

BOROUGH OF TELFORD & WREKIN

AUDIT COMMITTEE – 28 JUNE 2010

**TREASURY MANAGEMENT - REPORT ON 2009/10 OUTTURN AND
2010/11 TO DATE**

REPORT OF THE HEAD OF FINANCE

1. **PURPOSE**

To update members on the 2009/10 Treasury outturn and activities this year to date.

2. **RECOMMENDATIONS**

Audit Committee – For Information Only

Council Members were asked to:-

- 2.1 note the contents of the report,
- 2.2 note the Council's response to the Economic Climate,
- 2.3 note the performance against Prudential Indicators.

3. **SUMMARY**

The report updates members on the outcome of Treasury Management activities for 2009/10 and details the position for 2010/11 to date.

4. **PREVIOUS MINUTES**

Council 5th March 2009
Council 25th June 2009
Council 4th March 2010

5. **BACKGROUND**

Treasury Management in local government is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services : Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities.

A requirement of the Council's Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council's treasury management activities in that year (this annual treasury report).

6. **2009/10**

The annual report is covered in paragraphs 7-16 and deals with: -

- 2009/10 Portfolio position;
- the borrowing strategy for 2009/10;
- the borrowing outturn for 2009/10;
- compliance with treasury limits;
- investments strategy for 2009/10;
- investments outturn for 2009/10;
- debt rescheduling;
- Shropshire County Council debt
- overall outturn position
- leasing

7. **2009/10 PORTFOLIO POSITION**

The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2010		31 March 2009	
	Principal £m	Rate %	Principal £m	Rate %
Borrowing	<u>123.076</u>	3.86	<u>189.123</u>	4.03
Total Debt	123.076	3.86	189.123	4.03
Investments - in-house	54.000	4.51	84.507	6.02
- with external managers	<u>19.811</u>	1.27	<u>58.397</u>	6.24
Total Investments	73.811	3.64	142.904	6.11
Net Indebtedness	<u>(49.265)</u>		<u>(46.219)</u>	

The main reasons for the changes over the year include;

- Investment opportunities were taken in previous years to lock in at favourable interest rates.
- Investments were reduced through not reinvesting investments as they matured and reducing fund manager investments in order to lessen the need to borrow and reduce investment risk and volatility.
- Some PWLB was taken during 2009/10, but only in shorter maturities. Two PWLB loans were repaid during the year, one with a small premium and the other with a small discount.

The Adopted Treasury Strategy was to:-

- Monitor potential rescheduling opportunities for borrowing.
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- As in previous years the overall Investment Strategy for 2009/10 was to gain maximum benefit at minimum risk whilst achieving as a minimum target the 7 day deposit rate.

8. COUNCILS RESPONSE TO ECONOMIC CLIMATE

- 8.1 2009/10 saw the aftermath of the financial crisis that impacted during 2008/09. Base rate fell to 0.5% in late 2008/09 and remained there throughout the whole of 2009/10. The UK economy entered recession in first quarter 2009 and remained there until quarter 4 2009. The recovery to date has only been relatively slight.
- 8.2 The Council has allowed investments to mature and not reinvested them and has withdrawn money from fund managers, reducing the number of fund managers from 3 to 1. These funds were used to reduce the need to borrow, reduce investment risk and volatility.
- 8.3 There has also been a move to look to achieve more security and liquidity with any new investments undertaken.

9. BORROWING 2009/10

- 9.1 Original Economic Projections
The Expectation for Interest Rates – When the budget was set for 2009/10 the “average” City view anticipated that Bank Rate would fall to 0.5% and remain there until the end of 2009 due to the scale of the recession before starting to rise back towards more normal levels in 2010, though it would be 2012 before Bank Rate returned to around 4.5%.
- 9.2 Outturn 2009/10

During 2009/10 the Monetary Policy Committee (MPC) was focused on helping the economy to turn around from plunging into the deepest and longest recession the UK economy had experienced for many years.

Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year, the MPC also had to resort to extreme measures in terms of pumping liquidity into the economy through quantitative easing by purchasing £200bn of gilts and corporate bonds. This had the effect of boosting prices for gilts and corporate bonds and therefore bringing down yields, so also reducing borrowing costs for both the corporate and public sector.

