REPORT TO:	**FINANCE AND MANAGEMENT COMMITTEE (SPECIAL – FINAL ACCOUNTS)**	**AGENDA ITEM: 7**
DATE OF MEETING:	**26th JUNE 2008**	**CATEGORY: DELEGATED**
REPORT FROM:	**DIRECTOR OF CORPORATE SERVICES**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (595811)**	**DOC:** u/ks/treasury management/annual report2007-08
SUBJECT:	**TREASURY MANAGEMENT ANNUAL REPORT 2007/08**	**REF:**
WARD (S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: FM 08**

1.0 Recommendations

1.1 That the Treasury Management Annual Report for 2007/08 is considered and approved.

1.2 That the Statement on the Minimum Revenue Provision for 2007/08 and 2008/09 as set out in the report (paragraphs 4.43 and 4.45) is recommended to Council for approval.

2.0 Purpose of Report

2.1 To detail the Council's actual borrowing and lending performance for 2007/08 compared to the approved strategy, including performance against its Prudential Indicators. This is in accordance with the Local Government Act 2003 and associated regulations.

3.0 Executive Summary

3.1 The Council's borrowing strategy for the year required that its cash flow requirements were managed through short-term borrowings and bank deposits. Overall, the Council's cash flow remained more favourable during the year compared to that projected.

3.2 This generated additional interest of approximately £247,000 in 2007/08 compared to that estimated. This had been forecast throughout the year and reported in financial monitoring reports (the last monitoring report in March 2008 had projected £202,500).

3.3 In undertaking its treasury management functions during the year, the Council managed its activities within its prudential indicators and lending policy.

3.4 In addition, the average interest rate earned on deposits was 5.81% compared to the average market rate of 5.61%. This was despite a much tighter lending policy being in place due to market conditions brought about the so called “credit crunch.”

4.0 Detail

Borrowing During 2007/08

4.1 The Council’s approved borrowing strategy for 2007/08 was:

- To manage its cash flow requirements through short-term borrowings and bank deposits and that no longer-term borrowing be undertaken in the year.

- That the one remaining Money Market loan of £1m be repaid should the Lender invoke their option to increase the interest rate.

The Council’s Cash Flow During 2007/08

4.2 The Council’s cash flow on a daily basis can fluctuate depending on the timing of income and expenditure.

4.3 At certain times of the year, the Council may need to borrow to cover shortfalls on a temporary basis, whilst when cash flow is positive any surplus funds are invested on a temporary basis.

