

**NEW FOREST NATIONAL PARK AUTHORITY**

**AUTHORITY MEETING - 25 JUNE 2009**

**ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL  
PRUDENTIAL INDICATORS 2008/09**

**Report by Paul Carey-Kent, Section 151 Officer**

**1. Introduction**

1.1 The annual treasury report is a requirement of the Authority's reporting procedures and covers the treasury activity for 2008/09. The report also covers the actual Prudential Indicators for 2008/09 in accordance with the requirements of the Prudential Code.

**2. Background**

2.1 The Authority's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI also requires the Authority to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the DCLG has issued Investment Guidance to structure and regulate the Authority's investment activities.

2.2 This Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that any activities are undertaken in a prudent, affordable and sustainable basis.

- 2.3 The Code requires as a minimum the regular reporting of treasury management activities to:
- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report); and
  - Review actual activity for the preceding year (this report).
- 2.4 This report sets out the information in the following appendices:

**Appendix 1**

- A summary of the treasury strategy agreed for 2008/09
- A summary of the economic factors affecting the strategy over 2008/09
- The decisions taken and performance of the treasury service and their revenue effects
- The Authority's treasury position at 31 March 2009

**Appendix 2**

- The main Prudential Indicators and compliance with limits
- Performance indicators set for 2008/09
- Risk and performance

**3. Recommendations**

**To note the treasury management stewardship report for 2008/09 and the actual 2008/09 prudential indicators within the report.**

<b>Further Information</b>	<b>Background Papers</b>
Paul Carey-Kent, Section 151 Officer Telephone: 023 8028 5821	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance
e-mail: paul.carey-kent@hants.gov.uk	Published Papers

## APPENDIX 1

### TREASURY MANAGEMENT STEWARDSHIP REPORT – 2008/2009

#### 1. Introduction

This appendix sets out the performance for the Authority's treasury management activities.

#### 2. Treasury strategy for 2008/09

The Authority approved the Treasury Management Strategy for 2008/09 in March 2008 (NFNPA RPC46/08).

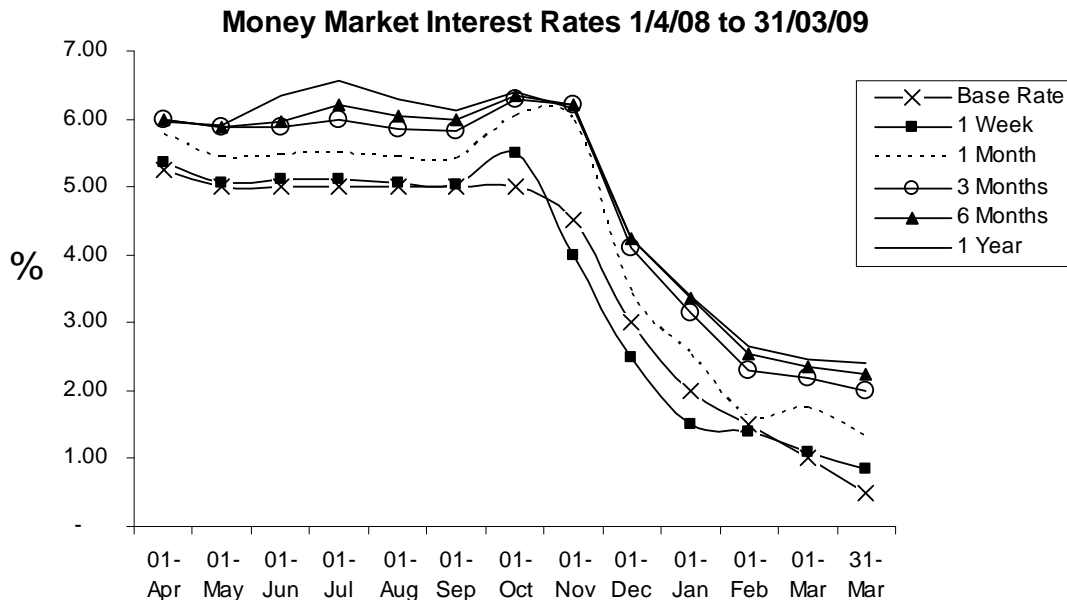
The main principles of the investment strategy cover:

- The security of investments;
- The liquidity of investments;
- Monitoring investment categories and counterparties;
- The use of money brokers;
- Performance indicators

#### 3. Summary of economic factors

- 3.1 Following the Credit Crunch of 2007/08 market conditions remained nervous throughout 2008/09. The US authorities had cut interest rates in March. The Bank of England and European banks had resisted, mainly because of inflation concerns.
- 3.2 The failure of US investment bank Bear Stern (rescued by JP Morgan Chase), increased fear and suspicion in the banking sector.
- 3.3 Banks possessed sufficient liquidity but their reluctance to lend to each other meant that money markets failed to function normally.
- 3.4 The Bank of England announced a Special Liquidity Scheme to aid liquidity in April 2008. The Scheme proved popular and the sum injected into the market was £100 billion, twice the amount anticipated. However, banks were still reluctant to lend and a very wide margin between the official bank rate and money market rates persisted.
- 3.5 During the summer conditions began to ease gradually and there were signs of a return to more normal market conditions.
- 3.6 In mid-September 2008 the US authorities allowed investment bank, Lehman Brothers, to fail and rescued the country's largest mortgage lenders.

