Agenda item 17

Cabinet – 16 September 2009

Annual review of Treasury Management Policy Statement and Annual Report on Treasury Management Activity for 2008/09

Portfolio: Councillor C Towe - Finance and Personnel

Service: Corporate Finance

Wards: All

Key decision: No

Forward plan: No

1. Summary of report

1.1 This report details the council's borrowing and investment activities in 2008/09 and seeks approval for the revised treasury management policy statement for 2009/10 onwards. There was no increase in Walsall council's long term borrowing in 2008/09 and investments decreased by £14.7m. The average rate for borrowing during 2008/09 was 4.85% (4.64% excluding other local authority debt). If our borrowing was at the average rate for the IPF benchmarking group (i.e. 5.30%), this would have increased spend by £1.32m. This demonstrates that Walsall's treasury management function continues to provide excellent value for money. Investment performance improved relative to other councils and additional investment income was recouped.

1.2 In order to comply with the CIPFA Code of Treasury Management, the council is required to review and update its treasury management policy statement and treasury management practices (TMPs). These are contained for approval in **Appendix A** and include amendments to the responsible posts under delegated powers to reflect changes to the staffing structure of the finance service. In response to issues arising from the Icelandic banking crisis TMP1 relating to treasury management risk management has also been further strengthened.

2. Recommendations

2.1 That Cabinet approve the revised treasury management policy statement and practices set out in **Appendix A.**

2.2 That Cabinet note the 2008/09 treasury management activities and performance statistics in **Appendix B** and the monitoring of Walsall's prudential indicators as at 31.03.09 contained in **Appendix C.**

3. Background information

3.1 The council has a number of key policies and objectives for borrowing and investment. The policies are laid out in the treasury management policy statement attached as **Appendix A**. The objectives for borrowing are aimed at minimising the revenue cost of borrowing whilst maintaining a balanced loan portfolio. The council's objectives for investments are the prudent investment of council monies in sterling with secure institutions at the best possible rates of interest. Details of these objectives are provided within the treasury management report attached as **Appendix B**.

3.2 To ensure that Walsall's treasury management activities are affordable, prudent and sustainable, prudential indicators are maintained and reviewed during the year. Details of these indicators are contained within **Appendix C**. A set of local indicators are also maintained to provide additional assurance.

3.3 The council's borrowings decreased by £0.86m in the year. Total debt at year end was £264.69m (£237.43m excluding other local authority debt) at an average rate of 4.85% (4.64% excluding other local authority debt). The council's investments decreased by £14.7m split between an increase in long term (£5m) and a decrease in short term (£19.7m). During the year interest rates fell sharply and thus the average investment return rate for the council decreased by 0.72%. The balance of total investments at the year end was £76.48m at an average rate of 5.22%. Walsall achieved a return on its investments of 5.22% which was at the average of other councils.

3.4 Further details of the council's treasury management performance can be found as **Appendix B**.

3.5 There was considerable market turbulence during the year which reflected the turnaround in interest rate sentiment as a result of the sub-prime crisis in the US and the fall of the Icelandic banks. This had effects on the council's investments. The income received being high at the start of the year and very low at the end. The fall in investment income is expected to continue to be a large spending pressure in 2009/10.

3.6 In October 2008 Icelandic banks Landsbanki, Giltnir and Kaupthing collapsed. At the time 127 councils had £954 million deposited in these banks. It is uncertain how much of this will ever be recovered. Nationally, this represents 3% of total investments by English councils and it has naturally led all councils to question and review its investment operations. Although Walsall council has never invested in Icelandic banks, reports on the subject provide helpful advice and information for the council to take account of when reviewing and updating its practices.

3.7 The Audit Commission report "Risk and Review" and the Parliamentary Communities and Local Government Committee report "Local authority investments" make a number of recommendations to central Government, CIPFA and to local government. A key issue that emerges is that the council's appetite for Risk versus Return should be considered at the highest level. In conjunction with this report a risk/reward matrix specific to treasury management has been developed and is referred to in TMP1 (**Appendix A)**.

Confidence should also be gained that a number of strengths detailed in these reports have already been adopted, including:

- The primary consideration for our investment strategy is security and liquidity
- Robust governance and control arrangements are in place
- No deposits were made with Icelandic banks
- External advice is used to inform decisions
- The treasury management team is well qualified and has recently been strengthened.
- All Codes of practice are being adhered to
- Briefings have been provided to the council's Audit Committee who has responsibility for treasury management.
- The council has an established treasury management panel consisting of the treasury management advisor, CFO and other senior officers, to review and determine performance within existing policy.

4. Resource considerations

4.1 **Financial:**

4.1.1 The treasury management policy statement is a key document for the operation, review and performance assessment of treasury management and is reviewed annually. It forms part of the council's financial framework and supports delivery of the medium term financial strategy.

4.2 **Legal**:

4.2.1 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and the revised Code in 2002.

4.3 **Staffing**:

4.3.1 There are no staffing implications as a result of this report.

5. Citizen impact

Capital investment can impact on the quality of service provision across the borough.

6. Community safety

None directly related to this report.

7. Environmental impact

None directly related to this report.

8. Performance and risk management issues

8.1 **Risk**:

8.1.1 It is recognised that the management of risk is as important as maximisation of performance. The treasury management policy seeks to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council. The Prudential Code allows the council to manage financial risks by permitting additional borrowing to fund capital investment, subject to risk-assessed controls by use of a series of pre-determined performance indicators. In response to the Icelandic banking crisis additional emphasis is placed with treasury management on risk management.