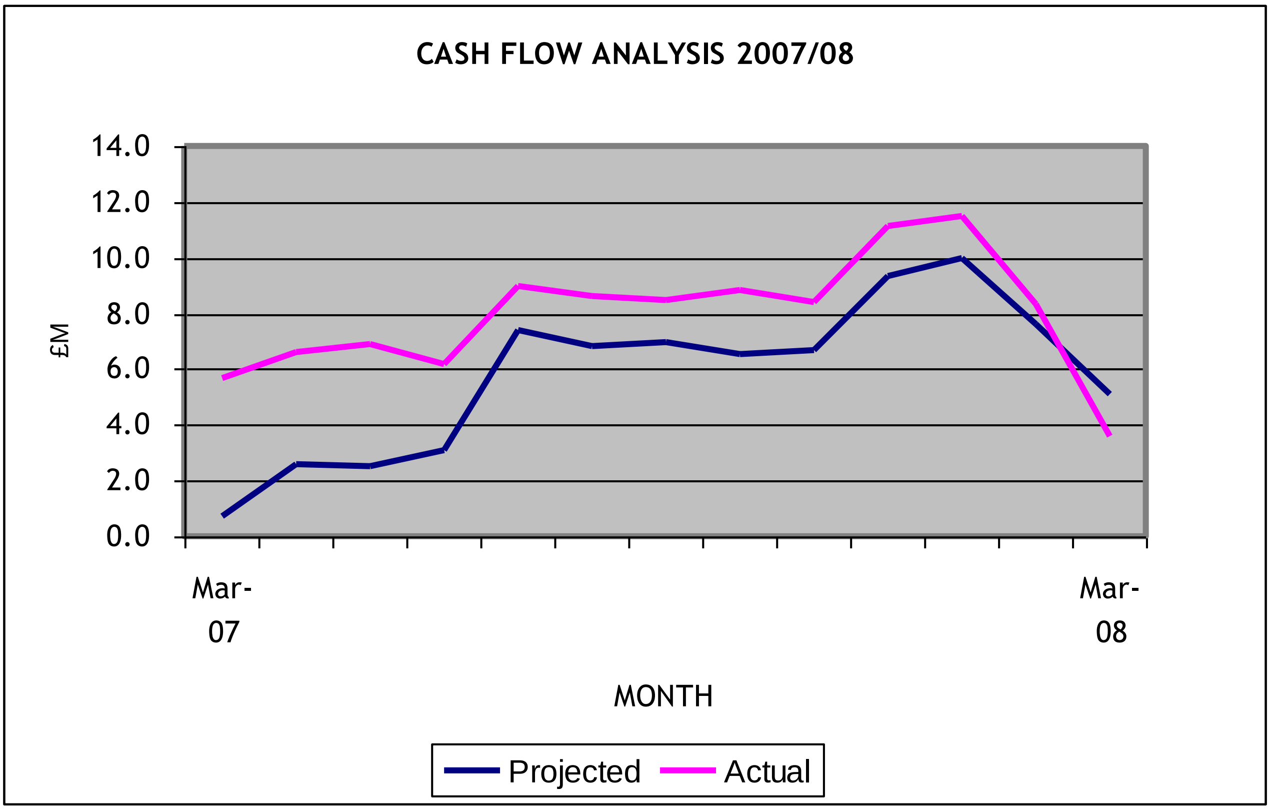
4.4 For several years the Council has not been required to enter into any form of long-term borrowing and infact repaid all of its Government debt in March 2004.

4.5 This was due to substantial capital receipts that the Council had generated from council house and land sales, a significant proportion of which had been set-aside to repay debt in accordance with accounting regulations.

4.6 These receipts were placed on deposit and earned interest for the Council’s revenue funds. In addition, these receipts have effectively been used to finance new capital expenditure and to meet the Council’s shorter-term cash flow requirements when this was negative.

4.7 The Council continued to benefit from this positive cash flow position during the year. This was due to the amount of revenue and capital reserves it currently has at its disposal.

4.8 The Council’s cash flow during 2007/08 with a comparison to that originally projected is shown in the following graph.



4.9 In general, the actual pattern of cash flow followed that projected. However, the amount of funds available was much higher than estimated, especially during the earlier part of the year.

Interest Rates

4.10 The projections assumed interest rates averaging 5% in 2007/08 in accordance with the prevailing market rate and economic predictions guiding its movement during the year.

4.11 The standard measure of interest rates in the U.K. i.e. the Bank Base Rate stood at 5.25% in April 2007. This rate had been fairly stable for several months in the previous year and was expected to fall over the course of this year.

4.12 However, the rate was infact increased twice in quick succession by July 2007 to 5.75% in order to combat inflationary pressures in the economy. The rate has since fallen back to 5% (by April 08) in response to the "credit crunch" and to offset any impact of a potential recession.

4.13 Rates on the Council's temporary borrowings averaged about 1% less than the prevailing base rate during the year. However, there was only a minimum requirement to borrow throughout the year. Infact the main interest payable during the year was on funds held on behalf of Parish Councils.

4.14 Rates achieved on temporary deposits were generally above the Base Rate especially in the later part of the year. This was due to a lack of funds in the general financial market, brought about by the effects of the "credit crunch."

