THE ASSEMBLY

21 JULY 2010

REPORT OF THE CORPORATE DIRECTOR OF FINANCE & COMMERCIAL SERVICES

Title: Treasury Management Annual Report 2009/10 and Amendments to the Treasury Management Strategy	**For Decision**

Summary:

The Treasury Management Annual Report presents the Council's outturn position in respect of its treasury management activities. The key points to note are as follows:

- Investment income for the year was in line with revised budget; and
- The Council borrowed £20m in 2009/10 to finance the capital programme, in line with the original budget strategy.

The report also sets out amendments to the Council's Treasury Management Strategy as detailed in sections 7 and 10 of the report.

This report was considered and endorsed by the Cabinet at its meeting on 8 June 2010.

Wards Affected: None.

Recommendation(s)

The Assembly is asked to:

(i) Note the Treasury Management Annual Report for 2009/10; and

(ii) Approve revisions to the Council's Treasury Management Strategy to incorporate:

a. The new MRP Policy as set out in paragraph 7.1 of the report; and

b. Provisions for the Council to make loans to external organisations in order to deliver continued value for money, in line with the powers vested in local authorities under Section 2 of the Local Government Act 2000, as referred to in paragraph 10 of the report.

Reason(s)

This report is presented in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.

Implications:

Financial:

This report sets out the outturn position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions. Returns above the budgeted levels on the Council's investments and borrowing at lower than budgeted levels enable additional funds to be available for other service use.

Legal:
The legal implications have been incorporated into this report.

It is a statutory duty for the Council to remain within authorised limit (as set out in the 2009/10 Treasury Management Strategy presented to Cabinet on 17 February 2009 and the Assembly on 25 February 2009).

Members will also note that section 10 proposes inclusion in the Treasury Management Strategy of a power to lend to external organisations. Section 2 of the Local Government Act 2000 (the '2000 Act') allows principal local authorities in England and Wales to do anything they consider likely to promote the economic, social and environmental well-being of their area unless explicitly prohibited elsewhere in legislation. CLG's guidance on 'Practical Use of the Wellbeing Power' confirms that authorities have used the power to spend, lend, and give guarantees among other things. Officers should be mindful of the fiduciary duty to act in the best interests of residents and the usual considerations as to reasonableness and value for money in making individual decisions.

Risk Management:
The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income throughout the past year. There is an amendment being recommended as part of this report that allows the Council to lend to external organisations as a way of mitigating cost risk in any future contracts or partnerships the Council may wish to enter into.

Social Inclusion and Diversity:
No specific implications.

Crime and Disorder:
No specific implications.

Options Appraisal:
Insofar as this report is concerned an options appraisal is not required.

Head of Service: John Hooton	Strategic Financial Controller	**Contact Details:** Tel: 020 8227 2801 Fax: 020 8227 2770 E-mail: john.hooton@lbbd.gov.uk

1. Purpose of Report

1.1. The Council is required to report on the Treasury Management activities of the Council and those of the external cash portfolio managers for each financial year in accordance with the Revised CIPFA Code of practice for Treasury Management in the Public Services 2009 adopted by this Council on 16 February 2010.

1.2. The primary requirements of the Revised Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- Receipt by the Full Council of an annual treasury management strategy report for the year ahead, a midyear review report (as a minimum to be reported to the Executive) and an annual review report of the previous year;
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions; and
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to the Public Accounts and Audit Select Committee PAASC.

1.3. Treasury management in this context is defined as:
"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "
The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual report of treasury management activities, for the financial year 2009/10.

1.4 This Annual Treasury Report covers:

- The Council's treasury position as at 31st March 2010;
- Annual Strategy Statement 2009/10;
- Economic Factors in 2009/10;
- Performance Management in 2009/10;
- Debt rescheduling;
- Revised MRP Policy;
- Treasury Management costs in 2009/10;
- Compliance with treasury limits and treasury indicators; and
- Policy on lending to a Strategic Partnership.

