

## **Meeting of the Council – 10<sup>th</sup> October, 2011**

### **Report of the Audit Committee**

#### **Treasury Management**

##### **Purpose of Report**

1. To outline treasury activity during the financial year 2010/11 and in the current financial year up to August.

##### **Background**

2. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund (WMDAF). The Council are responsible for administering capital funding of approximately £420m on its own account and another £188m on behalf of other West Midlands councils in respect of the WMDAF. The treasury function is governed by the Council's Treasury Policy Statement and Treasury Management Practices.

##### **Treasury activity in 2010/11 on the Dudley fund**

3. The Council's treasury activities were undertaken in the context of the Treasury Strategy Statement 2010/11 approved by Audit Committee and Full Council in February 2010. The Strategy Statement stated:

“The primary factor in determining whether we undertake new long-term borrowing will be cash flow need. We may elect to borrow one or two years in advance of anticipated need if we judge that this is necessary in order to avoid being forced to borrow at higher rates at a later date.”
4. During 2010/11 investments averaged around £34 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.88%. The majority of investments were for less than one month or were in call accounts (NB: A call account is a deposit account with a financial institution without a fixed maturity date. The deposit can be "called" (withdrawn) at any time and deposits can also be made at any time. Call accounts and the specific terms associated with them differ depending upon the bank offering the account). All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2010/11. Investment activity for 2010/11 is set out in more detail in Appendix 1.

5. The average value of long-term borrowings in 2010/11 was £211 million for Dudley's debt. The average rate of interest on these borrowings was 5.55% and they were due to mature on dates ranging from 2011 to 2058. The rate for a 50-year loan from the Public Works Loan Board (PWLB) has fluctuated during 2010/11 from 4.65% in April 2010 to about 5.24% in March 2011. The increase was mainly due to the Comprehensive Spending Review in October, which raised PWLB rates to one percent above UK government gilts. In the light of these rates, together with forecasts for future rates and the availability of investment balances to meet cash flow, the Council did not enter into any new long-term borrowing during the year.
6. It was not necessary to undertake any short-term borrowing in the year. Daily cash flow was managed through the use of call accounts.

#### Treasury activity in 2010/11 on the WMDAF

7. The Council's borrowing activities in 2005/6 placed it in a position where it was not necessary to undertake any new longer-term borrowing in the financial years from 2006/7 to 2010/11. Having consulted with the Council's treasury advisors at Sector, no opportunities to improve the Council's position by restructuring of debt were identified.

#### Performance comparisons 2010/11

8. The Council's performance, both for Dudley and the WMDAF, has been compared with our neighbours in the West Midlands. The results are summarised in the following table:

#### **West Midlands performance comparisons 2010/11**

	<b>Dudley</b>	<b>WMDAF</b>	<b>West Midlands average</b>
<b>Gross average borrowing rate</b> (the cost of borrowing, ignoring the return on investments)	5.55%	6.52%	5.32%
<b>Investment return rate</b> (the return on investments, ignoring the cost of borrowing)	0.88%	0.97%	1.14%
<b>Net average borrowing rate</b> (a combination of the above, representing the cost of borrowing net of the return on investments)	6.43%	6.52%	5.85%
<b>Lender's Option Borrower's Option (LOBO)* loans as a proportion of all borrowing</b>	5%	5%	11%

\* NB: The lender has the option (at regular intervals stipulated in the loan agreement) to vary the rate of interest. The borrower then has the option to either accept the new interest rate or repay the loan.

9. The Council's cost of borrowing in 2010/11 was higher than the average and the return on investments was lower than the average of our neighbours. The Council were less exposed than the average of our neighbours to the potential volatility of LOBO loans. The cash flow position during the year constrained both investment and borrowing activities and the policy on investments has been very cautious. In respect of the WMDAF, Dudley has been constrained by the statutory timetable for closure of the fund (March 2026) and has not been able to take advantage of very cheap long-term debt that has been available in recent years. It should be remembered that treasury performance measurement is not an exact science. These statistics represent the cumulative effect of decisions dating back over many years and the performance of our neighbours may have been achieved in circumstances different from our own.

#### Prudential indicators 2010/11

10. The 2003 Prudential Code for Capital Finance in Local Authorities sets out a framework for the consideration and approval of capital spending plans. In so doing, it requires the Council to set a number of prudential indicators, some of which concern matters of treasury management. Appendix 2 outlines those indicators for 2010/11. In all cases, actual outturn was within the targets and limits set by the Council.