Budgetary Implications

4.15 The level of interest actually received and paid is built into the General Fund Revenue Account (subsequently a proportion of this is recharged into the Housing Revenue Account under a prescribed calculation).

4.16 The actual interest received compared to that included in the approved budget is summarised below.

CASH FLOW INTEREST 2007/08	ESTIMATE £	ACTUAL £
Overall interest received from money lent/on deposit	121,500	368,102
Less – Interest payments on temporary borrowings (mainly Parish Councils)	-12,500	-11,474
Net Interest Received	**109,000**	**356,628**

4.17 The net effect is that overall interest received was higher compared to that estimated by approximately £247,000. This is line with that previously reported as part of financial monitoring reports and reflects the better overall cash flow position during the year.

Other Interest Paid and Received

4.18 In addition, the Council paid and received other interest during the year as set out in the following table.

Item	Estimate (£)	Actual (£)
Fixed Rate Money Market Loan	48,750	48,884
Bank Interest (charged daily on any overdraft)	1,000	1,702
Covenants	182,900	180,726
Late Payments	0	1,576
Miscellaneous Interest Received (Credits)	0	(924)

Money Market Debt

4.19 The only long-term debt still remaining is one money market loan for £1m. As the above table shows, this costs around £48,000 per year in interest charges at a fixed rate of 4.875%. It is due to mature in 2032.

4.20 Potentially, there is a break clause. The lender has the option of reviewing the interest rate at any time and increasing it if they so wish. However, the Council then has the option of rejecting this and can instead choose to repay without incurring any penalty.

4.21 In setting the borrowing strategy for 2007/08, it was noted that it was not cost effective to prematurely repay the loan due to the penalty payment involved. However, it was also resolved that should the lender exercise their option to increase the interest rate, then the loan should be repaid at that time from money set-aside to do so.

4.22 The lender did not invoke their option during the year and the situation will be kept under review. The same strategy regarding this loan was adopted as part of the treasury management policy for 2008/09.

Investments 2007/08

4.23 The Council does not have any long-term investments, but the Council is required to maintain an investment strategy covering short-term investments such as the deposit of surplus funds.

4.24 The overall strategy in the year was to effectively invest surplus funds to meet cash flow requirements within the year. In addition, there was no proposal to enter into longer term and externally managed funds.

4.25 The Council invests surplus funds in accordance with an approved policy and associated lending list. This is summarised in the following table.

Institution	Limit
Specified Investments	
• UK Debt Management Office (DMO)	£10m
• Local, Police, Fire and Parish Authorities	£5m
• Other Bodies with a High Credit Rating of F1+/AA-	£7.5m
Non-Specified Investments	
• F1/AA Rated Bodies – First Call	£2m
• F1/A Rated Bodies – Second Call	£1m
• F2/A Rated Bodies – Third Call	£0.25m

General Policy

4.26 Priority is given to specified investments in any investment decision. This is in accordance with current practice and these institutions are usually the only ones used in any case.

4.27 The length of investments are made in accordance with overall cash flow requirements, subject to the condition that they are for less than 1-year to meet regulations. An analysis of deposits made in the year is provided in the following table.

INSTITUTION	AVERAGE DEPOSIT LODGED £'000	HIGHEST AMOUNT LODGED £'000	AVERAGE INTEREST RATE
Co-op Bank Overnight Reserve Account	92	1,000	4.59%
Bank of Scotland (Instant Access Account)	3,434	7,500	5.59%
The DMO, other Authorities, and mainstream Banks	5,340	9,000	5.97%

4.28 A substantial amount of available funds were lodged with the Bank of Scotland and other mainstream banks. This provided a competitive return on larger but short-term deposits with instant access. All deposits made were in accordance with the approved lending list and were all Specified Investments.

Performance Indicators

4.29 The main indicator is for the return on short-term investments to average over the year, **the local authority 7-Day Rate,** a standard measure of performance. The Council's performance for 2007/08 (with a comparison to recent years) is shown in the following table.

