
Decrease in net external borrowing		<u>-4.2</u>

- 3.2. Table 6 below summarises the relationship between movements in the capital financing requirement and net external borrowing requirement and provides an analysis of the composition of external borrowing and of the internal resources which reduce the requirement to borrow.

Table 6: Net capital financing requirement

	Capital financing requirement			
	1.4.09		31.3.10	
	£m	£m	£m	£m
Long-term borrowing				
Public Works Loan Board	263.0		263.6	
Lender's option/borrower's option (LOBOs)	74.0	337.0	73.0	336.6
			<u> </u>	<u> </u>
Finance lease associated with Waste Management contract		88.7		85.5
Temporary loans				
Pension Fund	70.9		48.6	

	Capital financing requirement			
	1.4.09		31.3.10	
	£m	£m	£m	£m
Police Authority	13.8		7.6	
Other	15.1		32.0	
Cash overdrawn	16.7	116.5	15.4	103.6
		542.2		525.7
Temporary investments		-195.2		-182.9
Net external borrowing		347.0		342.8
Internal resources				
Earmarked reserves and provisions	165.3		159.6	
Revenue account balance	34.5		36.9	
All other internal resources	165.9	365.7	175.6	372.1
Capital financing requirement		712.7		714.9
Less				
Advances for transferred Services		40.8		38.9
Net capital financing requirement		671.9		676.0

Actual external debt

- 3.3. Actual external debt at 31 March 2010 was £525.7m. Total external borrowing decreased by £16.5m during 2009/10. This was accompanied by a corresponding decrease of £12.3m in the level of temporary investments. The reasons for the decrease in net external borrowing of £4.2m over the year are set out in paragraph 3.1 to this report.

4. External borrowing

- 4.1. At its meeting in February 2009 the County Council set authorised and operational prudential limits on total external debt of £690m and £570m respectively. These limits have since been adjusted by £90m to £780m and £660m respectively in order to provide for the inclusion of the Waste Management contract, which has been re-classified as a finance lease. External borrowing stayed within these limits throughout the year, reaching a maximum level of £556m in October 2009.

Long-term borrowing

- 4.2. In February 2009, the Cabinet approved a target for long-term borrowing in 2009/10 of £17m. Subject to the close monitoring of interest rates, it was agreed to take out new long-term borrowing at rates of 4.2% or less, although such borrowing would also be considered at rates higher than this if clear signs of a rising trend in rates were to occur and it proved timely to lock into low interest rates.
- 4.3. At the time, it was envisaged that longer-term interest rates would remain on a stable path during 2009/10.
- 4.4. As a result of the liquidity crisis in the banking sector, LOBO loans have lost their competitiveness and borrowing has been taken out exclusively from the PWLB in 2009/10.
- 4.5. A total of seven new PWLB loans were taken out since the borrowing strategy for 2009/10 was approved in February 2009, which are shown in Table 7. A total of £14m long-term borrowing has been taken out in respect of the £17m indicative target for 2009/10 at an average rate of 4.11%. This rate compares favourably with the 2009/10 borrowing strategy's 'trigger rate' of 4.2% or less.

Table 7: New PWLB loans in 2009/10

		£m
PWLB		
18 March 2009	£2m for 24 years at 3.97%	2
7 April	£2m for 9 years at 3.39%	2
18 August	£2m for 25 years at 4.40%	2
20 August	£2m for 25 years at 4.23%	2
7 September	£2m for 25 years at 4.20%	2
8 October	£2m for 24 years at 4.09%	2
29 January 2010	£2m for 27 years at 4.50%	2
		14

- 4.6. The average rate payable on the £276m long-term PWLB fixed-rate portfolio fell during the year from 5.4% to 5.3% due to a combination of new loans being taken out at rates below the portfolio's average rate and old loans at historically higher rates maturing. The 25-year PWLB loan rate currently stands at 4.4%.

Debt restructuring

- 4.7. The Cabinet approved a debt restructuring strategy in February 2007 and gave the County Treasurer delegated authority to repay PWLB loans held at high coupon rates prematurely, replace with longer term loans at lower rates, and amortise the early termination penalties over the outstanding periods of those replacement loans. A series of loan modifications in respect of a £10m PWLB loan were carried out in autumn 2007, generating interest savings in the period to 2018 at no longer term cost to the County Council.
- 4.8. However, the PWLB introduced a separate set of rates applicable to early repayments from 1 November 2007. Hitherto, the same set of rates had applied to loan advances and to calculating the premium or discount due on an early repayment. The rates used to calculate the premium/discount due on the early repayment of a loan are now lower than those applying to advances. This has had the effect of increasing the premiums payable in respect of the early repayment of loans, and makes the longer term impact in interest costs of debt restructuring much less attractive. For this reason, no further loan modifications were carried out in 2009/10.

