TELFORD & WREKIN COUNCIL

COUNCIL – 4 MARCH 2010

TREASURY MANAGEMENT STRATEGY AND UPDATE – SUMMARY REPORT

PURPOSE

The report

i. provides an update to Members on Treasury Management activities for 2009/10

ii. presents the revised CIPFA Treasury Management Code of Practice 2009 and revised Treasury Management Statement for adoption

iii. presents the following 2010/11 Strategies and Policies for approval:
   a. the Treasury Management Strategy
   b. the Minimum Revenue Provision Policy
   c. the Annual Investment Strategy

The Audit Committee have scrutinised the Treasury Strategy at their meetings on the 2 and 10 February 2010 and comments arising from the 2 February meeting have been incorporated. The Committee may, within their terms of reference, make recommendations to Cabinet.

2009/10 TREASURY MANAGEMENT UPDATE

The overall Portfolio position at the 31 December 2009 is shown below:

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	53.0		
	Market	55.0	108.0	3.9
Variable rate funding	PWLB	0.00		
	Market	13.6	13.6	0.4
TOTAL DEBT			121.6	3.1
INVESTMENTS				
Fund Managers			39.5	0.9
In House			46.8	5.2
TOTAL INVESTMENTS			86.3	3.2

Borrowing
The borrowing strategy for the year has been to use maturing investments to reduce the requirement to borrow and exposure to risk. The number of fund managers has been reduced from 3 to 2 during the year which released £19m for this purpose.

New Borrowing
Two x £5m new PWLB loans, with a duration of 4 years, have recently been taken at the current favourable borrowing rates (2.63% and 2.58%); these will replace £10m PWLB due to mature in 2010/11, running at 2.69% and 2.87%. All other borrowing during the year has been temporary, again taking advantage of the favourable interest rates.

Rescheduling
Two loans have been rescheduled which has resulted in an annual saving of £14k for 10 years plus lower temporary borrowing costs, which will save around £650k in 2009/10.

Investments
The strategy is to gain maximum benefit, subject to risk control parameters, whilst achieving as a minimum the 7 day deposit rate.

Fund Managers
The average value of the portfolios held by the two remaining Fund Managers in the nine months to 31 December 2009 is:

	Average Capital Value	Interest Year to date (annualised %)	
	£m	£m	%
Invesco	19.639	0.057	0.5
Investec	19.695	0.202	1.3
	39.334	0.259	0.9

The current climate makes it very difficult for Fund Manager to achieve reasonable rates of return and we anticipate reducing the amount held by Fund Managers even further by year end.

Investments Managed In-House
A number of longer term investments are managed internally, as an alternative to Fund Managers. Further, temporary investments are made in order to maximise returns from day to day cash flows. Performance at the end of December was:

Target return: 7 day deposit rate	0.43%
Actual return	5.46%
Overachievement	5.03%

Appendix 1 shows a full analysis of all the Council's investments at the end of December.
Appendix 2 shows the total investment with each counterparty.

CIPFA TREASURY MANAGEMENT CODE OF PRACTICE

In response to the collapse of the Icelandic banks, CIPFA have issued a revised Treasury Management Code of Practice and Treasury Management Policy. These are presented in Appendices 7 and 8 for formal adoption by the Council. One of the key recommendations is delegating the role of scrutinising treasury management to a specific committee and the Audit Committee terms of reference now include this role. Other recommendations are to strengthen processes and procedures and highlight the need for regular training for members and officers involved in Treasury Management. Internal Audit has completed a review of Treasury Management, taking into account the new guidance, and officers have completed, or an in-progress of completing, all actions.

The Treasury Management Strategies have been prepared in accordance with the revised guidance.

2010/11 TREASURY MANAGEMENT STRATEGY

The strategy covers:

- treasury limits and prudential indicators in force which will limit the treasury risk and activities of the Council [Section 6.2];
- the projected portfolio position [Section 6.3];
- the borrowing requirement [Section 6.4];
- prospects for interest rates [Section 6.5];
- the borrowing strategy [Section 6.6];
- Policy on borrowing in advance of need [Section 6.7];
- debt rescheduling [Section 6.8];
- the investment strategy [Section 6.10];
- creditworthiness policy [Section 6.10.2];
- policy on use of external service providers [Section 6.10.7];
- the MRP Strategy [Section 7];

Statutory Limits and Prudential Indicators

The Council must have regard to the CIPFA prudential code when borrowing and must set a number of Treasury Indicators which define how much it can borrow in terms of affordability, sustainability and prudence.

