

TREASURY MANAGEMENT ANNUAL REPORT 2008/09
(Report by the Head of Financial Services)

1. INTRODUCTION

- 1.1. This report reviews the performance during 2008/9, considers if the strategy that the Council has adopted has been effective, and addresses any issues of risk and compliance with statutory and regulatory requirements.
- 1.2. During 2008/09 the Council borrowed £10m from the PWLB to fund future capital spending. This was matched by temporary investments thus allowing gross investments to rise by £2.2m.

Manager	April 2008	March 2009
	£m	£m
City Deposit Cash Managers (CDCM)	26.5	18.0
In-house medium term	12.0	10.0
In-house cash flow	1.8	14.5
Gross investments	40.3	42.5
Borrowing from the PWLB		-10.0
Borrowing for cash flow		-6.0
Net investments	40.3	26.5

- 1.3. Annex A gives details of these totals as at 31 March 2009.

2. PERFORMANCE OF FUNDS

- 2.1. During the year the bank base rate fell from 5.25% at 1 April 2008 to 0.5% on 3 March 2009. Despite this the performance of the fund exceeded the base rate at the start of the year and the budget level.
- 2.2. The table below shows the returns by fund manager. Whilst the benchmark for in-house funds is officially the 7 day rate, a split has also been shown to indicate a comparison for the medium term element against the 3 month rate as used for CDCM:

PERFORMANCE FOR THE YEAR APRIL 2008 – MARCH 2009			
	Performance	Benchmark	Variation from
	%	%	benchmark
CDCM	5.4	4.6**	+0.8
In-house	5.5	3.7^^	+1.8
In-house medium term	4.4	2.1**	+2.3
In-house cash flow	5.5	3.8^^	+1.7

** 3 month LIBID ^^ 7 day rate

- 2.3. This very good performance was due to many of the investments being locked into higher rates before the year started or before rates had dropped too far.
- 2.4. The actual net investment interest (after deduction of interest payable on loans) was £2,491k compared with a budget of £2,162k

3. BORROWING IN ADVANCE AND IN-HOUSE INVESTMENT OF FUNDS

- 3.1. The 2008/09 MTP showed that from 2009/10 the Council would need to borrow to finance capital expenditure. Following discussion with our external auditor, it had been agreed that the Council could borrow in anticipation of the need to fund the five year MTP period if it was considered that the rates were attractively low.
- 3.2. In December 2008 the long-term PWLB rates were considered to be very low and so £5m was borrowed for 50 years at 3.90% and £5m for 49 years at 3.91%. This judgement proved to be correct as the 50 year rate bottomed out at 3.86%. It has now risen to 4.8% (26 May).
- 3.3. Due to the interest rate structure available at that time it was decided to invest the sum borrowed for 4 and 5 years pending use for financing capital expenditure.
- 3.4. The remaining investments are 'in-house' funds that are either short term funds that fluctuate on a daily basis due to the volatility of the cash flow to and from the Authority, or invested for up to 15 months to meet cash flow needs in the medium term. The cash position varied from net investments of £8m to £33m

4. STRATEGY

- 4.1. The Council's strategy for 2008/09 was based on using CDCM to manage a reducing value of time deposits with the remainder, mainly cash flow, managed in-house.
- 4.2. The strategy was reviewed on two occasions during the year with the Capital Receipts Advisory Group (CRAG). The first meeting was in response to a number of major Icelandic Banks going into administration in October 2008. Whilst this Council did not have any investments with them at that time other local authorities had nearly £1bn invested. This raised fundamental questions about the value of credit ratings in managing risks and the role of Treasury Management advisors.

- 4.3. CRAG considered the balance of the risk of investments being lost with the investment return and agreed that they still felt safe with investing in building societies and banks with high credit ratings. This Council has never expected its Treasury Investment advisor to take a view on the safety of individual borrowers and so this was not the issue that it subsequently became with some other authorities.
- 4.4. The Annual Treasury Management Strategy includes the mandates for Fund Managers and in-house investments; copies of the mandates, in place as at March 2009, are attached at Annex B. A change was made during the year on the maximum investments with counterparties:

	2008/09 strategy	New limits from Nov 2008
F1+ or have a legal position that guarantees repayment for the period of the investment		£6m
F1		£5m
Building Society with assets over £2bn in top 25 (Currently 16)	£4m	£6m
Building Society with assets over £1bn if in top 25 (Currently 3)	£3m	£5m
Building Society with assets under £1bn in top 25	£2m	£3m

- 4.5 In addition to the above limits a new category was added: each group (or institution if not part of a group) can have an additional limit of £5m for a “liquidity” account which is defined for this purpose as any account where we can recall our funds the same day.

5. RISK IMPLICATIONS

- 5.1 The Treasury Management Policy approved by the Cabinet in 2002, emphasises the importance of controlling risk of which there are three main elements:
- that the borrower will be unable to return the loan when it is due
 - that the Fund Manager/in-house team will take the wrong view on interest rate movements leading to poor returns
 - that the investments are not sufficiently liquid to be able to be returned in time to meet the cash flow needs of the Authority.