8.1.2 The additional levels now incorporated into TMP1 to ensure there is an acceptable level of risk to be managed with specific aims are :-

- to have a large proportion of debt on fixed rates to provide stability.
- to have investments over a range of period lengths
- to use UK highly rated banks or strong building societies
- to obtain a fair return without any undue risk.

8.2 **Performance management**:

8.2.1 The treasury management function participates in a local and national benchmarking group which compares Walsall council's treasury management performance with those of other councils. Performance is regularly reviewed by the treasury management panel. Logotech, a treasury management system specifically designed for Local Authorities has been received.

8.2.2 All Prudential indicators (PrIs) as at 31.03.09 were complied with. One Local Indicator, L2, was not fully achieved. The target range for the average length of long term debt is between 20 to 25 years currently the average length is 17.79 years. The overriding consideration in the taking out of new debts is the interest rate. In 2008/9 loans of £20m were repaid with a longer average length than the new loans of £20m that were taken out. This was considered prudent in the current banking climate when we are seeking to reduce our cash balance and interest rates at the long end are significantly higher than short term rates

9. Equality implications

None directly related to this report.

10. Consultation

The issues in the report have been considered collectively by CMT, the Chief Finance Officer and the Cabinet Portfolio Holder for Finance and Personnel who have provided a steer to assist in setting our Risk versus Reward appetite.

Background papers:

Annual Treasury Management and Investment Strategy – Prudential Indicators 2007/08 – Cabinet – 06 February 2008
Annual Treasury Management and Investment Strategy – Prudential Indicators 2008/09 – Cabinet – 04 February 2009
The Audit Commission report "Risk and Review" April 2009
Parliamentary Communities and Local Government Committee report "Local authority investments" June 2009.
Various financial working papers.

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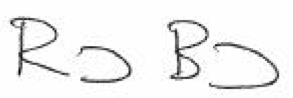


Rory Borealis – Executive Director (Resources)
7 September 2009

Cllr Chris Towe
Finance & Personnel
7 September 2009

James Walsh - Chief Finance Officer
4 September 2009

APPENDIX A

TREASURY MANAGEMENT POLICY STATEMENT

The CIPFA Code recommends that authorities should:

i. Put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

ii. Policies and practices should make clear that the effective management of risk, having regard to return, is a prime objective of the treasury management activities.

iii. Acknowledge that the pursuit of best value in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, the treasury management policies and practices should reflect this.

In order to do this, the council should once again adopt a treasury management policy statement as shown below and create and adopt treasury management practices (TMPs):

- A treasury management policy statement, stating policies and objectives of its treasury management activities.
- Suitable TMPs, setting out the manner in which the council will seek to achieve those policies and objectives, prescribing how the council will manage and control those activities.
- The contents of the policy statement and TMPs will follow the recommendations contained in section 6 and 7 of the Code, subject only to amendment where necessary to reflect this council's particular circumstances.

There are amendments to the responsible posts under delegated powers, which reflect changes to the staffing structure of the finance service.

Later in 2009/10, CIPFA are expected to release an update to the Treasury Management Code of Practice. Walsall's policies and procedures will be reassessed in light of the update and if necessary appropriate updates will be sent to the Treasury Management Panel and Cabinet.

THE TREASURY MANAGEMENT PRACTICES 2009/10 ONWARDS

Walsall Council defines its treasury management activities as:
"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."

Walsall Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

Walsall Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principle of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

TREASURY MANAGEMENT FUNCTION	
	The approved activities of the treasury management function are as follows: **Activities:** • Borrowing • Investment of temporary surplus funds and other balances • Setting and reviewing the treasury management strategy • Cash flow management • Management of school investments · Management of debt and investments, including rescheduling, management of interest rate exposure and maturity profile management.

TMP 1 – TREASURY RISK MANAGEMENT
The Section 151 Officer (CFO) shall: • Ensure that appropriate arrangements are in place for the design, implementation and monitoring of all arrangements related to the identification, management and control of treasury management risk. • Report at least annually on the adequacy/suitability thereof, and report as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the council's objectives in this respect. · In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives will be set out in schedules.
Liquidity <u>Objective</u>: Adequate but not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable the council at all times to have the level of funds available which are necessary for the achievement of its service objectives.
Interest Rates <u>Objective:</u> Management of the council's exposure to fluctuations in interest rates with a view

to containment of its net interest costs.

Exchange Rates

<u>Objective</u>: Management of the council's exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

Inflation

<u>Objective</u>: Control of exposure to the effects of inflation, in so far as they can be identified as impacting on treasury management activities.

Credit and Counterparties

<u>Objective</u>: To secure the principal sums invested. A counterparty list will be maintained and the named organisations and limits will reflect a prudent attitude towards organisations with whom funds may be deposited

Rescheduling & Refinancing of Debt

<u>Objective:</u> All borrowing, private financing and partnership arrangements will be negotiated, structured and documented. The maturity profile of debt will be managed with a view to obtaining terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

Relationships with counterparties in these transactions will be managed in such a manner as to secure this objective, and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.

Legal and Regulatory

<u>Objective</u>: Compliance with statutory powers and regulatory requirements for all treasury management activities. The council will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities.

In framing its credit and counterparty policy under **TMP1.1.5** *Credit and Counterparty risk management,* the council will ensure that there is evidence of counterparties powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

The council will seek to minimise the impact of future legislative or regulatory changes on its treasury management activities so far as it is reasonably able to do so.

Fraud, Error and Corruption, and Contingency Management

<u>Objective</u>: Identification of circumstances which may expose the council to the risk of loss through fraud, corruption or other eventualities in its treasury management dealings. Employ suitable systems and procedures and maintain effective contingency management arrangements.