Lender's option/borrower's option loans

- 4.9. Over recent years, the commercial money market has endeavoured to offer loan products to local authorities which are competitive with those available from the PWLB. Since June 2002, lender's option/borrower's option loans (LOBOs) have been of particular interest as an alternative form of borrowing in order to generate short-term savings in interest borrowing costs.
- 4.10. A standard LOBO means taking out a long-term loan for an initial primary period (normally between one and three years) at a preferential fixed interest rate, followed by a higher rate for the remaining period of the loan. 'Single-rate only' LOBOs are also available, where the rate over the primary period is the same as that for the remaining period. In both instances, the lender can choose to increase the rate at the end of the primary period and every six months or annually thereafter. If the lender increases the rate, the Council as a borrower can choose to repay the loan.
- 4.11. LOBO loans can generate short-term savings in borrowing costs over the initial primary periods. However, such loans will track any upward movement in long-term interest rates and may therefore equate to higher future long-term borrowing costs. Unlike long-term fixed rate PWLB loans, LOBOs cannot provide guaranteed long-term interest rate stability. Whilst the Council has a choice over repaying the LOBO loan when the lender opts to increase the relevant interest rate, it will

ultimately need to re-finance this by taking out a replacement loan at prevailing borrowing rates.

- 4.12. For information, the Council currently has a total of £73m LOBOs at interest rates ranging between 3.89% and 5.0% and an average overall rate of 4.45%.
- 4.13. However, the liquidity crisis in the banking sector has meant that LOBO loans have lost their competitiveness and borrowing has been taken out exclusively from the PWLB in 2009/10.

Temporary borrowing

- 4.14. Temporary external debt consists mainly of borrowing from the Pension Fund and Hampshire Police Authority. Borrowing from these two sources reached peaks of £75m and £47m respectively. To comply with revised statutory requirements, interest paid to the Pension Fund was based on the actual interest earned on instant access monies, which over the year averaged 0.72%. Interest paid to the Police Authority continued to be based on the monthly average seven-day notice rate, which over the year averaged 0.31%.

5. External lending

- 5.1. At the time that the Cabinet approved a treasury management strategy for 2009/10 in February 2009, the base rate had been cut to 1.0% which was its lowest recorded level since the Bank of England was formed in 1694.
- 5.2. In order to counter the effects of a global recession, the Bank of England made one further cut to its current unprecedented level of 0.5%, where it has remained unchanged since March 2009.
- 5.3. The County Council has taken a cautious approach in respect of which counterparties to lend monies to. The “credit crunch” and general lack of confidence in the banking sector in particular added to an even greater focus on capital security over investment return than would have normally been the case.
- 5.4. Surplus cash balances were lent out during the year to borrowers on the Council’s approved list. Limits are placed on the amount that may be placed with each institution and on the duration of the deposit. The current policy is to lend for no longer than 364 days.
- 5.5. The list is kept under continuous review to avoid the possibility of any capital losses arising. In 2009/10, it included the major UK clearing banks of Lloyds TSB, HSBC, Barclays, Royal Bank of Scotland (NatWest), highly rated building societies such as Nationwide, and three Aaa-rated money market funds and, if necessary for security, the Government’s Debt Management Office. Funds can also be lent to other local authorities.
- 5.6. A number of counterparties were removed from the Authority’s lending list during the course of the year due to credit rating downgrades, which included Clydesdale Bank and the building societies of Britannia, Yorkshire, Coventry, Chelsea and Skipton. Instead, a much greater

proportion of cash was placed with Aaa-rated money market funds for reasons of security and liquidity.

- 5.7. The average lending term was also reduced significantly during 2009/10, with lending for periods of longer than three months restricted to the top four High Street banks of Lloyds TSB, HSBC, Barclays & NatWest and the Nationwide Building Society. Lending limits were also reduced where there was either an actual or perceived increase in a counterparty's risk.
- 5.8. In 2009/10, the average daily cash balance was £260.98m and given interest earned of £3.06m, the average rate achieved on funds lent out temporarily was 1.17%. This rate is significantly higher than the seven-day notice rate of 0.31% due to the speed and severity at which the base rate was cut to 0.5% in March 2009, whilst there were a number of longer term deposits which matured beyond this time at previously much higher fixed interest rates. In addition, lending has been cautiously lent for periods of up to a year with a restricted number of counterparties in order to attract higher rates.