2. Treasury Position as at 31 March 2010

2.1 The Council's debt and investment position at the beginning and end of the financial year was as follows;

	31st March 2010 Principal £'000	Rate /Return	Average Life (yrs)	31st March 2009 Principal £'000	Rate/ Return	Average Life (yrs)
Fixed Rate Funding:						
PWLB	30,000	4.06%	4.5	30,000	4.06%	4.5
Market	20,000	3.98%	69.5	20,000	3.98%	69.5
Variable Rate Funding:						
PWLB	0	0	0	0	0	0
Market	20,000	0.65	2	0	0	0
Total Debt	**70,000**	**3.99%**	**10.86**	**50,000**	**4.02%**	**37.0**
Investments						
In-House	53,172	3.52%		47,023	5.76%	
External Managers:						
Investec	28,007	1.38%		36,961	5.81%	
SWIP	18,785	3.48%		22,942	5.03%	
RBS	15,000	2.86%		15,000	8.00%	
Total Investments	**114,964**	**2.69%**		**121,926**	**5.68%**	

3. Annual Strategy Statement 2009/10

3.1 The Cabinet approved an annual strategy for 2009/10 on 17 February 2009 and this was endorsed by the Assembly on 25 February 2009.

3.2 The key points from that strategy were:

- To set an authorised borrowing limit of £200m;
- After careful consideration of rate forecast that the Council's in-house team and external investment managers would perform against a benchmark of either 2.0%, or the "3 Month LIBID rate", whichever was higher. This ensured that we provided sufficient challenge to our external fund managers;
- That the Council and its fund managers will have regard to the Council's investment priorities being:
  - (a) The security of capital; and
  - (b) The liquidity of its investments

- That the Council and its fund managers adhere to the procedures set for use of different classes of asset (specified and non-specified) and the maximum periods which funds can be committed;
- That the Council and its fund managers adhere to its counterparty limits;
- That the Council would borrow to finance its capital programme below trigger rates of 4.5% for PWLB loans and 4.25% for market loans;
- The Council would operate both borrowing and investment portfolios at short and long term periods and as a consequence reduces the risk of being impacted by a sharp unexpected rise in short-term variable interest rates; and

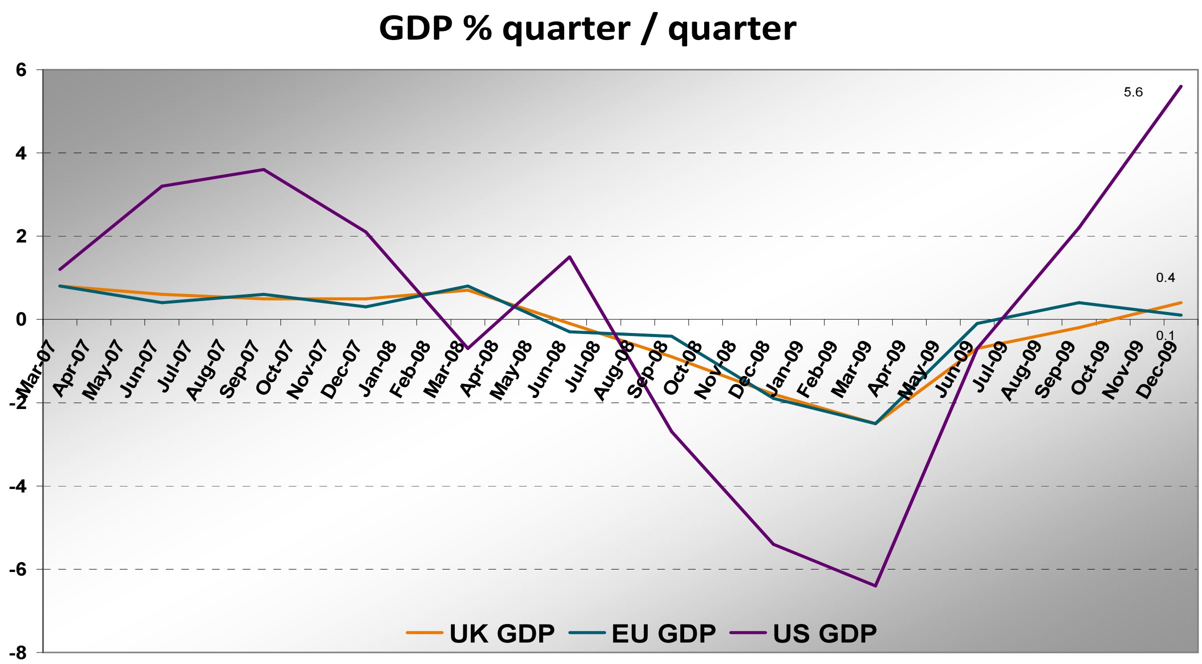
- That the Council maintain a balance of funding at shorter-term rates to match short-term investments thus maintaining balanced treasury risk.