Market Risk

<u>Objective</u>: Protection from adverse market fluctuations in the value of the principal sums invested.

Additional Level Risk / Reward

Objective: - to ensure that the risk/ reward balance is appropriate and consistent with the risk appetite of the council the following aims are managed:-

- to have a large proportion of debt on fixed rates to provide stability.
- to have investments over a range of period lengths
- to use UK highly rated banks or strong building societies
- to obtain a fair return without any undue risk.

A high risk credit rating is defined as Banks/Institutions with a national credit rating of > 1.

TMP 2 – BEST VALUE AND PERFORMANCE MEASUREMENT

The council actively works to promote value for money and best value in its treasury management activities. The treasury management function will be the subject of regular reviews to identify scope for improvement. In addition annual benchmarking is undertaken to measure performance and to ensure that relative to other councils the council is achieving a fair investment return without any undue risk.

TMP 3 – DECISION- MAKING AND ANALYSIS

Full records will be maintained of its treasury management decisions, and of the processes and practices applied in reaching those decisions to demonstrate that reasonable steps have been taken to ensure that all issues relevant to those decisions were taken into account.

TMP 4 – APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

Only approved instruments, methods and techniques will be used, within the limits defined in **TMP1** *Risk Management.*

Sources of Borrowing

There shall be no restriction in principle on sources or methods of borrowing other than those imposed by law. The sources or methods of borrowing at any time will be determined by the current approved treasury management strategy.

Other Sources of Finance

The Assistant Director of Finance shall arrange operating leases and similar arrangements for items of equipment, vehicles, etc., where the acquisition or use of such items has been approved in line with the council's contract and procedure rules.

Approved Organisations for Investments

The Assistant Director of Finance (CFO) shall approve and revise from time to time, a list of organisations within the statutory definitions of approved investments, which would be eligible to receive investments from the council. Apart from the Government, and, in any emergency, the council's own bank, the maximum limit for investment with any single organisation shall be £15 million and £5 million and the maximum period for investment shall be 3 months, 1 year or 5 years in accordance with each individual institution's credibility. This review should be at least monthly and incorporate any changes in ratings of counter parties.

Interest Rate Exposure

The limits on temporary borrowing and the proportion of interest at variable rates are set by Council, in accordance with Section 45 of the Local Government & Housing Act 1989.

TMP 5 – ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES AND DEALING ARRANGEMENTS

Treasury management activities will be properly structured in a clear and open fashion and a rigorous discipline of segregation of duties will be enforced to ensure effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions and audit of the treasury management function.

If and when the council intends, due to a lack of resources or other circumstance, to depart from these principles, the section 151 Officer will ensure that the reasons are properly reported in accordance with **TMP6** *Reporting Requirements & Management Information*

Arrangements and the implications properly considered and evaluated.

- The Section 151 Officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management and the arrangements for absence cover.
- The Section 151 Officer will ensure that there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

The delegations to the Section 151 Officer in respect of treasury management are set out in the Constitution. The Section 151 Officer will fulfil all such responsibilities in accordance with the Policy Statement and TMPs and the Standard of Professional Practice on Treasury Management. This includes, but not exclusively, the following activity.

Activity	Prepared By	Delegation / Accountability
Approval of Treasury Management Policy and Strategy.	Head of Finance / Assistant Director of Finance	Cabinet - Policy Statement Council - Strategy
Review the debt portfolio and reschedule loans when considered appropriate	Corporate Financial Systems and Treasury Manager	Assistant Director of Finance / Head of Finance
Undertake budget monitoring and initiate actions when necessary	Corporate Financial Systems and Treasury Manager	Head of Finance
Authorisation of loan interest payments	Finance Assistant – treasury management	Principal Loans Accountant
Approval of overnight investments	Principal Loans Accountant	Principal Loans Accountant
Preparation of borrowings documentation	Finance Assistant – treasury management	Principal Loans Accountant
To arrange borrowing from time to time for the council's purposes. Sources of funds will comprise temporary loans, loans from PWLB, other mortgages and bonds, money bills, bank overdraft and internal funds of the council, subject to any restrictions which may be made by statute, Council or Cabinet	Corporate Financial Systems and Treasury Manager	Assistant Director of Finance / Head of Finance
To arrange finance and operating leases as required in accordance with council's capital programme	Corporate Financial Systems and Treasury Manager	Assistant Director of Finance / Head of Finance
To invest council funds temporarily not required in accordance with the statutory provisions regulating approved	Finance Assistant – treasury management	Principal Loans Accountant

investments as defined in Section 66 of the Local Government and Housing Act 1989, subject to any restrictions which may be made by statute, by Council or by cabinet		
To maintain a counter party list of approved organisations eligible to receive council investments, this involves; - ongoing monitoring of ratings on investment products and institutions. - signing off by the treasury manager as evidence of a monthly review and mid month changes if necessary. - if ratings change for an investment product or institution currently held then actions for a possible exit of that strategy are undertaken as approved by the Treasury Management Panel	Principal Loans Accountant	Treasury Manager Treasury Manager Treasury Manager Treasury Manager and / or Assistant Director of Finance / Head of Finance dependent on limits set by TMP of exit strategy
Daily cash flow forecast	Finance Assistant – treasury management	Principal Loans Accountant
Update loan records	Finance Assistant – treasury management	Principal Loans Accountant

RESERVE POWERS

Any powers available to officers under these financial regulations may at any time be exercised by the Chief Executive or a member of the Corporate Management Team, except where otherwise provided.