	2003/04	2004/05	2005/06	2006/07	2007/08
7-Day Rate (target)	3.51%	4.47%	4.44%	4.82%	5.61%
Actual Rate	3.55%	4.63%	4.50%	4.86%	5.81%

Prudential Indicators

4.30 Under the Code of Practice for Capital Finance, the Council must set and regularly monitor Prudential Indicators. These indicators are designed to measure and place controls over the level of borrowing and capital financing during the year.

4.31 They are set following the annual budget round where the Section 151 (Chief Finance) Officer is required to provide an assessment of these indicators and the implications for the Council's spending plans and overall financial position.

4.32 The prudential system provides the flexibility for these indicators to be changed depending on local circumstances. It is the responsibility of the Section 151 Officer to advice the Council accordingly.

4.33 The actual indicators for 2007/08 with a comparison to those set, are detailed in **Appendix 1.** There were no major variations to the approved indicators during the year and the Council operated within its capital budgets and limits for external borrowing at all times.

Minimum Revenue Provision (MRP) - Background

4.34 Local authorities are required each year to set-aside some of their revenues as a provision to repay any borrowings or other credit (shorthand this is technically called "debt"). This set-aside is known as MRP and is a charge on the Council's General Fund.

4.35 This requirement has existed for many years and is designed to ensure that authorities, prudently, make provision to meet their credit liabilities into the future. With effect from 2007/08, the regulations governing this have been amended.

4.36 This is to ensure that authorities make a sufficient and prudent provision in their accounts, in particular where they have made any unsupported borrowing under the Prudential System.

4.37 Under the previous regulations, the calculation of MRP was effectively a set formula, although there was provision to increase this amount if an authority so wished. The new regulations now effectively force authorities to undertake their own calculation under 1 of 4 options, depending on local circumstances.

4.38 It is the responsibility of the Section 151 Officer to advise on the treatment of MRP and to recommend a suitable policy for adoption. Consequently, authorities are also now required to prepare an annual statement on making a MRP.

The Calculation – Out-going Regulations

4.39 MRP traditionally has been calculated (at a rate of 4%) based on an assumed historical level of debt. This assumed level is in effect set by central government in their annual financial settlement. It is based on previous "permissions to borrow."

4.40 These permissions are backed by support towards servicing the associated debt (including MRP) through revenue support grant.

4.41 It is important to note however, that over time, the assumed level will not in practice, usually match the actual level of debt outstanding at an authority.

4.42 This is because actual repayments and new borrowing will have been undertaken over different time scales and at varying interest rates to suit an authority's borrowing requirement, their cash flow and prevailing money market conditions.

4.43 In addition, debt restructures will also have created a difference between the assumed level and actual debt outstanding at any one time.

New Calculation – 4 Options

4.44 The new calculation is designed to ensure that a "prudent" provision is made for debt repayment. The 4 options are as follows:

- **Option 1** - For debt that is supported by the Government through the grant system, authorities may continue to use the formula in current regulations (4%), since revenue support grant is calculated on that basis. Technically however, this option has in fact been revoked, but has been maintained temporarily as a transitional measure for capital expenditure incurred before 1st April 2008.

- **Option 2** – A simplified method of option 1 that reflects supported debt based on an authority's capital financing requirement. This method should have been in place since 2004 when the Prudential System was introduced.

- **Option 3** – The method to use for new borrowing under the Prudential System for which no Government support is given, MRP being based on the life of the asset being purchased.

- **Option 4** – As above, but MRP relates to the depreciation charge on the asset purchased.

Effect on South Derbyshire

4.45 The Council is operating under Option 2. Technically, the Council has been debt free under these regulations since 2004 (having repaid its Government borrowings). In addition, it has not entered into any new borrowing in recent years to finance its capital expenditure.