#### Treasury activity 2011/12 to August

11. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2011/12 approved by Audit Committee and Full Council in February of this year. In that document it was anticipated that long term borrowing would be required in the next 12 months due to cash flow need.
12. Investments up to the end of August have averaged around £52.9 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.80%. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2011/12. Investment activity for 2011/12 is set out in more detail in Appendix 3.
13. The average value of long-term borrowings up to the end of August has been £210 million. The average rate of interest on these borrowings was 5.53% and they were due to mature on dates ranging from the current year to 2058. It has not as yet been necessary to undertake any new long-term borrowing, but interest rates and cash flow are being closely monitored. Officers continue to anticipate that action may be required before the financial year-end.
14. It has not been necessary to undertake any short-term borrowing in the current year to date. Daily cash flow has been managed through the use of call accounts.

15. There has been no change to the position on the WMDAF.
16. The Audit Committee at its meeting held on 22<sup>nd</sup> September, 2011, considered these matters and agreed to recommend Council as set out in paragraph 20.

**Finance**

17. Forecasts of performance against budget for treasury management activities are highly sensitive to movements in cash flow and interest rates.

**Law**

18. These matters are governed by Part IV of the Local Government and Housing Act 1989 and Section 111 of the Local Government Act 1972, which empowers the Council to do anything which is calculated to facilitate or is conducive or incidental to the discharge of its various statutory functions.

**Equality Impact**

19. The treasury management activities considered in this report have no direct impact on issues of equality.

**Recommendation**

20. That the Council note the treasury activities outlined in this report.



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**Chairman of the Audit Committee**

**Investment Activity 2010/11**

<b>Counterparty name</b>	<b>Number of investments</b>	<b>Average value £ million</b>	<b>Average rate %</b>	<b>Average duration (days)</b>
Barclays Bank Plc	1	0.2	0.30	14
Barclays Treasury Direct	21	2.4	0.36	8
DMO Bank of England	7	0.1	0.25	3
Nationwide Building Society	10	1.4	0.34	18
Santander Call account	N/A	8.4	0.80	Call
Bank of Scotland Call account (1)	N/A	5.6	0.75	Call
Nat West	N/A	5.1	0.80	Call
Royal Bank of Scotland Call account	N/A	4.0	0.80	Call
Yorkshire Bank Call account	N/A	6.3	0.75	Call
Salford MDC	N/A	0.5	11.25	Matures in 2020

The table above includes investments that commenced during 2009/10 and matured in 2010/11. It also includes investments that commenced during 2010/11 and were due to mature in 2011/12.

There is also a fixed term deposit of £500,000.00 with Salford MDC at an interest rate of 11.25% that was made in 1985 and is due to mature in 2020.

**Prudential indicators relating to treasury management 2010/11****External debt**

These indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. The operational boundary is a lower threshold allowing for a prudent but not worst case scenario for cash flow.

	<b>£m</b>
Authorised limit for external borrowing	710
Operational boundary for external borrowing	520
Outturn - actual maximum external borrowing	473

**CIPFA Code of Practice for Treasury Management in the Public Services**

The Council adopted the Revised CIPFA Treasury Management in the Public Services Code of Practice in February 2010.

**Interest rate exposures and maturity structure of borrowing and investments**

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

	<b>Indicator</b>	<b>Outturn</b>
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	15%	nil
Upper limit of principal maturing in any one year for sums invested for over 364 days	£15m	nil
Maturity structure of fixed rate borrowing:-		
under 12 months	0-10%	3%
12 months and within 24 months	0-10%	2%
24 months and within 5 years	0-15%	8%
5 years and within 10 years	0-25%	19%
10 years and above	40-100%	68%

**Investment Activity 2011/12 to August**

<b>Counterparty name</b>	<b>Number of investments</b>	<b>Average value £ million</b>	<b>Average rate %</b>	<b>Average duration (days)</b>
Barclays Bank Direct				
Barclays Treasury Direct	17	5.5	0.41	8
Debt Management Office	5	0.2	0.25	5
Nationwide Building Society	4	2.4	0.45	19
Bank of Scotland Call account	N/A	10.5	0.75	Call
Nat West	N/A	12.6	0.80	Call
Santander Call account	N/A	12.7	0.80	Call
Yorkshire Bank Call account	N/A	3.9	0.75	Call
Yorkshire Bank Instant Access account	N/A	4.6	0.50	
Salford MDC	N/A	0.5	11.25	Matures in 2020

The table above includes investments that commenced during 2010/11 and were due to mature in the current year. It also includes investments that commenced in the current year before August and were due to mature after August.

There is also a fixed term deposit of £500,000.00 with Salford MDC at an interest rate of 11.25% that was made in 1985 and is due to mature in 2020.