Officers authorised to sign cheques requiring manual signature and to sign other financial documents:

J. T. Walsh	Assistant Director of Finance and CFO
V Buckley	Head of Corporate Finance and Deputy CFO
S. Simcox	Service Accountancy Manager
M Tomlinson	Corporate Financial Systems and Treasury Manager
D Mortiboys	Service Accountancy Manager
S Wootton	Finance Manager
CMT	Chief Executive / Executive Directors
To release money transfer system payments only :	
T. Evans	Group Accountant
K. Griffin	Group Accountant

N. Imber	Group Accountant
C. Knowles	Group Accountant
R. Walley	Group Accountant
P Sandhu	Group Accountant

TMP 6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

Regular reports will be prepared for consideration by cabinet on:

- The implementation of its treasury management policies/practices
- Annual report on treasury management activities for the preceding year;
- Treasury Management Strategy for the year, reviewed at least once during the year;

Regular monitoring reports on prudential and local indicators will be prepared for the Treasury Management Panel.

Report	Frequency	When	To:
Review of Treasury Management Strategy Material changes	Annual Immediately	February/ March	Cabinet and Council Cabinet and Council
Review of Treasury Management Policy and Annual Reports	Annual	September / October	Cabinet
TM budget monitoring	Quarterly Monthly	July, Oct, Jan, April	Assistant Director of Finance Treasury Management Panel Head of Finance for inclusion in overall corporate financial monitoring reports to CMT and cabinet which are first reviewed by the CFO
TM performance indicators	Quarterly Monthly	July, Oct, Jan, April	Assistant Director of Finance Treasury Management Panel Head of Finance
Cash flow summary	Monthly		Corporate Financial Systems and Treasury Manager
Borrowing transactions	Monthly		Corporate Financial Systems and Treasury Manager
Government statistical return	Monthly		Office of the Deputy Prime Minister
Daily cash balance forecast	Daily		Principal Loans Accountant

TMP 7 – BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

The Section 151 Officer will prepare for cabinet, and full Council will approve and, if necessary from time to time, will amend, an annual treasury management budget which will

bring together all costs involved in running the treasury management function and associated income.
The council will account for its treasury management activities in accordance with appropriate accounting practices, standards and statutory and regulatory requirements.
The council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.
In line with market convention loans office staff, when dealing, are required to commit the council to terms of borrowing and investment transactions by telephone. Although these transactions are not legally binding until confirmed in writing, if subsequently dishonoured, this may damage the council's reputation. Electronic funds transfer requires the involvement of three officers, at least one of whom shall be on the list in **TMP 5.**

TMP 8 – CASH AND CASH FLOW MANAGEMENT
All council monies shall be aggregated for treasury management purposes and will be under the control of the Section 151 Officer. Cash flow projections will be prepared on a regular and timely basis and the Section 151 Officer will ensure that these are adequate for the purposes of monitoring compliance with **TMP1** *Liquidity risk management.*
TMP 9 – MONEY LAUNDERING
Procedures will be enforced for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff involved in this area are properly trained.
TMP 10 – STAFF TRAINING AND QUALIFICATIONS
The council will appoint individuals to the treasury management function who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The council's treasury manager will be CCAB qualified. An annual review of staff capacity including training needs and experience will be undertaken and reported to the TMP.
TMP 11 – USE OF EXTERNAL SERVICE PROVIDERS
When external service providers are employed, the Section 151 Officer will ensure it does so for reasons which have been subjected to a full evaluation of the costs and benefits. The terms of appointment and the methods by which service providers' value will be assessed will be properly agreed and documented. The council does not currently require external investment managers, but recognises it may do so in the future for general or specific advice on a range of matters. These future services would be procured using the council's prevailing regulations relating to obtaining supplies and services. The council employs external treasury advisors to provide economic outlooks and information relevant to making robust investment and borrowing decisions.
TMP 12 – CORPORATE GOVERNANCE
This authority is committed to the pursuit and achievement of proper corporate governance throughout its business and services and to establish principles and practices by which this can be achieved. Accordingly the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

The council has adopted and has implemented the key recommendations of the Code. The Section 151 Officer will monitor and when necessary, report upon the effectiveness of these arrangements.

A forum for the monitoring of Governance arrangements is the Treasury Management Panel. The Treasury Management Panel meets quarterly chaired by the CFO or (in his absence) the deputy CFO. It will receive reports on the monitoring of Prudential and Local Indicators and approve drafts of strategy and policy cabinet/council reports. It will also initiate work and projects to further ensure strong compliance of internal controls and effective Treasury performance.

APPENDIX B

REVIEW OF TREASURY MANAGEMENT ACTIVITY FOR 2008/09

1 Background

1.1 Councils are required by regulation to have regard to the Prudential Code. The Code requires councils to comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original Code in 1992 and the revised Code in 2002. This Code recommends that the council present an annual report to members covering the previous year's activity.

1.2 The authority's current treasury management and investment strategy approved by cabinet on 4 February 2009 contains the following objectives:

KEY OBJECTIVES FOR BORRROWING

Our borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the council's debt maturity profile, ensuring no single future year has a disproportionate level of repayments
- To maintain a view on current and possible future interest rate movements and borrow accordingly
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and prudential indicators.