- 3.7 Market liquidity dried up completely and well regarded institutions were driven towards bankruptcy. UK bank HBOS was unable to raise sufficient funding and was rescued by Lloyds TSB. Bradford and Bingley was nationalised.
- 3.8 Smaller banks were the hardest hit. The Irish Government announced guarantees for its country's banks. Icelandic banks failed in early October and deposits were frozen.
- 3.9 The financial markets descended into crisis amid concerns over a total collapse of the world's financial system. Governments, including the UK, launched rescue programmes. The UK programme included the recapitalisation of many of the high street banking groups by partial nationalisation and further cash injections.
- 3.10 In the US the rescue included the partial nationalisation of Citigroup and official interest rates were cut to a range between zero and 0.25%.
- 3.11 In the UK, the Bank of England initiated a series of interest rate cuts in the knowledge that the UK economy was declining into deep recession and inflation was set to fall sharply.
- 3.12 In March 2009 the Bank of England instigated a series of reverse gilt auctions, known as quantitative easing, to increase money supply in the economy. By the end of the year the bank base rate had been cut to an historic low of 0.5%.
- 3.13 The following chart shows how the money market interest rates reduced over the year.



The movements in the bank base rate during the year were as follows:

Date	Bank Base Rate
At 1 April 2008	5.25%
11 April 2008	5.00%
9 October 2008	4.50%

7 November 2008	3.00%
5 December 2008	2.00%
9 January 2009	1.50%
6 February 2009	1.00%
6 March 2009	0.50%

- 3.14 Analysts forecast that there will be no further bank base rate reductions and that the rate will remain stable during the summer and autumn of 2009. The next movement in bank base rates is forecast to be an increase in the winter of 2009.

#### **4. Investment strategy**

- 4.1 All new investments have been made for periods up to six months and have allowed for anticipated cash flow movements both on a daily and annual basis.
- 4.2 Investments have been made for an average period of 89 days in 2008/09. This is similar to the average of 85 days for 2007/08. Although some investments were made for up to six months at the beginning of the year, the length of investment was shortened considerably as the year progressed in response to the uncertainty that developed in the financial markets.
- 4.3 Investments have been made strategically where cash flow allows.

#### **5. Temporary Investments**

- 5.1 Temporary Investments are deposits which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.
- 5.2 Because the Authority has £500,000 invested with a failed Icelandic bank a proportion of the interest that would have been earned on this investment has been lost.
- 5.3 It is likely that 80% of the principal and interest will be repaid over a five year period.
- 5.4 The interest due for the full term of the original investment was £29,270. The adjusted interest, which is now due for a period from the initial date of the investment until the failure of the bank on 6 October 2008 only, is £16,645. The sum calculated to be receivable is estimated at £13,316 which is 80% of the interest earned up to 6 October, the date of default. The remainder will not be paid.
- 5.5 The first payment is due late in July 2009.
- 5.6 The interest rate earned on temporary investments for the year was 4.66% taking into account the interest lost on default.
- 5.7 For 2008/09, the interest receivable on temporary money market investments is £134,094.
- 5.8 Further interest earnings from the Treasury Call account and the bank account total £8,656.

5.9 The total earnings are £142,750. This is an increase of £12,750 from the revised estimate for the year, reported in March 2009.

5.10 A list of investments at 31 March 2009 is shown below:

<b>Borrower</b>	<b>Amount</b>	<b>Interest Rate</b>
	<b>£</b>	<b>%</b>
<b>Temporary Investments</b>		
Stroud & Swindon Building Society	500,000	1.83
Chelsea Building Society	500,000	2.10
Saffron Building Society	450,000	2.10
Nationwide Building Society	500,000	1.80
Lloyds Bank Treasury Call A/c	<u>375,000</u>	0.15
<b>Sub Total</b>	<b>2,325,000</b>	
<b>Long Term Investment</b>		
Heritable Bank Ltd (estimated return of 80% of original principal invested and calculated at fair value)	299,327	n/a
<b>Total</b>	<u><b>2,624,327</b></u>	

5.11 The principal of the Heritable Bank investment is shown as the impairment calculations in the balance sheet in the final accounts and has been calculated in line with CIPFA guidelines of fair value.