4. Economic Factors in 2009/10

4.1 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 in the UK economy for many years. Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year. Gilts prices and corporate bonds were boasted due to the effect of quantitative easing.

4.2 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%.

The table below shows the movement in GDP figures (economic growth) for the UK, Europe and USA.



Source of Diagram: Sector Treasury Services

4.3 Key interest rate positions for borrowing and investments in 2009/10 were;

- At the start of 2009/10, investment rates were enhanced by a substantial credit crunch induced margin for investments entered into before 2008/09.
- The 12- month investment rates started the year at a credit crunch enhanced rate of 1.85% and fell steadily until reaching 0.85% in September. The year closed at 1.15%.
- In respect of borrowing, the 5 year PWLB rate started the year at 2.54% before then rising sharply to hit a peak of 3.29% in July. From there it fell reaching a low of 2.54% in October and then rose back up to a peak of 3.13% in January, closing at 2.89%.

- In respect of longer-term interest rates, the PWLB 50 year rate started the year at 4.57%. Rates peaked at 4.85% in June before falling back to a bottom of 4.18% in October. From there it rose again towards the end of the year and peaked at 4.79% in March. It finished the year at 4.70%.

5. Performance Measurement

Economic Issues Which Directly Impacted Performance

5.1 The major issue for treasury management in 2009/10 has been the huge difference between investment rates and borrowing rates that emerged during the recession due to the unprecedented fall in Bank Rate and the disappearance during the year of the margins over more normal investment rates caused by the credit crunch.
A further strong theme has been the major emphasis on mitigating risk by giving heightened preference to security and liquidity at a time when the world banking system was still under stress. In addition the issue of new CIPFA and statutory guidance on investing has meant that more of our investment portfolio was moved to being moved into investment instruments with lower rates of return but higher security and liquidity. This has compounded the significant fall in total investment earnings compared to previous years.

Overall Performance

5.2 Overall the general fund position was balanced.

5.3 **Specific Performance**

- **In–House Team**
  The rate of return for the year was 3.52%. Performance was improved by investments fixed for long periods when interest rates was at around 6.0%
- **Investec**
  The rate of return for the year was 1.38%. Performance in 2009/10 was adversely affected by consistent low interest rates through out the year and unrealised profit for 2009/10 realised in 2008/09.
- **Scottish Widows Investment Partnership (SWIP)**
  SWIP's rate of return in 2009/10 was 3.48%. Overall year end performance was well above benchmark. This was due to deals locked into when interest rates were still high.

Investment Funds Available

5.4 The level of investments available to the Council on the 1st April 2009 was £122.6 million. This figure was made up of a range of balances including, revenue reserves and general operational cash balances. The amount available for investment will vary throughout the financial year depending on:

- Use of investment funds ;
- Profile for the receipt of grants;
- Temporary use of internal cash to fund new capital projects rather than borrowing at periods of high borrowing interest rates; and
- Cash flow management.

At 31 March 2010 the level of investments had decreased to £114.9m. This position was anticipated through the regular monitoring and projections of cash flow movement and was in line with projections at the beginning of the year.

Management of Investment Funds

5.5 The Council's investments are managed by four sources being:

- Council In House Team including investments with Royal Bank of Scotland;
- Scottish Widows Investment Partnership Limited; and
- Investec Asset Management Limited.