It was notable that the increase in money supply in the economy generated by this programme brought the credit crunch induced spread between Bank Rate and 3 month LIBID (investment rate that depositors could earn) down from 0.95% at the beginning of the financial year to zero during August 2009.

The dominant focus in 2009/10 was on quarterly GDP growth figures. The recession bottomed out in quarter 1 of 2009. There was then major disappointment that the end of the recession failed to materialise in quarter 3 2009 but the fourth quarter of 2009 did then see economic growth return at +0.4%.

Inflation has not been a major concern of the MPC as it fell back below the 2% target level for CPI from June to November. However, it did spike upwards to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as this spike was expected to fall out of the inflation index and inflation was forecast by the Bank of England to fall back under target by the end of 2010.

Borrowing and Investment Rates in 2009/10

The overnight investment rate has varied little during the year, within a range of 0.38 to 0.49%. The 3 month investment rate fell gradually from a high point for the year of 1.5% on 1/4/09 to reach a low of 0.42% in September before finishing the year at 0.52%. The 12 month investment rate started the year at a credit crunch enhanced rate of 1.85% and fell steadily until reaching 0.85% in September. Since then it has risen to finish the year at 1.15% as the market looked ahead to when the MPC would have to start raising Bank Rate from its then current rate of 0.50%.

5 year PWLB started the year at 2.54% and then fell to a low for the year of 2.47% on the following day before then rising sharply to hit a peak of 3.29% in July. From there it fell until reaching 2.54% in October and then rose back up to a peak of 3.13% in January. It finished the year at 2.89%.

10 year PWLB rate started the year at 3.36% and then fell to a low for the year of 3.30% on the following day before then rising sharply and rose to hit a peak of 4.15% in July. From there it fell until reaching 3.55% in October and then rose back up to a peak of 4.42% in February. It finished the year at 4.19%.

Longer-term interest rates – The PWLB 45-50 year rate started the year at 4.57% (25 year at 4.28%) and then peaked at 4.85% (25 year at 4.74%) in June before falling back to a low of 4.18% (25 year 4.07%) in October. From there it rose again towards the end of the year and peaked at 4.79% (25 year 4.83%) in March. It finished the year at 4.70% (25 year 4.67%).

Treasury Borrowing and Rescheduling –

The borrowing strategy for the current year has been to take a pragmatic approach to the use of PWLB borrowing, spreading interest rate risk and taking advantage of rate movements when appropriate.

A summary of the transactions for the year is shown below. We took 2 short term PWLB loans to replace loans maturing during 2010/11 to take advantage of the current low rates and took one LOBO loan that is variable at 3 month LIBOR for the first 2 years and then converts to a fixed loan of 4.24% until maturity. This takes advantage of the current low interest rates whilst securing a good long term interest rate.

New Borrowing

The following new loans have been arranged during the year

Date	Action	Amount £m	Interest Rate
07/01/10	PWLB – 2.5 yrs	5.000	2.63%
15/01/10	PWLB – 2.5 yrs	5.000	2.58%
08/02/10	LOBO – 50 yrs	5.000	0.69%

PWLB Repayments & Discounts

The following loans were repaid.

Date	Action	Amount £m	Impact on budget
22/04/09	Repaid - 4.25% loan	10.000	Discount £213,378
22/04/09	Repaid - 4.50% loan	7.000	Premium £190,691

We have generated a discount of £0.213m. Under accounting rules these discounts have to be spread over 10 years, benefiting the revenue account by £0.021m in 2009/10 and ongoing. We also incurred an premium of £0.191m which under accounting rules is spread over 25 years costing the revenue account £0.008 in 2009/10 and ongoing. In total a net benefit of £0.013m for the first 10 years.

Temporary money market loans were used as usual to fund short term cash flow movements, in total £265m was raised over the year and rates ranged between 0.25% and 0.90%.

Interest rates were higher in the early part of the year, but fell later in the year. An analysis of the maturity structure of our debt is shown below.