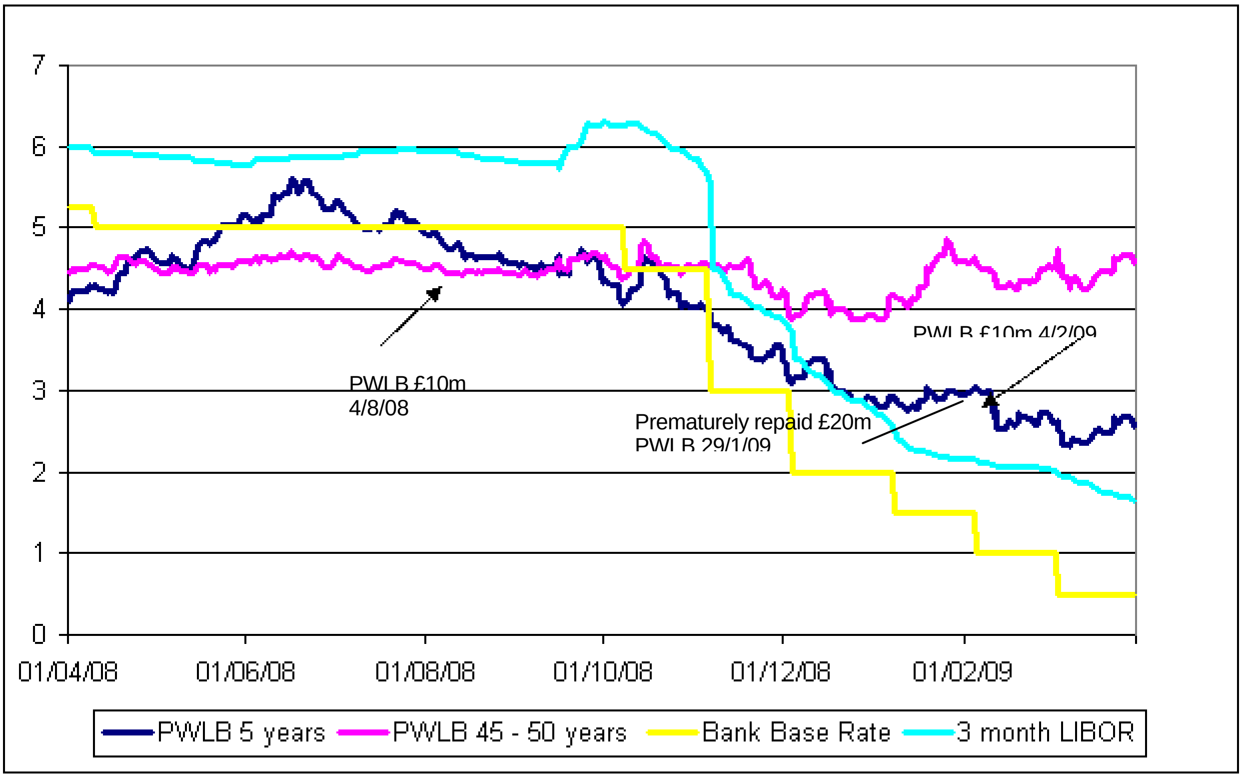
KEY OBJECTIVES FOR INVESTMENT

- The general policy objective for this council is the prudent investment of its treasury balances
- The council's investment priorities are:
  - The security of capital and
  - Liquidity of its investments
- All investments will be in sterling
- The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

1.3 Investments of less than 364 days are made regularly in managing cash flow. Investments of more than 1 year are undertaken and these are specifically monitored.

1.4 A review of TM activities should be undertaken with an understanding of the economic climate for the year. The following graph **(Diagram 1)** shows a profile of short term interest rates (bank base rate and 3 month LIBOR) and borrowing rates (PWLB 45-50 years and 5 years). The dates when significant loan repayments and borrowings were undertaken are indicated. The next section provides contextual information by providing an economic review of the year.

Diagram 1



2 Economic Review

2.1. Borrowing - Longer-term interest rates

The consensus at the beginning of 2008/09 was that longer-term fixed interest rates, over 50 years, would remain static at around 4.45% for the whole year. Walsall rescheduled two PWLB loans running at 4.50% and 4.45% with loans at 4.46% and 2.96% respectively, in 2008/09. The premature repayments generated a discount of £0.25m. **Diagram 1** indicates when Walsall took the new borrowing which averaged at a rate of 3.71%. The PWLB 45-50 year rate started the year at 4.44% and fell to a low of 3.88% in December 2008 and January 2009. There were several high points for 45-50 year was 4.86% before finishing the year at 4.58%. The volatility in yields was a direct reflection of the massive turnaround in interest rate sentiment brought about by the sub-prime crisis in the US.

2.2 Investments - Shorter-term interest rates

The UK Bank of England base rate started 2008/09 at 5.25%, The expectation was for it to reduce to 4.75% in the autumn and stay at that level for the remainder of the year. When the base rate decreased to 5% on 10 April 2008. Market fears were that rates were going to rise as the Consumer Price Index, the governments preferred inflation target , was well above the 2% target, two years ahead. Also the money markets were expressing concerns about liquidity and the spread between 3 month LIBOR and bank base rate was greater than had historically been the case.

This phase continued throughout the summer until 15 September 2008 when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets.

On 7 October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping a massive £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. The Monetary Policy Committee meantime had reduced interest rates by 50bp on 9 October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out (see **Diagram 1**). The short end of the PWLB fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. In December as the ramifications of the 'credit crunch' became increasingly clear, the Bank of England cut interest rates to 2%-a drop of a further 1%.

The New Year of 2009 only brought small relief to the prevailing sense of crisis and on 8 January the MPC reduced rates by 0.5% to 1.5%, a record low. In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Interbank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The MPC cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place. Investment income returns have been greatly reduced
.

3 Review of 2008/09 activities

3.1 **Table 1** shows borrowing and investments administered as at 31 March 2009 and 31 March 2008.