Council Statement on MRP

4.46 The Council still has an assumed level of debt (or capital financing requirement) that is being subsidised through grant. Therefore, given no actual debt outstanding together with no unsupported borrowing, it is recommended that "prudence" be best achieved by continuing to provide a MRP under **Option 2**.

4.47 It is recommended that this policy be endorsed for 2007/08 and adopted for 2008/09. It will be kept under review depending on the Council's future capital expenditure and financing requirements.

4.48 Any proposed changes will be tabled as necessary to this Committee for consideration and recommendation to Council. The impact on the MRP will be considered in any decision to enter into any borrowing under the prudential System.

5.0 Financial Implications

5.1 As detailed in the report. The changes to the MRP and the proposed Statement, has no additional financial implications for the Council at this stage.

6.0 Corporate Implications

6.1 None directly.

7.0 <u>Community Implications</u>

7.1 None directly.

8.0 <u>Background Papers</u>

8.1 Local Government Act 2003 and associated Statutory Instruments detailing regulations under the Local Authorities (Capital Finance and Accounting England Regulations) of 2003, 2006 and 2008.

PRUDENTIAL INDICATORS 2007/08	Estimate £'000	Actual £'000
CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE		
Capital Expenditure – General Fund		
Supported spend	3,337	4,113
Unsupported spend	0	0
Total spend	3,337	4,113
Financed by:		
Capital receipts	1,365	791
Capital grants and contributions	1,472	2,419
Capital reserves	225	589
Revenue	275	314
Total financing	3,337	4,113
Net financing need	0	0
Capital Expenditure – Housing Revenue Account		
Supported spend	2,865	2,629
Unsupported spend	0	0
Total spend	2,865	2,629
Financed by:		
Capital receipts	795	755
Capital grants and contributions	2,070	1,864
Capital reserves	0	0
Revenue	0	10
Total financing	2,865	2,629
Net financing need	0	0
Capital Expenditure – Total		
Supported spend	6,202	6,742
Unsupported spend	0	0
Total spend	6,201	6,742
Financed by:		
Capital receipts	1,760	1,056
Capital grants	3,542	4,283
Capital reserves	625	1,079
Revenue	275	324
Total financing	6,202	6,742
Net financing need	0	0

PRUDENTIAL INDICATORS 2007/08	Estimate £'000	Actual £'000
THE CAPITAL FINANCING REQUIREMENT		
The Capital Financing Requirement - General Fund		
Opening Balance	8,040	8,040
Net financing need	0	0
Less MRP & VRP	-296	-296
Less other financing movements	0	0
CFR Closing balance	7,744	7,744
Net movement in CFR	-296	-296
The Capital Financing Requirement - HRA		
Opening Balance	5,531	5,531
Net financing need	0	0
Voluntary RP	0	0
Less other financing movements	-18	-18
CFR Closing balance	5,513	5,513
Net movement in CFR	-18	-18
The Capital Financing Requirement - Total		
Opening Balance	13,571	13,571
Net financing need	0	0
Minimum and Voluntary Revenue Provisions	-296	-296
Less other financing movements	-18	-18
CFR Closing balance	13,257	13,257
Net movement in CFR	-314	-314

EXTERNAL DEBT & OTHER LONG TERM LIABILITIES		
Opening Balance 1 April	3,713	3,713
Maturing Debt	0	-450
Borrowing - Maturing Debt	0	-103
Borrowing - Change in CFR	0	0
Total Debt 31 March	3,713	3,160
Net movement in debt	0	-553
Other long term liabilities	1,892	1,892

AUTHORISED LIMIT AND OPERATIONAL BOUNDARY		
Authorised Limit	22,660	22,660
Operational Boundary	9,400	9,400
INVESTMENTS		
Opening Balance 1 April	5,458	5,458
Cash flow movements	762	-418
Movement in reserves /balances	-900	-1,450
Total Investments 31 March	5,320	3,590
Net movement in investments	-138	-1,868