CABINET **17th JUNE 2010**

TREASURY MANAGEMENT ANNUAL REPORT 2009/10
(Report by the Head of Financial Services)

1. INTRODUCTION

1.1 Council has always approved the Treasury Management strategy for the forthcoming year when it approves the budget and MTP each February. The CIPFA Code of Practice now requires full Council to receive a mid year report, and an annual report after the end of each financial year. This was included in the current approved strategy.

1.2 The Code also requires there to be scrutiny of the Treasury Management function and the Council has determined that this will be carried out by the Economic Well-being Scrutiny Panel.

1.2 The Council approved the 2009/10 treasury management strategy at its meeting on 18th February 2009. The key points were:

- to invest any available funds in a manner that balanced low risk of default by the borrower with a fair rate of interest.
- to ensure it had sufficient cash to meet its day-to-day obligations and to borrow when necessary to fund capital expenditure and to borrow in advance if rates were considered to be low.

2. ECONOMIC REVIEW

2.1 By the start of the financial year in April 2009, UK GDP had already contracted approximately 5.3%, due to a sharp fall in private sector spending. The financial crisis in late 2008 had prompted the Government to implement a number of extraordinary measures, including capital injections in some banks and the Credit Guarantee Scheme, to keep the banking system afloat amidst a wave of mistrust in financial markets.

2.2 In an attempt to avoid a more severe recession and possible deflation, the Bank of England had cut the Bank Rate to 0.5% in March 2009, where it remained for the whole year. To further loosen policy, the Bank initiated a policy of quantitative easing. Policymakers hoped to stimulate spending and economic activity by using newly created central bank reserves to purchase £200bn of government and commercial financial assets.

2.3 As a consequence of the recession and the various fiscal stimulus packages, UK Government borrowing rose significantly. By the end of 2009, the national debt had reached £890bn (62% of GDP) and the annual fiscal deficit was estimated to be £167bn.

2.4 The UK and other national governments are under intense pressure to cut spending and raise taxes in order to control debt levels. Although fears of a double-dip recession may eventually prove unfounded, austerity measures introduced by national governments will affect future economic activity.

2.5 Many European countries are given a AAA rating by the rating agencies, however during the year this was downgraded in some countries due to concern about the public sector deficits and the perceived higher credit risk.

Country	**Lowest long term credit rating 5 February 2010**
Greece	BBB+
Ireland	AA-
Italy	A+
Portugal	A+
Spain	AA+
UK for comparison	AAA

3. PERFORMANCE OF FUNDS

3.1 The following table summarises the treasury management transactions undertaken during the 2009/10 financial year:

	Principal Amount £m	**Interest Rate %**
Investments		
at 31st March 2009	42.5	4.28
less matured in year	-87.6	
plus arranged in year	+65.1	
at 31st March 2010	20.0	3.75
Average Investments	**36.3**	**4.09**
Borrowing		
at 31st March 2009	16.0	2.66
less repaid in year	-66.6	
plus arranged in year	+65.2	
at 31st March 2010	14.6	2.82
Average Borrowing	**12.7**	**3.16**
Net Investments		
31st March 2009	26.5	
31st March 2010	5.4	

3.2 As the Council's reserves have fallen over the last few years the number of fund managers have reduced leaving just CDCM at the start of the year with £18M. They also were given notice in March 2009 and as investments reached their maturity they were managed in-house. At the end of the year there was only £5M left with CDCM and the remaining investments will all mature during the current year. In-house investments started the year at £24.5M and were £15M at the end of the year. 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 2009 – MARCH 2010				
	Average Investment £M	Performance %	Benchmark %	Variation from benchmark %
CDCM	**12.5**	**4.8**	**0.6****	**+4.2**
In-house	**23.7**	**3.7**	**0.4^^**	**+3.3**
medium term	10.0	4.4	0.6**	+3.8
short-term for cash flow	13.7	3.1	0.4^^	+2.7

** 3 month LIBID ^^ 7 day rate

3.3 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.

3.4 The actual net investment interest (after deduction of interest payable on loans) was £1,085k compared with a budget of £607k.

4. STRATEGY – BORROWING

4.1 Long-term borrowing. The strategy allowed for ‘must borrow’ to finance that part of the capital programme that could not be met from internal funds. There was also a provision for ‘may borrow’ which allowed borrowing in anticipation of need, based on whether longer term rates seemed low compared with future likely levels. No long-term borrowing was carried out as the rates were not deemed to be low enough and there were sufficient internal funds to finance the capital spending in the year.

4.2 Short-term borrowing. The Authority did carry out short-term borrowing during the year to manage its cash flow; it averaged £2.7m

5. STRATEGY - INVESTMENTS

5.1 The Council’s strategy for 2009/10 was based on using CDCM managing a reducing value of time deposits with the remainder managed in-house.