Table 1: Borrowing and investment 2008/09

	Borrowing £ m	Investments £ m	Net Borrowing £ m
31 March 2009	264.7	(76.5)	188.2
31 March 2008	265.4	(91.2)	174.2
Change in year	(0.7)	(14.7)	14.0

3.2 **Borrowing**

Table 2 shows how Walsall's borrowing decreased by £0.86m during 2008/09. Walsall did reschedule two PWLB loans in 2008/09. **Diagram 1** shows the points when the new borrowing was taken. The aim was to prematurely repay these loans when the PWLB discount rates were in Walsall's favour and to try and take these loans at the optimum time and at a competitive rate. It is visible that Walsall achieved this.

Table 2: Changes in Borrowings 2008/09

	Opening Balance £ m	Ave. Rate	Movement in Year £ m	Closing Balance £ m	Ave. Rate
PWLB	115.28	4.80%	0.00	115.28	4.66%
Market Loans	122.00	4.59%	0.00	122.00	4.61%
Bonds	0.26	5.45%	(.11)	0.15	4.77%
Temporary Loans	0.34	6.03%	(0.16)	0.18	4.74%
Total excluding OLA debt	**237.88**	**4.68%**	**(0.27)**	**237.61**	**4.64%**
Other L A Debt	27.84	7.63%	(0.59)	27.25	6.70%
Total including OLA debt	**265.78**	**4.99%**	**(0.86)**	**264.86**	**4.85%**

3.3 **Investments**

Over the year Walsall's investment balance has decreased by £14.7m. The split of this across long term and short term investments is shown in **Table 3**.

Table 3: Changes in Investments during 2007/8

	Opening Balance £ million	Average Rate	Movement in Year £ million	Closing Balance £ million	Average Rate
Other Long Term Investments	(20.0)	5.58%	(5.0)	(25.0)	5.83%
Short Term Investments	(71.2)	5.87%	19.7	(51.5)	5.87%
Total	**(59.1)**	**4.91%**	**14.7**	**(91.2)**	**5.82%**

During 2008/09 the council has taken out an additional £5m long term investments at a return rate of 6.04%. In addition to this £11m came to the end of its term and was reinvested at a rate of 4.89%.The average rate of return over 2008/09 for new long term investments was 5.25%.

3.4 **Market Loans – Risk Management**

The council's borrowing portfolio contains some market loans with LOBO options attached. This is where the lender has the option to change the interest rate on the loan and the borrower has the choice to accept the proposal or repay. To balance the benefits of these loans and the exposure to rate changes on the debt portfolio the authority has a strategy to reduce the number of exposure points in a given year. There was no rescheduling done during 2008/09, however due to previous rescheduling the number of interest rate change points in the 5 year period from 2009 to 2013 has reduced from

15 to 9. These variable loans do represent a risk to the authority in a period of high interest rates. The possible effect of an increase in interest rates is monitored regularly. Performance Indicator PrI 11 – maturity ranges, will be reviewed in light of this risk management approach.

4. Comparison with other councils

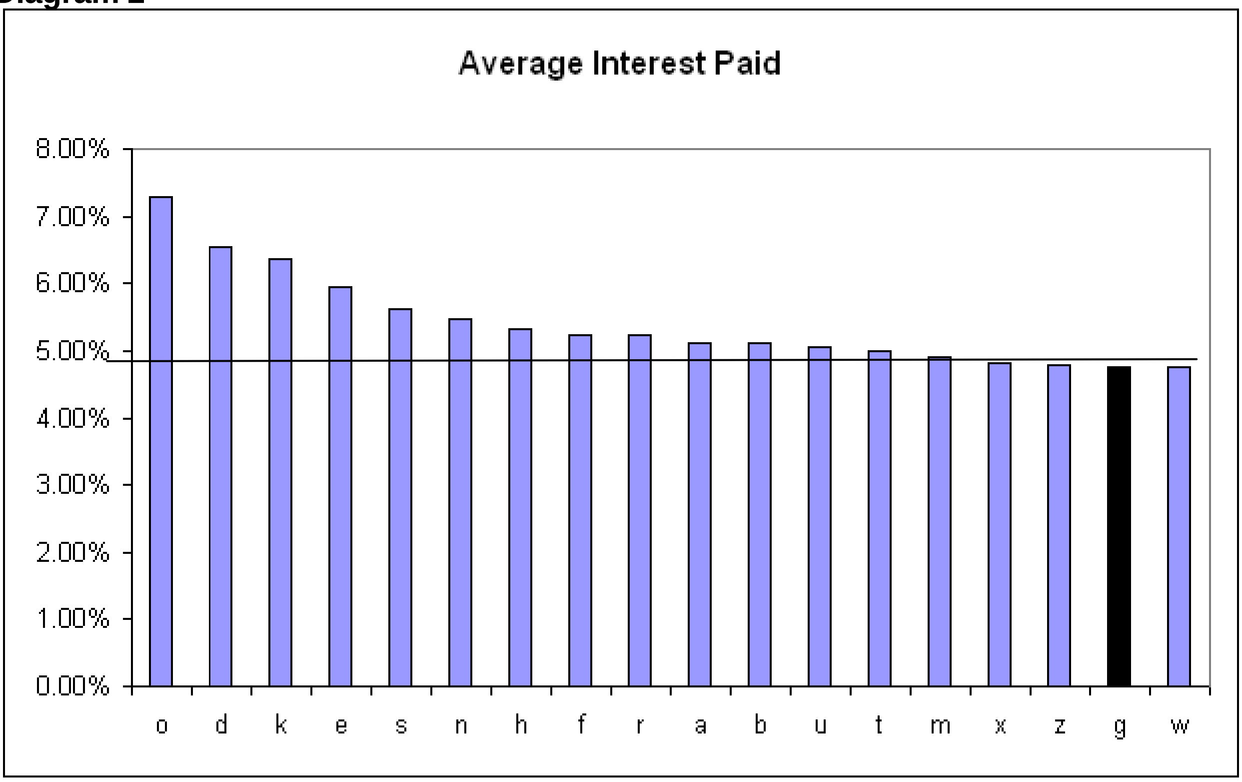
4.1.1 Table 3 compares interest paid and received during 2008/9 **(**excluding other local authority debt) with that of our family group. This shows that we were below the average interest rate on borrowing. If we had borrowed at the average rate for all family group councils, Walsall would have paid £1.33million more interest than was actually paid. It also shows that our rate of return on investments was slightly above average. If we had achieved the average investment rate of the councils that make up our family group, £0.024m less income would have been generated.