The Council meets quarterly with its two external investment managers as well as with its Investment Adviser to discuss financial performance, objectives and targets in relation to the investments and borrowing managed on behalf of the Council

Internally, the Council manages a proportion of its investments in-house. This is invested with institutions of high credit standing listed in the Council's approved lending list and specified limits. The Council invests for a range of periods from overnight to 30days and one year dependent on the Council's cash flows, its treasury management adviser's views, its interest rate view and the interest rates on offer.

The Council has investments managed externally by Investec and Scottish Widows Partnership (SWIP). The fund management agreements between the Council and the Fund Managers defines the limits for maximum weighting in gilts, CD's and maximum duration of the fund. Counterparty criteria and exposure limits defined in the treasury management annual strategy also apply to Fund Managers.

6. Debt Rescheduling

6.1 The council started borrowing in 2008/09 having not borrowed previously, there was no debt rescheduling in 2009/10. Debt rescheduling will be a future treasury management decision with considerations for savings, portfolio mix, capital programme requirement and interest rates. As investment rates continue to remain at an all time low, the council considered short term savings it could make by internally financing new capital expenditure using existing cash balances which are only earning minimal rates of interest due to the fact that Bank Rate was kept at 0.5% all year. Using cash balances also meant reduced counterparty risk on the investment portfolio.

7. Revised Minimum Revenue Provision (MRP) Policy

7.1 With effect from 1 April 2008, local authorities are required to make a 'prudent provision' for repayment of debt having regard to the statutory guidance issued by the Department for Communities and Local Government. This is known as Minimum Revenue Provision. The Council's revised MRP policy will be as follows:

"The MRP on expenditure financed by borrowing under Supported Capital Expenditure is 4% of that expenditure. The MRP on expenditure financed by borrowing that is unsupported is calculated using the Equal Instalment Method, i.e. the borrowing is written down over the life of the asset that it financed. The MRP for the PFI scheme is equivalent to the capital repayment required."

This is a change of accounting policy brought about as a result of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008. Previously, the Council had determined that the calculation of the Minimum Revenue Provision be based on 4% of the non-housing Capital Financing Requirement at the end of the preceding financial year.

8. Treasury Management Costs

8.1 The costs associated with the internal Treasury Management function (including an element for the regular performance monitoring of the external managers) were as follows:

Salaries	74,678
Sector Treasury Advice	17,000
	91,678

8.2 Fees paid to the external managers during 2009/10 were as follows:

Investec Asset Management	47,740.08
Scottish Widows	24,342.50
	72,082.58

9. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Treasury Indicators set out in the Council's annual Treasury Strategy Statement. The Council's prudential indicators are set out in Appendix A to this report.

10. Lending to commercial and external organisations

10.1 The Council will be required to work in different ways to obtain better outcomes for less in the future. As part of our mitigation of risk strategies around delivering continued value for money services with external organisations the council should have the ability to make loans to external organisations. The Treasury Management Strategy does not currently allow for this feature.

10.2 Section 2 of the Local Government Act 2000 (power of well-being) gives authorities the power to lend as part of promotion or improvement of economic /social wellbeing of the Borough. The guidance encourages local authorities to use the well-being power as the power of first resort removing the need to look for powers in other legislation. Further the power provides a strong basis on which to deliver many of the priorities identified by local communities and embodies in community strategies.

10.4 It is recommended that the Council's treasury management strategy is updated to enable the Council to lend to external organisations in accordance with the legislation under the 2000 act.

11. Conclusions

11.1 The key conclusions to draw from this report are as follows:

a) The position in respect of investment income and borrowing for the general fund was balanced at the end of the financial year;

b) That the value of investments as at 31st March 2010 totalled £114.9m; and
c) That value of long term borrowing as at 31st March 2010 totalled £70m. This comprised both market and Public Works Loans Board (PWLB) loans.

12. Consultees

John Hooton (Strategic Financial Controller)
Tracie Evans (Corporate Director of Finance & Commercial Services)
Winston Brown (Legal Partner)
Sector Treasury Services

Background Papers

- Assembly Report 25 February 2009 - Treasury Management Annual Strategy Statement 2009/10
- Assembly Report 24 February 2010 – Treasury Management Annual Strategy Statement 2010
- Revised CIPFA Code of Practice for Treasury Management in the Public Services 2009