Analysis of Debt Maturity as at 31st March

	2010		2009	
	£'000	%	£'000	%
Maturing in less than 1 year	10,052	8.2	64,099	33.9
Maturing in 1-2 years	15,001	12.2	10,001	5.3
Maturing in 2-5 years	15,002	12.2	20,002	10.6
Maturing in 5-10 years	5	0.0	4	0.0
Maturing in more than 10 years	<u>83,016</u>	67.4	<u>95,017</u>	50.2
	<u>123,076</u>	100.0	<u>189,123</u>	100.0

Debt Performance - As highlighted in section 7 the average debt portfolio rate has fallen over the course of the year from 4.03% to 3.86%. This is due to the low interest rates that have prevailed throughout the year and the opportunities taken by officers to restructure debt where possible.

10. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the Treasury Limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement at all times. The outturn for the Prudential Indicators is shown in Appendix 1.

11. INVESTMENTS :2009/10

11.1 Strategy

Internally Managed Investments - The authority manages an element of its investments in-house and invests within the institutions complying with its counterparty limits and credit ratings. Some investments are short term related to cash flows and others include longer term investment instruments that benefited returns in 2009/10.

Externally Managed Investments - The authority employed Investec, Invesco and Morley during the early part of the year to manage the remainder of its investments. Before reducing the number of fund managers firstly from 3 to 2 and then down to 1 by the end of the year. Restrictions set out in the managers' contracts limit the institutions in which investments can be made and market risk is controlled by limiting the Fund's exposure to the gilts market and to any individual counterparty. Fund Managers were given a benchmark of 3 month LIBID, although Invesco also have an element of Gilts in their benchmark. The only fund manager we now have is Investec.

Supranational Bonds – The final supranational bond of £4.0m matured during the year. These bonds are 'AAA' rated by Fitch IBCA but they are less attractive now as their margins have narrowed considerably when compared to other investments.

Investment Strategy - The agreed short term investment strategy for 2009/10 was to gain maximum benefit at minimum risk whilst achieving as a target the 7 day deposit rate.

11.2 **Outturn 2009/10**

Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return *
<u>Internally Managed</u>				
Investments	£62.037m	4.79%	4.79%	0.42%
<u>Externally Managed</u>				
Investec	£19.625m	1.27%	1.10%	0.73%
Invesco	£19.641m	0.59%	0.44%	0.85%
Aviva	£9.059m	1.31%	1.16%	0.73%
Total Externally Managed	£48.325m	1.00%	0.84%	0.77%

* The benchmark for Investec and Aviva is 3 month LIBID. Invesco's benchmark is a composite one based on a combination of 3 month LIBID and gilts.

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

12. **SHROPSHIRE COUNTY COUNCIL DEBT**

The Council makes an annual contribution (£2.352m in 2009/10) towards County Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.70% last year.

13. **OVERALL OUTTURN FOR 2009/10**

The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus proactive treasury management activities. The budget reflected the position when the budget was set, the decision to reduce investments and debt was taken after that date. Overall a net saving of just under £1.4m was made against budget for the year.

Summary of Outturn Position

	Estimate £m	Outturn £m	Variance £m
Interest Received	(5.294)	(3.388)	1.906
Discounts/Premia	0.000	(0.013)	(0.013)
Principal Repayments & Debt Management Costs	5.624	4.917	(0.707)
Interest Paid	<u>8.225</u>	<u>5.672</u>	<u>(2.553)</u>
Net Position	8.555	7.188	(1.367)

14 **LEASING**

Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

The final drawdown for 2009/10 was completed in March. The drawdown from JCB Finance and CHG Meridian totalled £0.309m and funded the purchase of mini buses and other equipment over three, five and seven year periods at interest rates of 2.04% and 3.11%.

15. **2010/11 UPDATE**

The remainder of this report deals with the current financial year based largely on information to 31 May 2010.

15.1 **Strategy**

In the current economic climate, the strategy for the next few months is to keep investments relatively short and use solely for cashflow purposes. We will review borrowing as we progress through the year and look to take advantage of the current low interest rates if possible.

We have retendered our Treasury Advisory Service and have appointed Arlingclose Ltd as our Treasury Advisors.

15.2 Interest Rates

Base rate began the year at 0.5% and has remained there. The expectation is that at some stage in the future interest rates will begin to rise again, but this is dependent on how the economy progresses. Any increase is unlikely in the short term and most city forecasters do not expect an increase until the second half of 2011.