Table 4:Comparison with other councils

	Walsall Council 2008/9 £m	**Family Group 2008/9**		
		Average %	**Upper %**	**Lower %**
Interest paid Interest received	11.36 (6.13)	[redacted]	[redacted]	[redacted]
Net interest cost	**5.23**	[redacted]	[redacted]	[redacted]
Average interest rates:				
On borrowing	4.77%	5.30%	7.29%	4.75%
On investment	5.22%	5.22%	5.99%	4.64%

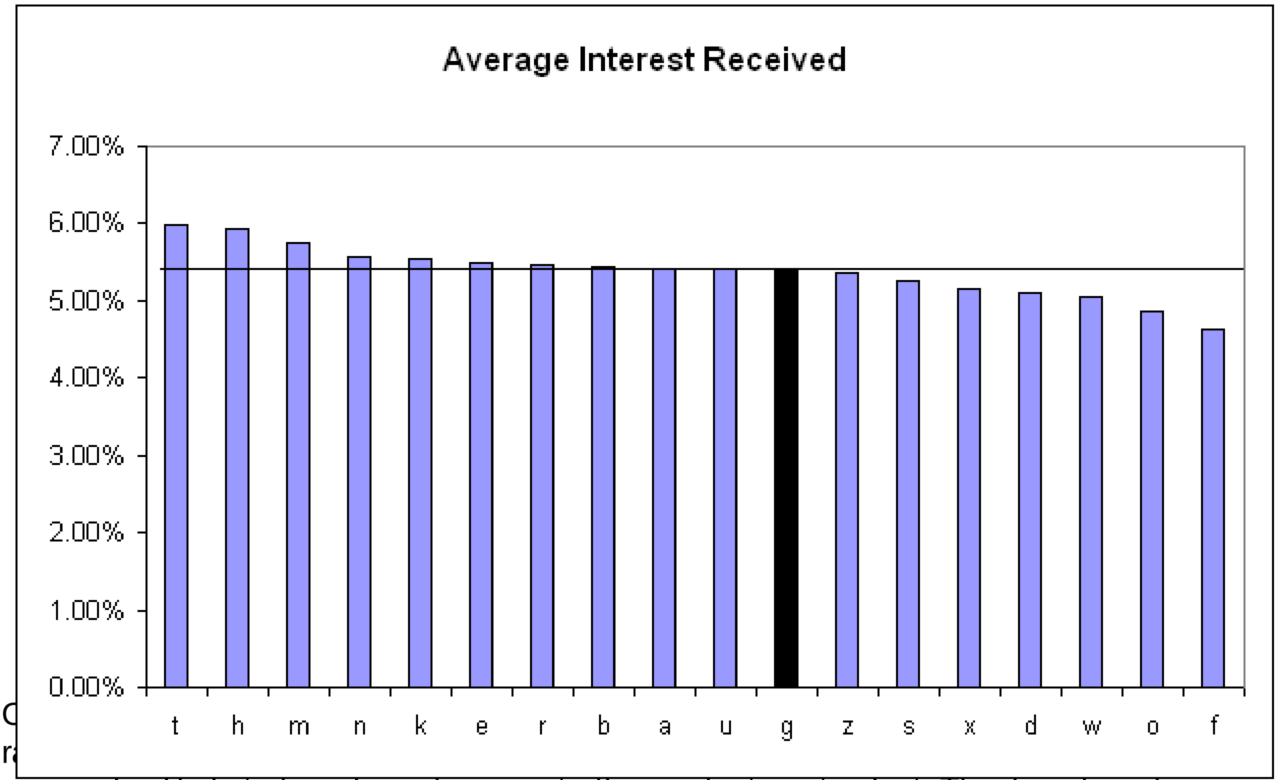
4.2 **Diagram 2** shows Walsall's position in comparison with our family group members within the IPF benchmarking group, for average rate on interest paid. The black column represents Walsall Council. The horizontal line is the family average.

Diagram 2



4.3 **Diagram 3** shows Walsall's position in comparison with our family group members within the IPF benchmarking group. The black column represents Walsall. The horizontal line is the family average.

Diagram 3



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principal is likely to be a long drawn out affair and interest is lost. This benchmarking exercise indicates that the council is not in comparison with other councils seeking an exceptionally high risk return.