5.2 The Authority has minimised these risks in the following ways:

Risk of the borrower being unable to repay the investment

The mandates specifically limit the organisations that can be invested with together with a limit for each counterparty. These restrict lending to the safest categories of bank, based on their credit rating, and UK Building Societies which are considered to have an element of support from the Government.

In that most investments are time deposits the fact that Credit Ratings can change after the investment is made can create a risk. This is mitigated by ensuring that we receive the very latest information on ratings as soon as they are issued.

CDCM are very experienced and able to identify any references in the financial press that may lead to reductions in ratings.

As our reserves fall the duration of time deposits will be reduced.

Experience has shown that building societies are effectively protected by the Government or other building societies. The most recent example was the Dunfermline Building Society which got into difficulties in March. Within a few days the Government organised a rescue package whereby most of the loans and investments were transferred to the Nationwide Building Society, including this Council's £4M investment. Whilst this experience resulted in some concern at the time the result has reinforced the view that building societies will be protected. Building Societies also have guaranteed access to Government loans.

None of the treasury management transactions during the year have compromised the mandate limits.

Risk of the wrong view on interest rates being taken

All CDCM investment recommendations are referred to the Council before the deal is made so the authority can question the proposal if they have any concerns on the rate proposed. Daily market information and periodic reports from the Council's advisers ensure that the Council has the information it needs to take a considered view on future interest rate trends.

The mandates limit the duration of the investments which reduces the impact on the value if the interest rate view turns out to be incorrect.

Risk of the funds not being available to be returned to the Council at the required time

The Council's use of time deposits, which cannot be traded, means that they will only be returned at the end of the agreed period. The Council therefore produces cash flow forecasts that help set the limit on the duration of those investments. The mandates therefore include the dates by which various sums must be available.

In general the Council projections have tended to be pessimistic but, if there was a shortfall, temporary borrowing is straightforward pending the repayment of the investment. Indeed, with the current interest rate structure, any temporary borrowing is likely to be at a lower rate than is being earned on our investments.

Seeking Professional Advice

Sterling Consultancy Services were appointed from 1 January 2008 and they have been pro-active in advising the Authority of changes to the credit ratings of counterparties and providing other relevant information.

Active monitoring

As well as reports to Cabinet, your officers monitor returns each month.

6. COMPLIANCE WITH REGULATIONS AND CODES

- 6.1 All the treasury management transactions have been carried out in accordance with the legislation and regulations concerning treasury management.
- 6.2 The Council met the requirements of the CIPFA Code of Practice on Treasury Management by adopting a Policy Statement in February 2002 and Treasury Management Practices in 2003/04. These assist both Members and Officers in the effective management and control of treasury management activities.
- 6.3 In 2003/04 CIPFA introduced the Prudential Code for Capital Finance and the DCLG brought out new guidance on Local Government investments. Both of these became effective from 1 April 2004. These require the Council to approve Prudential Indicators and an annual Treasury Management Strategy. Those for 2008/09 were approved at the Council meeting on 20th February 2008. Annex C shows the relevant indicators and the actual results.

7 CONCLUSION

- 7.1 The performance of the funds in a year when rates fell drastically was very pleasing, exceeding both the benchmark and the budgeted investment interest
- 7.2 In a year of turmoil in the financial markets which included the collapse of the Icelandic Banks and Dunfermline Building Society getting into difficulties all of the Council's investments were repaid in full and on time.
- 7.3 The Authority borrowed £10m from PWLB in anticipation of its need to fund capital expenditure at a very attractive rate.

7.4 The Authority has carried out its treasury management activities with due regard to minimising risk, and in accordance with legislation. During the year it reviewed its strategy in the light of external events in the markets. It has adopted the CIPFA Code on Treasury Management, the Prudential Code for Capital Finance and the DCLG's guidance on Local Government investments.