15.3 Prudential Regime

This Council agreed its required indicators at Council on 4th March 2010. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £280m for 2010/11 and an Authorised limit of £300m. To date our total borrowing outstanding is £118m which is well within both limits.

15.4. Borrowing

The loan in the table below matured during 2010/11 .No new long term or temporary borrowing has been undertaken yet this year. As at 31 May 2010 temporary borrowing stood at £0.0m.

Date	Action	Amount £m	Impact on budget
01/05/10	Matured - 2.69% loan	5.000	None

15.5. Internally Managed Investments

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the 7 day deposit rate. For the period to 31 May 2009 some £188.1m worth of investments have been made from overnight deposits up to 21 days. Rates have ranged from 0.25% to 0.75%. As at 31 May 2010 internal investments stood at £57.3m.

15.6. Fund Managers

At the 31 May 2010 the investments managed on the Council's behalf by Investec, our fund manager (including accrued interest) was valued at £19.8m

15.7 Overall Investment Position

Total investments, including those managed internally, therefore, amount to £77.1m.

Potentially investment manager may place 15% of the funds managed on the Council's behalf with the same institution that the Council has placed up to £5m (£15m in respect of supranational bonds) with. The Council has excluded 3 institutions from Fund Managers' use in order to give itself flexibility in its own direct investments .At the end of May the greatest exposure with a single counterparty was £20.0m with Barclays

(just over 25.9% of the portfolio). The highest sovereign exposure to non UK sovereigns was 6.5% with Belgium. Total exposure is shown in Appendix 2, with a detailed breakdown in Appendix 3.

16. **EQUAL OPPORTUNITIES**

There are no direct implications.

ENVIRONMENTAL IMPACT

There are no environmental impacts directly arising from this report.

LEGAL COMMENT

Treasury management is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services: Code of Practice (the Code). The Council has adopted the code and fully complies with its requirements. The Prudential Indicators were set by Council on 1st March 2009, in line with the Prudential Code.

LINKS WITH CORPORATE PRIORITIES

Active treasury management links to creating a Modern, Effective Council.

OPPORTUNITIES & RISKS

It is important that the Council meets the statutory requirements of the Treasury Management Code of Practice and the Prudential Code as this contributes to good governance for the authority. The report provides information to the general public on the Council's financial performance in relation to Treasury Management and contributes to public accountability. Any other opportunities and risks associated with the treasury management process have been identified and reviewed as part of the process.

FINANCIAL IMPLICATIONS

The body of the report covers the financial implications in detail.

WARD IMPLICATIONS

District Wide.

Background Papers

CIPFA Code of Practice for Treasury Management in Local Authorities

Fund Manager Valuations

Temporary Borrowing records

PWLB records

Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2008/09	2009/10	2009/10
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£m	£m	£m
	Actual Outturn	Original Estimate	Actual Outturn
Capital Expenditure			
TOTAL	62.6	69.2	45.2
Ratio of financing costs to net revenue stream			
General fund	0.11%	2.19%	1.81%
Net borrowing requirement			
brought forward 1 April	170.622	189.123	189.123
carried forward 31 March	189.123	135.000	123.076
in year borrowing requirement	18.501	(54.123)	(66.047)
Capital Financing Requirement as at 31 March (excluding PFI)			
TOTAL	186.718	135.945	140.732
Annual change in Cap. Financing Requirement			
TOTAL	19.022	15.851	18.904
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in council tax (band D) per annum (not cumulative)	11.48	4.22	4.22

PRUDENTIAL INDICATOR	2008/09	2009/10	2009/10
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£m	£m	£m
	final	original	final
Authorised limit for external debt -			
borrowing	270	300	300
other long term liabilities	6	6	6
TOTAL	276	306	306
Operational boundary for external debt -			
borrowing	250	280	280
other long term liabilities	4	4	4
TOTAL	254	284	284
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	180	190	190
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments:-	80%	80%	80%
Upper limit for total principal sums invested for over 364 days (per maturity date)			
	80%	80%	80%

Maturity structure of fixed rate borrowing during 2009/10	lower limit	upper limit
under 12 months	0%	20%
12 months and within 24 months	0%	25%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%