APPENDIX 5

QUARTERLY TREASURY MANAGEMENT REPORT – MONTH 9

Treasury Management is a complex subject but in summary the core elements of the strategy for 2009/10 are:

- To make use of short term variable rate debt to take advantage of the current market conditions of low interest rates
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
  - Security of invested capital
  - Liquidity of invested capital
  - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

In essence treasury management can always be seen in the context of the classic 'risk and reward' scenario and following this strategy will contribute to the Council's wider Treasury Management objective which is to minimise net borrowing cost in the short term without exposing the Council to undue risk either now or in the longer term.

The main activities undertaken during 2009/10 to date are summarised below:

- Investment returns have decreased from £3.7M in 2008/09 to an estimated £1M in current year as a result of a fall in interest rates. The average rate achieved to date (0.88%) is above the performance indicator of the average 7 day Libid rate (0.59%).
- In order to balance the fall in investment income we have switched to short term debt which is currently available at lower rates than long term debt due to the depressed market. As a result the average rate for repayment of debt (the Consolidated Interest Rate – CRI) has reduced from 4.15% in 2008/09 to 3.18%. As this is a temporary arrangement any savings are to be transferred to the Interest Equalisation Reserve until we lock back into long term debt. It should be noted that the forecast for longer term debt is a steady increase in rates over the next few years, so new long term borrowing will be taken out above the current CRI and therefore an increase in the CRI should be expected.
- In order to comply with the revised Chartered Institute of Public Finance and Accountancy (CIPFA) code for Treasury Management training for members was undertaken by an independent company recommended by our advisors (Arlingclose) on the 10th December 2009.

The Council approved a number of indicators at its meeting of the 18th February 2009. Following the September update of the Capital Programme and an analysis of Treasury Management activity during 2008/09 and between April and December 2009 these have been reviewed for 2009/10 as detailed below and are reported in accordance with best practice contained in the CIPFA code of practice on Treasury Management and in line with the approved Treasury Management Strategy.

1. Interest Rate Exposures

This indicator sets upper limits on the amount of net borrowing (total borrowing less investments) with fixed interest rates and variable interest rates for next year and the following two years and has the effect of setting ranges within which an authority would limit its exposure to both fixed and variable interest rate movements.

1.1. Upper Limit on Fixed Interest Rates

The limits (expressed as a percentage of total borrowing less investments) were set and will remain at:

	Lower Limit %	Upper Limit %
Year to Date Actual	90.7	99.2
2009/10	35.0	100.0
2010/11	35.0	100.0
2011/12	35.0	100.0

Performance to date remains within these parameters and as at the end of December the percentage stands at **98.3%**
In principle, it may be necessary/desirable for all borrowing at a point to be at a fixed rate, although in practice this would be unusual.

1.2. Upper Limit on Variable Interest Rates

The Upper Limit represents the maximum proportion of borrowing which is subject to variable rate interest and was set at 50%, although in practice it would be unusual for the exposure to exceed 20% based on past performance, the highest to date is 10.6%. The limit was set at a higher level to allow for a possible adverse cash flow position, leading to a need for increased borrowing on the temporary market.

There has been no adverse cash flow to date but it is proposed that the limit remain at 50%, in case of any slippage in expected capital receipts. The actual range for the year to date is between 8.2% and 10.6% with the position at the end of December standing at **8.8%**

2. Maturity Structure of Long Term Borrowing

This indicator sets limits on the amount of borrowing due to be repaid in a given period on fixed rate borrowing. The table overleaf shows the estimated position as at 31st March 2010 for the amount of total borrowing (fixed & variable) due for repayment as a % of total borrowing and the position as at the end of December:

Maturity	31st March 2010 %	December 2009 %
Under 12mths	13	42
Between 12mths and 24mths	5	15
Between 24mths and 5yrs	10	13
Between 5yrs and 10yrs	0	0
In excess of 10yrs	72	30

This demonstrates the clearly planned and considered switch to short term debt in response to current market conditions.

The prudential limits for borrowing that is fixed rate maturing in each period (as a percentage of total projected borrowing that is fixed rate) is detailed below along with the position as at the end of December 2009.

Maturity	Lower Limit %	Upper Limit %	December 2009 %
Under 12 Months	0	45	40
12 to 24 Months	0	45	17
24 Months to 5 Years	0	50	15
5 to 10 Years	0	75	0
In Excess of 10 Years	0	100	28

At this stage, no change is required to the borrowing limits detailed above.

3. **Total Principal Sums Invested for more than 364 Days**

This sets a maximum limit on the amount of money than can be invested for more than one year; the current approved limit is set at £50M.

Southampton City Council's core investment portfolio has been identified as being around £40M and on the advice of the Council's Treasury Management consultants a rolling programme of one year cash deposits have been entered into that will provide a greater degree of certainty and stability in returns generated than is currently achieved. The aim is to place investments with start and maturity dates that are spaced at roughly equal gaps of one month, giving the Council the added benefit of the liquidity afforded by the upcoming rolling maturity of deposits. This will provide opportunities to invest in whichever investments offer the best fit solution to the risk/reward appetite of the Council at that time. In addition, further investments have been made when attractive interest rates and cash flow have allowed. The principle sum invested for more than 364 days as at 31st December 2009 was **£16.2M**, plus **£6M** in long term bonds.

4. **Authorised Limit for External Debt**

This is the maximum amount the authority allows itself to borrow in each year. It is made up of an authorised limit for borrowing and an authorised limit for other long term liabilities. It covers both short (temporary) and long term borrowing. The approved limit for 2009/10 is £383M and there is no proposal to change this at this time. The highest level reached this year is £134M with the level at end of December at **£98.5M**.

5. Operational Boundary

This is also an external debt limit and is made up of borrowing and other long term liabilities. This limit is set to reflect the most likely (prudent) but not worst case scenario of the debt position of the authority and is detailed in the table below. This limit is linked directly to the authority's capital spending plans, capital financing requirements and cash flows. It also allows maximum flexibility to undertake debt restructure. The borrowing to date is well within the set limits and there is no proposal to change this at this time.

	2009/10 Approved £M	2009/10 Highest to Date £M	December 2009 £M
Borrowing	351	134	99
Other Long Term Liabilities (including contingency)	21	20	19
Total	**372**	**149**	**118**

6. Actual External Debt

The Council's actual external debt at 31st March 2010 is expected to be £163M, comprising £144M borrowing and £19M of other long term liabilities. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time.

7. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. It differs from actual borrowing due to decisions taken to use internal balances and cash rather than borrow.

	2009/10 Approved £M	2009/10 Actual £M	2010/11 Proposed £M
General Fund	146	133	153
HRA	97	92	95
Total	**243**	**225**	**248**