Agenda Item No. 7

Audit Committee – 21st September 2006

Report of the Director of Finance

Treasury Management

Purpose of Report

1. To outline treasury activity between April 2005 and August 2006.

Background

2. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund *(WMDAF)*. We are responsible for administering capital funding of approximately £257m on our own account and another £229m on behalf of the WMDAF. The treasury function is governed by the Council's Treasury Policy Statement and Treasury Management Practices.

Treasury activity on the Dudley fund

3. In January 2006, in line with our Treasury Strategy, we identified an opportunity to undertake new long-term borrowing from the Public Works Loan Board (PWLB) at historically low interest rates. On 11th January we borrowed £10m at a rate of 3.90% (£5m due to mature in 2052 and £5m due to mature in 2055). On 23rd January we borrowed a further £10m at a rate of 3.70% (£5m due to mature in 2047 and £5m due to mature in 2049). These were our first new[1] borrowings on the Dudley fund since 1997. The rate of 3.70% was the lowest rate ever offered for loans of any duration by the PWLB.

4. On 29th June 2006 we made early repayment of just under £14m of PWLB loans that were due to mature on various dates between 2008 and 2033 with an average rate of 5.35%. We replaced these with the same value of new loans due to mature on dates between 2052 and 2056 all at a rate of 4.40%. This restructuring was designed so as to spread out the maturity dates of our debt and, as such, reduces the risk inherent in having to replace large amounts of debt at any one time (when interest rates might be unfavourable). It was achieved without incurring a penalty on early repayment and generates ongoing revenue savings.

[1] As distinct from borrowing undertaken to replace existing borrowing as part of a debt restructuring exercise.

5. The performance of our investments is largely dependent on movements in short-term *(up to one year)* rates. The average return on our investments for the year 2005/6 was 5.13%. This compares very favourably with the average 3-month LIBID[2] in the same period of 4.54%. Our good performance was due in large part to our £10m holding of euro-sterling bonds due to mature in December 2006 and earning yields of around 5.4%.

Treasury activity on the WMDAF

6. On 24th May 2005, we borrowed £8m from the PWLB. Of this, £2m was at a rate of 4.45% and due to mature in 2011. The remaining £6m was at a rate of 4.50% and due to mature on various dates between 2012 and 2014. These borrowing decisions place us in a position where we will not need to undertake any new longer-term borrowing for the WMDAF until 2010 and, from then until the closure of the fund in 2026, our need to borrow in any one year will never exceed £2m. This protects us against the risk of having to borrow large sums of money at any one time (when interest rates might be unfavourable).

Prudential indicators

7. 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 1 outlines those indicators for 2005/6. In all cases, actual outturn was within the targets and limits set by the Council.

Performance comparisons 2005/6

8. We have compared our performance, both for Dudley and the WMDAF, with our neighbours in the West Midlands. The results are summarised in the following table:

[2] 3-month LIBID is a measure of the average return from a 3-month investment on the London money market.

West Midlands performance comparisons 2005/6

	Dudley	WMDAF	West Midlands average
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	6.61%	6.71%	7.03%
Investment return rate (the return on investments, ignoring the cost of borrowing)	5.13%	4.73%	4.75%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	7.18%	6.83%	7.51%

9. In previous years we have received comparative data from all of the metropolitan councils in the West Midlands. This year, two of our neighbours have been unable to respond in time for this report. That said, the comparisons we do have are encouraging. They show that in general we have invested at a better return and borrowed more cheaply than the average for the councils that have provided data. 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. The performance of our neighbours may have been achieved in circumstances different from our own.

Finance

10. Forecasts of performance against budget for treasury management activities are highly sensitive to movements in cash flow and interest rates. At this stage in the year we are forecasting a surplus of £0.7m on our budget for 2006/7. This forecast is based on prudent assumptions and the final outturn may improve beyond this position.

Law

11. 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

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

Recommendation

13. That the Committee note the treasury management activity set out in this report prior to submission to full Council in accordance with the Treasury Policy Statement and Treasury Management Practices.

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List of Background Papers

- Treasury Policy Statement, Treasury Management Practices and Schedules to the Treasury Management Practices.

Appendix 1

Prudential indicators relating to treasury management 2005/6

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.

	£m
Authorised limit for external borrowing	529
Operational boundary for external borrowing	480
Outturn - actual maximum external borrowing	426

CIPFA Code of Practice for Treasury Management in the Public Services

The Council adopted the CIPFA Code of Practice for Treasury Management in the Public Services in March 2002.

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.

	Indicator	**Outturn**
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	20%	0%
Upper limit of principal maturing in any one year for sums invested for over 364 days	£15m	£10m
Maturity structure of fixed rate borrowing:-		
under 12 months	0-10%	2%
12 months and within 24 months	0-10%	3%
24 months and within 5 years	0-15%	7%
5 years and within 10 years	0-25%	15%
10 years and above	40–100%	73%