The key treasury indicators being set are :

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
	Probable Outturn	Estimate	Estimate	Estimate	Estimate	Estimate
(1). EXTRACT FROM BUDGET SETTING REPORT						
Impact of capital investment decisions	£m	£m	£m	£m	£m	£m
Revenue Impact – In Year		0.389	1.431	1.765	-0.053	-0.352
Revenue Impact – Cumulative		0.389	1.820	3.585	3.532	3.180
	£p	£p	£p	£p	£p	£p
Increase in council tax (band B, in year)	4.22	6.47	30.25	58.84	59.39	55.29
(full year ongoing impact is £46.80 from 2015/16 onwards).						
	£m	£m	£m	£m	£m	£m
Capital Expenditure	69.263	95.510	95.350	97.560	71.762	73.442
Ratio of financing costs to net revenue stream	2.19%	2.95%	3.90%	4.60%	4.00%	3.60%
Net borrowing requirement						
Brought forward 1 April	189.123	135.000	182.457	214.121	213.179	219.892
Carried forward 31 March	135.000	182.457	214.121	213.179	219.892	198.966
In year borrowing requirement	-54.123	47.457	31.664	-0.942	6.713	-20.926
In year Capital Financing Requirement	**15.851**	**42.857**	**26.246**	**-7.229**	**-0.145**	**-27.594**
Capital Financing Requirement (as at 31 March)	135.945	178.802	205.048	197.819	197.674	170.080

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£m	£m	£m	£m	£m	£m
Authorised limit for external debt *– the maximum amount the council may borrow at any point of time in the year –this must never be exceeded.*	306	306	337	348	348	338
Operational Boundary – *the most amount of money the council would normally borrow at any time during the year –this may be exceeded temporarily*	284	284	315	326	326	316
Upper Net limit on fixed rate borrowing/investments	190	190	200	210	210	210

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Upper Net limit on exposure to variable rate borrowing/investments (for T&W this has been set at nil so that variable borrowing does not exceed variable investments)	0	0	0	0	0	0
Upper limit for variable rate exposure i.e. the absolute limit of variable rate exposure on gross investments and borrowing	80%	80%	80%	80%	80%	80%
Upper limit for total principal sums invested for over 364 days (per maturity date)	90%	90%	90%	90%	90%	90%

Projected Portfolio Position at the 1 April 2010 and estimated average interest rates for 2010/11:

		Principal		Ave. rate
		£m		%
Fixed rate funding	PWLB	63.0		
	Market	55.0	118.0	3.6
Variable rate funding	PWLB	0.00		
	Market	5.0	5.0	2.0
TOTAL DEBT			123.0	3.5
INVESTMENTS				
Fund Managers			30.0	2.0
In House			45.0	5.0
TOTAL INVESTMENTS			75.0	3.8

Borrowing Requirement

	2010/11	2011/12	2012/13
	£m Estimate	£m Estimate	£m Estimate
New borrowing	47.5	31.7	-0.9
Alternative financing arrangements (Leasing)	1.0	1.0	1.0
Replacement borrowing	0.0	0.0	0.0
TOTAL	48.5	32.7	0.1

Interest Rates Forecast

	March 2010 %	March 2011 %	March 2012 %	March 2013 %
Bank Rate	0.50	1.50	3.50	4.50
5 year PWLB	3.05	3.60	4.60	4.85

10 year PWLB	4.00	4.45	5.00	5.15
25 year PWLB	4.55	4.90	5.20	5.35
50 year PWLB	4.60	5.00	5.30	5.45

The Borrowing Strategy

The borrowing strategy is flexible to take into account changing market conditions and activities will be determined by the prevailing market. The key influences are:

- rates are expected to increase during the year and new longer term borrowing will be considered when it is deemed advantageous

- variable rate borrowing is expected to be cheaper than longer term borrowing and therefore more attractive in the short term

- PWLB loans of less than 10 years are expected to be substantially lower than longer term loans

- PWLB Loans in the 25-30 year periods are likely to become more attractive than 50 year borrowing as they will maximise the potential for debt rescheduling and spread debt maturities.