5.12 All temporary investments have been invested according to the parameters set within the Authority's Treasury Policy Statement.

## 6. Icelandic Bank Deposit

6.1 On 14 March 2008 an investment of £500,000 was placed with Heritable Bank, a UK registered subsidiary of Landsbanki Islands, a major Icelandic bank.

6.2 The investment was for 364 days and the interest rate applicable was 5.87%.

6.3 At the time that the investment was placed, the credit rating by FITCH, a major credit rating agency, was:

Short term rating	Long term rating	Support rating
F1	A	1

6.4 This met the approved credit criteria contained within the Authority's Investment Strategy.

6.5 The meaning of these ratings is as follows:

Credit Rating	Meaning of Rating
<b>Short-Term F1</b>	Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments.
<b>Long-Term A</b>	High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong.
<b>Support Rating 1</b>	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question.

6.6 On the 1 April 2008 all Icelandic banks were put on a negative rating watch for both Long Term and Short Term credit ratings. This means that the credit rating agency had some concerns with the strength of the credit ratings of the bank and that they would be checking to see if a downgrade was warranted.

6.7 No more money was placed with any Icelandic bank.

6.8 On 19 May 2008 the negative rating watch was removed from both Heritable and Landsbanki and ratings were affirmed as they had been at 14 March 2008.

6.9 Still no more funds were placed as there were a few negative comments in the markets about Iceland generally.

6.10 On 30 September 2008 the Heritable Bank was given new credit ratings:

Short term rating	Long term rating	Support rating
F3	BBB	2

6.11 The meaning of these ratings is as follows:

<b>Credit Rating</b>	<b>Meaning of Rating</b>
<b>Short-Term F3</b>	Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non investment grade.
<b>Long-Term BBB</b>	Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non investment grade.
<b>Support Rating 2</b>	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question.

6.12 On the 7 October 2008 the banking crises peaked with the failure of the Icelandic Banks, see 3.8 above.

6.13 The Authority has received information estimating that a return of 80% on the amount of investment is likely to be received. An initial indication of 80% of the principal element and interest up to the date of default is now anticipated but will be paid over a five year period.

## **7. Investment benchmark**

7.1 The temporary investment interest earnings are measured against a benchmark.

7.2 The benchmark is equivalent to the average 7 day LIBID rate available through the money markets and is measured over the financial year.

7.3 The table below shows the performance of the Authority's investments compared to the benchmark. The impaired Heritable Bank Deposit is included in these figures. The performances are shown as annualised figures.

7.4 Results to 31 March 2009 are summarised as follows:

	<b>%</b>
Benchmark Return	3.69
Actual Return	4.66
Return above Benchmark	<u>0.97</u>

7.5 As at 31 March 2009 temporary investment interest earnings exceeded the benchmark by 0.97%; this equates to £27,912.

## **8. Investment instruments**

8.1 All of the investments are made in money market deposits other than balances held in the instant access Treasury Call Account with Lloyds TSB.

8.2 Money market deposits earn a yield that is made up entirely of interest earnings. There is no capital appreciation. No Gilts or Certificates of Deposits are used.

## 9. Borrowing Strategy

9.1 It was not envisaged that any long – term borrowing would be required in 2008/09.

9.2 Any short-term requirements would only be for cash flow purposes.

9.3 Two loans were raised during the year. These were for £250,000 and £200,000, were raised in order to meet a short-term unexpected cash flow requirement and were for a maximum of 14 days.

9.4 The total interest payable on temporary borrowing was £616, an additional £8 was payable for bank interest.

## 10. Compliance with the CIPFA code of practice

10.1 All treasury functions and debt management procedures, which were undertaken during the period, complied with the existing CIPFA Code of Practice on Treasury Management, as set out in the Authority's Treasury Policy Statement, and the Treasury Management Strategy for 2008/09.

## 11. Treasury Position at 31 March 2009

The following table shows the treasury position at the 31 March 2009 compared with the previous year. All investments have interest payable at a fixed coupon rate for the period of the investment other than the Call Account which is variable:

	31 March 2008		31 March 2009	
	Principal	Average Rate	Principal	Average Rate
	£ million	%	£ million	%
Temporary Cash-flow Investments	£2.00	5.93	£1.95	1.95
Heritable Bank Deposit (Impaired)	£0.50	5.87	£0.30	n/a
Call Account	£0.25	4.80	£0.37	0.15
<b>Total Investments</b>	<b>£2.75</b>	<b>5.82</b>	<b>£2.62</b>	<b>1.44</b>