6. Ratio of capital financing costs to net revenue stream

- 6.1. The ratio of financing costs to the net revenue stream shows the estimated annual revenue costs of borrowing (interest payable on debt plus the minimum revenue provision for repaying the principal less interest on balances) as a percentage of the amount in the draft revenue budget to be met from central government grant and by local taxpayers. Actual figures for 2008/09 and 2009/10 are set out in the table below, along with estimates for 2010/11, 2011/12 and 2012/13.

Table 9: Ratio of capital financing costs to net revenue

	2008/09 Actual £m	2009/10 Estimate £m	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Financing costs	39.4	50.9	43.8	59.7	64.0	61.2
Net revenue stream	642.7	657.0	657.0	672.1	680.0	688.9
Ratio	6.13%	7.75%	6.67%	8.88%	9.41%	8.88%

- 6.2. The ratio in 2009/10 is lower than the estimated 7.75% because of lower net financing costs due to higher interest on balances. The financing costs include £10.3m per annum in respect of the Waste Management contract. These were previously treated as service costs.

7. Financial health indicators

- 7.1. The Cabinet in February 2009 approved a set of financial health indicators, with the intention that they should be monitored on a quarterly basis as one element of the County Council's regular budget monitoring. A number of the indicators are prudential indicators which are commented on in the previous section of this report. The indicators are included in the attached Annex.
- 7.2. There was a nil budget variance in respect of net service spending in 2009/10.
- 7.3. The actual capital expenditure compared with estimate shows a variance of -8.7%, which is within the +/-10.0% target. Whilst still above the 20% target, the level of capital programme schemes carried forward in 2009/10 at 24.3% is lower than in 2008/09.
- 7.4. External debt was contained both within the operational and authorised limits throughout 2009/10. All income collection indicators are more favourable than targeted. The proportion of debt more than 12 months old and more than 6 months old have been reduced significantly and are both well within their targets. The proportion of outstanding debt under 60 days old is significantly more favourable than targeted, and the proportion of debt written off compared with debt raised at 0.3% is well within the Authority's target of less than 1.0%.

Summary of Indicators		2008/09 Actual	2009/10 Estimate	2009/10 Actual	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
A Prudential indicators							
Prudential indicators for capital expenditure							
Capital expenditure	£m	193.6	185.6	167.6	210.3	161.0	117.1
Capital financing requirement	£m	712.7	653.5	714.9	743.3	729.7	724.5
Prudential indicators for affordability							
Ratio of financing costs to net revenue	%	6.13	7.75	6.67	8.88	9.41	8.88
Prudential indicators for external debt							
Actual external debt	£m	542.2	n/a	525.7	n/a	n/a	n/a
B Financial Health indicators							
Variance from budget							
Net service spending	%	-0.1	-0.3	0.0	+/-1	+/-1	+/-1
Overall spending met from formula grant, council tax and balances	%	-0.8	-0.7	-0.9	+/-2	+/-2	+/-2
Balances as a % of budget requirement	%	5.4	4.5	5.6	3.2	2.6	2.7
Capital programme management							
Carry forward of schemes	%	32.0	20.0	24.3	20.0	20.0	20.0
Actual capital expenditure compared with estimate	%	-9.1	+/-10.0	-8.7	+/-10.0	+/-10.0	+/-10.0
Actual capital receipts and third party							

Summary of Indicators		2008/09	2009/10	2009/10	2010/11	2011/12	2012/13
		Actual	Estimate	Actual	Estimate	Estimate	Estimate
contributions compared with estimate	%	-12.6	126.8	76.0	+/-10.0	+/-10.0	+/-10.0
Other prudential indicators							
Maximum level of external debt:							
£m	£m	563.0	780.0	556.0	770.0	760.0	750.0
As % of authorised limit	%	79.3	100.0	71.3	100.0	100.0	100.0
Upper limit on:							
Fixed rate borrowing	£m	357.0	410.0	363.0	410.0	430.0	450.0
Variable rate borrowing	£m	212.0	440.0	195.0	420.0	390.0	370.0
Income collection							
Outstanding debt more than 12 months	%	10.4	17.5	7.4	17.5	17.5	17.5
Outstanding debt more than 6 months	%	14.6	20.0	13.0	20.0	20.0	20.0
Outstanding debt under 60 days old	%	60.5	60.0	81.3	60.0	60.0	60.0
Debt written off compared with debt	%	0.3	<1.0	0.3	<1.0	<1.0	<1.0