8 RECOMMENDATION

8.1 It is recommended that the content of this report be noted

BACKGROUND INFORMATION

2008/09 cash management files and working papers

Reports to the Cabinet and Capital Receipts Advisory Group

CONTACT OFFICER

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ANNEX A

BORROWING AND INVESTMENTS AT 31 MARCH 2009

	RATING		DATE INVESTED/ BORROWED	AMOUNT £'000	£'000	INTEREST RATE %	REPAYMENT DATE	YEAR OF MATURITY
HDC LOANS								
SHORT TERM								
			25-Mar-09	- 3,000		0.600	15-Apr-09	2009/10
			30-Mar-09	- 3,000		0.550	16-Apr-09	2009/10
					- 6,000			
LONG TERM								
			19-Dec-08	- 5,000		3.910	19-Dec-57	2057/58
			19-Dec-08	- 5,000		3.900	19-Dec-58	2058/59
					- 10,000			
					- 16,000			
HDC TOTAL LOANS								
HDC INVESTMENTS								
SHORT TERM								
	F1	P1	6-Mar-09	2,000		2.120	08-Jun-09	2009/10
		P2	19-Mar-09	1,000		2.250	21-Sep-09	2009/10
			19-Mar-09	1,000		2.350	21-Sep-09	2009/10
	F2	P2	24-Nov-08	4,000		4.400	24-Feb-10	2009/10
	F1	P1	24-Nov-08	3,000		4.350	24-Feb-10	2009/10
	F1	P2	24-Nov-08	1,000		4.350	24-Feb-10	2009/10
		P2	19-Mar-09	2,500		2.500	18-Mar-10	2009/10
					14,500			
LONG TERM								
	F1+	P1	19-Dec-08	5,000		4.040	19-Dec-12	2012/13
	F1	P1	19-Dec-08	5,000		4.850	19-Dec-13	2013/14
					10,000			
HDC Total								
					24,500			
CDCM								
	F1	P2	24-Nov-08	3,000		4.400	24-Aug-09	2009/10
			15-Sep-07	3,000		5.010	15-Sep-09	2009/10
		P1	09-Jan-09	2,000		3.200	09-Oct-09	2009/10
	F1+	P1	28-Nov-07	2,000		5.780	28-Nov-09	2009/10
			21-Aug-08	3,000		6.150	22-Feb-10	2009/10
		P2	25-Jun-08	2,000		2.209	24-Jun-10	2010/11
		P1	21-Aug-08	3,000		6.100	30-Sep-10	2010/11
					18,000			
TOTAL - INVESTMENTS								
					42,500			
NET - LOANS/INVESTMENTS								
					26,500			

EXTERNAL FUND MANAGER MANDATE

CDCM

Duration of investments	£4.5M must be available at 31 March 2008 £4.5M must be available at 31 March 2009 £6.5M must be available at 31 March 2010 £4.5M must be available at 31 March 2011 £4.5M must be available at 31 March 2012 £3M must be available at 31 March 2013	
Types of investments	Fixed Deposits Deposits at call, two or seven day notice Variable rate investments limited to 50% of the portfolio	
Credit Ratings	F1 by FITCH IBCA or equivalent	
Maximum limits	English and Scottish Clearing Banks and their subsidiaries, and Overseas Banks, per institution or group and Building Societies: F1+ or have a legal position that guarantees repayment for the period of the investment	£6m
	F1	£5m
	Building Society with assets over £2bn in top 25 (Currently 16)	£6m
	Building Society with assets over £1bn if in top 25 (Currently 3)	£5m
	Building Society with assets under £1bn in top 25	£4m
Benchmark	3	

IN-HOUSE FUND MANAGEMENT

Duration of investments	£8M must be available at 31 March 2008 £12M must be available at 31 March 2009 No investment shall be longer than 3 years.	
Types of investments	Fixed Deposits Deposits at call, two or seven day notice Money Market Funds No variable rate investments	
Credit Ratings	F1+ by FITCH IBCA or equivalent	
Maximum limits	English and Scottish Clearing Banks and their subsidiaries, and Overseas Banks, per institution or group and Building Societies F1+ or have a legal position that guarantees repayment for the period of the investment	£6m
	F1	£5m
	Building Society with assets over £2bn in top 25 (Currently 16)	£6m
	Building Society with assets over £1bn if in top 25 (Currently 3)	£5m
	Building Society with assets under £1bn in top 25	£4m
	Additional limit per group for liquidity account	£5m
Benchmark	LGC 7 day rate	

Prudential Indicators for 2008/09 relating to Treasury Management Comparison of actual results with limits

The authorised limit for external debt.

This is the maximum limit for borrowing and is based on a worst-case scenario. This limit, and the operational boundary below, were set to allow up to £26.3m of borrowing in anticipation of need.

2008/9 Limit £000	2008/9 Actual £000
46,300	15,250

The operational boundary for external debt.

This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

2008/9 Limit £000	2008/9 Actual £000
41,300	15,250

Both of these actual results reflect the fact that long term rates were not considered low enough to borrow the maximum possible of long-term loans in anticipation of need.

Adoption of the CIPFA Code

The Prudential Code requires the Authority to have adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

This has been adopted.

Exposure to investments with fixed interest and variable interest.

These limits are given as a percentage of total investments.

	2008/9 Limit	2008/9 Actual
Upper limit on fixed rate exposure	100%	100%
Upper limit on variable rate exposure	50%	12%

This reflects the investments that CDCM had during the year where the rate is revised every half-year. By the year-end these investments had been re-paid and 100% of investments were fixed rate

Borrowing Repayment Profile

The proportion of 2008/9 borrowing that will mature in successive periods.

Cash flow borrowing	Upper limit	Actual	Lower limit
Under 12 months	100%	100%	100%
12 months and within 24 months	0%	0%	0%
24 months and within 5 years	0%	0%	0%
5 years and within 10 years	0%	0%	0%
10 years and above	0%	0%	0%

Funding capital schemes	Upper limit	Actual	Lower limit
Under 12 months	0%	0%	0%
12 months and within 24 months	0%	0%	0%
24 months and within 5 years	0%	0%	0%
5 years and within 10 years	0%	0%	0%
10 years and above	100%	100%	0%

Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days.

2008/9 Limit £000	2008/9 Actual- maximum £000	2008/9 Actual – 31/3/09 £000
22,500	17,000	10,000