5.2 The in-house investments would be of two types: time deposits with banks with a high credit rating and the top 25 building societies by asset value, and liquidity (call) accounts with banks. The strategy included limits on the size of investments with each organisation and country limits. The mandates for CDCM and in-house funds are shown in Annex B

5.3 The strategy was reviewed during the course of the year with the Capital Receipts Advisory Group (CRAG) when there was concern about the reducing number of banks and building societies where monies could be placed. This was due to the merger of a number of building societies and concerns about the financial stability of some European countries where the Authority has regularly placed funds with banks, for example Ireland.

5.4 The review concluded that the Authority should continue to invest in banks and building societies based on the approved strategy, but if we borrowed in anticipation of need leading to a temporary increase in funds to be invested, the policy should be reviewed

6. RISK MANAGEMENT

6.1 The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return.

6.2 **Security** is managed by investing short-term with highly-rated banks, building societies and local authorities in the UK. The Authority receives regular updates from its advisors, Sterling Consultancy Services, sometimes daily, on changes to the credit rating of counterparties. This allows the Council to amend its counterparty list and not invest where there is concern about the credit rating.

6.3 **Liquidity.** The majority of the funds are time deposits which cannot be traded and this means that they will not be returned until the end of the agreed period. However the Council has also made use of liquidity accounts which have a rate or interest above base rate and provide instant access to funds. The interest rate on credit balances at the bank has been generous and so the account has been kept in credit, providing additional liquidity.

6.4 Overall, liquidity is managed by producing cash flow forecasts that help set the limit on the duration of the investments in time deposits. The projections tended to be cautious which sometimes resulted in funds being available before they were needed with any surplus easily being invested on a temporary basis.

6.5 **Return on investments.** Security and liquidity take precedence over the return on investments, which has resulted in investments during 2009/10 generally being of short duration at lower rates of interest.

6.6 The risk was mitigated in two ways. When the Authority borrowed £10M in advance in December 2008 it invested the funds, in the meantime, at marginally higher interest rates thus protecting the Council from any short term loss of interest. Secondly, the use of the above-market rates on credit balances in the bank account (until bank charges have been covered) and liquidity accounts have given attractive returns at minimal risk.

7. COMPLIANCE WITH REGULATIONS AND CODES

7.1 All the treasury management activity undertaken during the financial year complied with the approved strategy, the CIPFA Code of Practice, and the relevant legislation

7.2 In 2009 CIPFA issued a new Code on Treasury Management which has been adopted. The Code requires the Council to approve Treasury Management and Prudential Indicators. Those for 2009/10 were approved at the Council meeting on 18th February 2009. Annex C shows the relevant indicators and the actual results.

8. PARISH AND TOWN COUNCILS

8.1 The Council was made aware of the difficulty of some Parish and Town Councils in achieving any returns on their cash deposits and in January 2010 introduced a scheme whereby Parish and Town Councils could invest funds with this Council. Once received they simply form part of the Council's investment portfolio. The terms of the scheme are shown in Annex D.

8.2 To date only one investment has been received of £100k from Brampton Parish Council

9 CONCLUSION

9.1 The performance of the funds in a year when rates stayed very low was pleasing, significantly exceeded both the benchmark and the budgeted investment interest.

9.2 In a year of uncertainty in the financial markets all of the Council's investments were repaid in full and on time.

9.3 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.

10 RECOMMENDATION

10.1 It is recommended that Cabinet note this report and forward it to Council

BACKGROUND INFORMATION
2009/10 cash management files and working papers
Reports to the Cabinet and Capital Receipts Advisory Group
CIPFA Code on Treasury Management

CONTACT OFFICER

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ANNEX A

BORROWING AND INVESTMENTS AT 31 MARCH 2010

	RATING		DATE INVESTED/ BORROWED	AMOUNT £M	£M	INTEREST RATE %	REPAYMENT DATE	YEAR OF MATURITY
BORROWING								
Short term								
West Sussex County Council			23-Mar-10	-1.0		0.400	06-Apr-10	2010/11
Surrey County Council			22-Mar-10	-2.5		0.500	15-Apr-10	2010/11
Leicester City Council			31-Mar-10	-1.0		0.550	16-Apr-10	2010/11
Brampton Parish Council			01-Mar-10	-0.1		0.500		
					- 4.6			
Long term								
PWLB			19-Dec-08	- 5.0		3.910	19-Dec-57	2057/58
PWLB			19-Dec-08	- 5.0		3.900	19-Dec-58	2058/59
					-10.0			
TOTAL BORROWING					**- 14.6**			
INVESTMENTS								
IN-HOUSE								
Short term								
Nottingham BS		P2	24-Feb-10	2.5		2.142	23-Feb-11	2010/11
Lloyds TSB Bank	F1+	P1	24-Feb-10	2.5		1.800	24-Feb-11	2010/11
					5.0			
Medium term								
Royal Bank of Scotland	F1+	P1	19-Dec-08	5.0		4.040	19-Dec-12	2012/13
Skipton BS	F2	P2	19-Dec-08	5.0		4.850	19-Dec-13	2013/14
					10.0			
In-house Total					**15.0**			
CDCM								
Nationwide (Cheshire) BS	F1+	P1	25-Jun-08	2.0		1.147	24-Jun-10	2010/11
Nationwide (Dunfermline) BS	F1+	P1	21-Aug-08	3.0		6.100	30-Sep-10	2010/11
					5.0			
TOTAL - INVESTMENTS					**20.0**			
NET INVESTMENTS					***5.4***			