Appendix C

Capital Financing Indicators

As at 31 March 2009

Prudential Indicators defined within Prudential Code

Prudential indicators of affordability

Indicator		Actual 2007/08 £'000	Target 2008/09 £'000	Position as at 31-Mar-09 £'000	Variance to target £'000	Variance to target %
PrI 1	Capital Expenditure	63,418	57,706	**53,099**	- 4,607	-7.98%
PrI 2	Ratio of financing costs to net revenue stream	7.47%	8.51%	**7.56%**	-0.95%	-11.20%
PrI 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£9.64	£6.49	**£6.49**	£0.00	0.00%
PrI 4	Capital Financing Requirement	263,279	272,073	**256,708**	- 15,365	-5.65%
PrI 5	Authorised Limit for external debt	291,236	299,280	**299,280**	-	0.00%
PrI 6	Operational Limit for external debt	257,281	272,073	**272,073**	-	0.00%

External debt figure is excluding attached premiums and discounts

Prudential indicators for prudence

		Actual 2007/08 £'000	Target 2008/09 £'000	Position at 31-Mar-09 £'000	Met
PrI 7	Net Borrowing exceeds capital financing requirement	No	No	**No**	Y
PrI 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	**Yes**	Y
PrI 12	Total principle sums invested for longer than 364 days	15,000	25,000	**25,000**	Y

Indicator		Upper Limit	Lower Limit	Actual 2007/08	Position as at 31-Mar-09
PrI 9	Fixed Interest Rate Exposure	95%	40%	**71%**	**92%**
PrI 10	Variable Interest Rate Exposure	45%	0%	**29%**	**8%**
PrI 11	***Maturity Structure of Borrowing***				
& PrI12	Under 12 months	15%	0%	**0%**	**9%**
	12 months and within 24 months	20%	0%	**8%**	**14%**
	24 months and within 5 years	25%	0%	**14%**	**12%**
	5 years and within 10 years	50%	10%	**19%**	**12%**
	10 years and above	85%	40%	**59%**	**54%**

Locally defined prudential indicators

		Actual 2007/08 £'000	Target 2008/09 £'000	Position at 31-Mar-09 %	Variance to target %	Met %
L1	Full compliance with prudential code	Yes	Yes	**Yes**		Y
L2	Average length of debt	19.97	20 to 25 years	**17.79**		N
L3	Ratio of unsupported financing costs to net revenue stream	1.36%	1.69%	**1.14%**	-0.55%	Y
L4	Net actual debt vs operational debt	97.18%	96.00%	**97.00%**	1.00%	Y
L5	Average interest rate of external debt outstanding including OLA	4.64%	4.70%	**4.69%**	-0.01%	Y
	Average interest rate of external debt outstanding excluding OLA		4.50%	**4.37%**	-0.13%	Y
L6	Gearing effect of 1% increase in interest rate	6.31%	5.00%	**1.87%**	-3.13%	Y
L7	Average interest rate received on short term investments				0.00%	
	Cumulative	6.02%	5.25%	**4.15%**	-1.10%	Y
L8	Average interest rate received on STI vs 71 month LIBID rate					
	Cumulative	-0.34%	0.10%	**1.0%**	0.90%	Y
L9	Average rate on all investments					
	Cumulative	5.94%	5.30%	**5.22%**	-0.08%	Y
L10	% daily bank balances within target range					
	Cumulative	99.00%	97.00%	**98%**	1.00%	Y

EXPLANATION OF TECHNICAL TERMS USED IN THIS REPORT AND APPENDICES

1. TERM	DEFINITION
Bills	Also known as Bills of Exchange. Written order to pay sum on given date to a named person.
Bond	A government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.
Borrowing	Obtaining money for temporary use that has to be repaid.
Capital receipts	The proceeds from the disposal of land or other assets. Capital receipts can be used to fund new capital expenditure but cannot be used to finance revenue expenditure
Cash flow management	The management of the authority's receipts and payments to ensure the authority can meet its financial obligations.
Credit arrangements	Are defined in section 48 of the 1989 Act – they comprise diverse forms of leases and contractual arrangements whereby authorities obtain credit other than by the borrowing of money.
Dividends	Sum to be payable as interest on loan.
Investments	The employment of money with the aim of receiving a return.
Local bonds	A local authority's document undertaking to repay borrowed money usually with a fixed rate of interest.
Long term borrowing	Borrowing of money for a term greater than one year.
Market convention	The rules and regulations by which all brokers and dealers should abide by. It includes standards of practice and calculation conventions for interest. They are defined in the London Code of Conduct ("The London Code") published by the Bank of England.
Operating leases	Fixed assets held and occupied , used or consumed by the local authority in the direct delivery of those services for which it has either a statutory or discretionary responsibility
Other local authority debt	Debt that is owed by one local authority to another local authority.
Prudential code	The current system on financial controls for capital financing introduced on 1 April 2004 that local authorities are required to operate by, contains specified performance indicators.
Redeemable stock	Stocks that are recovered by particular terms.
Short term borrowing	Borrowing of money for a term of up to 364 days.
Stock	Subscribed capital of trading company, or public debt of nation, municipal corporation etc regarded as transferable property
Supported Borrowing	The amount of borrowing that Government believes is required by an authority in any one year to provide its capital programme. Financial support is provided for this through Formula Grant.
Temporary borrowing	Borrowing of money for a term of up to 364 days.
Treasury management	The management of the local authority's cash flows, its borrowings and its investments, management of associated risks, and pursuit of the optimum performance or return consistent with those risks.
Treasury policy statement	A statement of key policies followed in pursuit of effective treasury management, including borrowing limits and strategy.
Unsupported Borrowing	Borrowing undertaken by an authority above its supported borrowing level to support the capital programme. Can only be undertaken if it is proven to be prudent to do so.
Variable debt	This is money which has been borrowed at a variable interest rate, and as such is subject to interest rate changes.