- Fixed rate market loans at 25 – 50 basis points below the PWLB target rate will be considered

- 2010/11 is expected to be one of historically abnormally low bank rates. Investment rates are therefore expected to be below longer term borrowing rates and so value could best be obtained by avoiding new external borrowing and using internal cash balances to finance new capital expenditure/replace maturing debt.

- Short term savings from deferring borrowing will be balanced against the need for future long term borrowing and the potential of higher long term rates.

- Opportunities for rescheduling will be monitored throughout the year

- The strategy will be adjusted to take into account any significant risk of a sharp fall or rise in rates.

Borrowing in advance of Need

The Council will only borrow in advance of need under specific circumstances, for example linked to funding the capital programme, and will not do so purely to gain profit.

Debt Rescheduling

Opportunities for debt rescheduling will be monitored throughout the year. There will be a need to balance potential savings against any re-financing costs.

2010/11 ANNUAL INVESTMENT STRATEGY

The aim is to achieve optimum return on investments commensurate with proper levels of security and liquidity.

Creditworthiness Policy

The Council uses the creditworthiness service provided by Sector Treasury Services. The service has been developed over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies – Fitch, Moodys and Standard and Poors. This approach combines credit ratings, credit watches, credit outlooks and Credit Default Swaps spreads in a weighted scoring system which the Council uses to determine the suitability of counterparties.

If a down grade results in a counterparty no longer meeting the Council's minimum criteria they are immediately withdrawn; where we already hold investment with a downgraded counterparty this will be reviewed on a case by case basis.

The Council will also use other market intelligence in relation to investment and dis-investment decisions from available data and information to supplement the service provided by Sector.

Exposure to Risk

There is a degree of risk associated with every investment decision. Our aim is to minimise the risk. The Council is exposed to a variety of risks associated with treasury and has strategies in place to minimise exposure:

Credit Risk –other parties might fail to pay amounts due to the authority. The creditworthiness service, described above, is used to mitigate the risk. Deposits are only made with banks and financial institutions with high credit ratings – a guide to the credit ratings and detail of minimum ratings required are shown in the main report.

Sovereign Exposure – exposure to one country; to reduce risk our exposure will be limited to 20% of our investments in any one country. There is no limit on the amount that can be invested in the UK. This will be monitored and reviewed and where appropriate action taken if any sovereign exposure nears this limit.

Liquidity Risk – as we have ready access to PWLB borrowing there is no significant risk that we will not be able to raise funds to meet commitments. There is a risk that we will have to replace a significant proportion of our borrowings at a time of unfavourable rates. The strategy to minimise this risk is to ensure that not more than 40% of fixed rate loans are due to mature within the next three year period.

Market/Interest Rate Risk – financial loss due to changes in interest rates. There are a number of strategies in place to manage this risk: variable rate borrowing will not exceed variable rate investments; up to date and prudent assumptions for interest rates are fed into the budget strategy.

Policy on the Use of External Service Providers
The Council use Sector Treasury Services as its external treasury management advisers. The responsibility for treasury management decisions remains with the authority at all times.

The Minimum Revenue Provision Strategy
Local authorities are required each year to set aside a minimum amount from revenue to provide for the repayment of external loans. This amount is the Minimum Revenue Provision. It is the responsibility of each authority to decide on the most appropriate method of making prudent provision. The MRP Strategy sets out the Council's approach. For prudential borrowing MRP will be charged to revenue based on the life of the asset, MRP will only become due when the asset if fully operational, and MRP holidays can be taken in relation to assets that will be temporarily funded by prudential borrowing in lieu of capital receipts. The budget strategy includes some prudent use of MRP holidays in relation to 4 schemes (detailed in section 7 of the main report) which represents an exposure to future increased revenue charges should the receipts not be delivered.