ANNEX B

EXTERNAL FUND MANAGER MANDATE 2009/10

CDCM

Duration of investments	No investment shall be longer than 2 years. The following funds must be available for return by the dates listed below: £13m by 31 March 2010 £7m by 31 March 2011	
Types of investments	Fixed Deposits Deposits at call, two or seven day notice	
Credit Ratings	Short term rating F1 by FITCH IBCA or equivalent Long term rating of A- by FITCH IBCA or equivalent if the investment is longer than 1 year	
Maximum limits	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	£3m
	Other Country limits - £6m in a country outside the EU - £10m in a country within the EU (excluding UK) - £20m in EU countries combined (excluding UK) These totals apply to investments made up until 31 March 2010 but lower limits may be introduced for later years to avoid too high a proportion of the Council's funds being with any one counterparty.	
Benchmark	3 month LIBID	

IN-HOUSE FUND MANAGEMENT 2009/10

<table>
<tr><td>Duration of investments</td><td colspan="2">No investment shall be longer than 5 years.</td></tr>
<tr><td>Types of investments</td><td colspan="2">Fixed Deposits
Deposits at call, two or seven day notice</td></tr>
<tr><td>Credit Ratings</td><td colspan="2">Short term rating F1 by FITCH IBCA or equivalent
Long term rating of A- by FITCH IBCA or equivalent if the investment is longer than 1 year.</td></tr>
<tr><td>Maximum limits</td><td>F1+ or have a legal position that guarantees repayment for the period of the investment
F1
Building Society with assets over £2bn in top 25 (Currently 16)
Building Society with assets over £1bn if in top 25 (Currently 3)
Building Society with assets under £1bn in top 25
In addition to the above:
Liquidity (Call) Account with a credit rating of F1+ or with a legal position that guarantees repayment.

Other Country limits
- £6m in a country outside the EU
- £10m in a country within the EU (excluding UK)
- £20m in EU countries combined (excluding UK)

These totals apply to investments made up until 31 March 2010 but lower limits may be introduced for later years to avoid too high a proportion of the Council's funds being with any one counterparty.</td><td>£6m

£5m
£6m

£5m

£3m</td></tr>
<tr><td>Benchmark</td><td colspan="2">LGC 7 day rate</td></tr>
</table>

Annex C

Prudential Indicators for 2009/10 relating to Treasury Management
Comparison of actual results with limits

EXTERNAL DEBT

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 £36.5m of borrowing in anticipation of need.

2009/10 Limit £000	**2009/10 Actual £000**
56,500	**20,400**

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.

2009/10 Limit £000	**2009/10 Actual £000**
51,500	**20,400**

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

TREASURY MANAGEMENT

Exposure to investments with fixed interest and variable interest.
These limits are given as a percentage of total investments.

	2009/10 Limit	**2009/10 Actual**
Upper limit on fixed rate exposure	100%	**96%**
Upper limit on variable rate exposure	50%	**10%**

This reflects the investments that CDCM had during the year where the rate is revised every half-year.

Borrowing Repayment Profile

The proportion of 2009/10 borrowing that matured 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	25%	0%	0%
12 months and within 24 months	25%	0%	0%
24 months and within 5 years	25%	0%	0%
5 years and within 10 years	50%	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.

2009/10 Limit £000	**2009/10 Actual- maximum £000**	**2009/10 Actual – 31/3/10 £000**
36,000	**15,000**	**10,000**

Annex D

DEPOSIT OF PARISH AND TOWN COUCNIL FUNDS WITH HUNTINGDONSHIRE DISTRICT COUNCIL

The terms of the scheme

Minimum sum
£25,000.

Period
Either a fixed term of not less than 3 months
OR
A minimum of 3 months with a minimum of 30 days notice for repayment after 3 months

Rate
Prevailing Bank Base Rate during the period of the investment

Payment of Interest
Paid annually on 31 March or on repayment whichever is the earliest

Transmission
Funds must be received electronically and repaid in same way

Agreement
The Parish or Town Council will be sent an email confirming receipt of the deposit and confirming the terms.

Changes to these terms
The District Council reserves the right to vary or cancel this offer but this will not affect any investment already completed.