

**Audit Committee – 23rd September 2010**

**Report of the Treasurer**

**Treasury Management**

**Purpose of Report**

1. To outline treasury activity during the financial year 2009/10 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*). We are responsible for administering capital funding of approximately £426m on our own account and another £193m 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 2009/10 on the Dudley fund**

3. Our treasury activities were undertaken in the context of the Treasury Strategy Statement 2009/10 approved by Audit Committee and Full Council in February 2009. 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.”

While there was some uncertainty, particularly about the timing and value of any payments in respect of Equal Pay, we did not anticipate when we set the strategy that it would be necessary to borrow long term to meet cash flow.

4. During 2009/10 our investments averaged around £41 million (with significant day to day variation as a result of cash flow). The average return on these investments was 1.35%. The majority of our investments were for less than one month or were in call accounts<sup>1</sup>. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2009/10. Our investment activity for 2009/10 is set out in more detail in Appendix 1.
5. The average value of long-term borrowings in 2009/10 was £213 million. The average rate of interest on these borrowings was 5.53% and they were due to mature on dates ranging from 2010 to 2058. The rates quoted by the Public Works Loan Board (PWLB) for new borrowing were relatively stable (with the 50-year rate ranging between 4.2% and 4.9% during the period). In the light of these rates together with forecasts for future rates and the availability of investment balances to meet cash flow, we did not enter into any new long-term borrowing during the year.
6. It was necessary, due to fluctuations in cash flow, to undertake short-term borrowing on 29 occasions during the year. The daily average value of short-term borrowing was £1.5 million, the average rate was 0.3% and the average duration was 4 days.

#### Treasury activity in 2009/10 on the WMDAF

7. Our borrowing activities in 2005/6 placed us in a position where it was not necessary to undertake any new longer-term borrowing in the financial years from 2006/7 to 2009/10. Having consulted with our advisors at Sector Treasury Services, we did not identify any opportunities to improve our position by restructuring of debt.

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<sup>1</sup> 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.

## Performance comparisons 2009/10

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:

### **West Midlands performance comparisons 2009/10**

	<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)	5.53%	6.56%	5.46%
<b>Investment return rate</b> (the return on investments, ignoring the cost of borrowing)	1.35%	0.43%	2.21%
<b>Net average borrowing rate</b> (a combination of the above, representing the cost of borrowing net of the return on investments)	6.52%	6.58%	5.96%
<b>Lender's Option Borrower's Option (LOBO)<sup>2</sup> loans as a proportion of all borrowing</b>	5%	5%	13%

9. Unlike previous years, our cost of borrowing in 2009/10 was higher than the average and the return on our investments was lower than the average of our neighbours. We were less exposed than the average of our neighbours to the potential volatility of LOBO loans (see footnote). Our policy on investments has been cautious, including investments at low rates with the Debt Management Office (effectively with the UK Government) on a number of occasions when we could not place funds with other institutions meeting our credit criteria. The cash flow position during the year constrained both our investment and borrowing activities. In respect of the WMDAF we have been constrained by the statutory timetable for closure of the fund (March 2026) and have 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.

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<sup>2</sup> 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.

## Prudential indicators 2009/10

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 2009/10. In all cases, actual outturn was within the targets and limits set by the Council.

## Treasury activity 2010/11 to August

11. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2010/11 approved by Audit Committee and Full Council in August of this year. In that document we anticipated that long term borrowing would be required in the next 12 months.
12. Our investments up to the end of August have averaged around £35 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.88%. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2010/11. Our investment activity for 2010/11 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 £211 million. The average rate of interest on these borrowings was 5.55% and they were due to mature on dates ranging from the current year to 2058. The rates quoted by the Public Works Loan Board (PWLB) have been generally more attractive than last year (with the 50-year rate having recently fallen below 4%). It has not as yet been necessary to undertake any new long-term borrowing, but we are monitoring interest rates and cash flow closely. We continue to anticipate that action will 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.

## **Finance**

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

## **Law**

17. 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**

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

## **Recommendation**

- 19 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.

**Investment Activity 2009/10**

<b>Counterparty name</b>	<b>Number of investments</b>	<b>Average value £ million</b>	<b>Average rate %</b>	<b>Average duration (days)</b>
Santander	41	5.3	0.49	24
Barclays Bank Plc	9	3.2	0.60	9
Barclays Treasury Direct	6	1.4	0.43	30
Bank of Scotland	2	5.4	2.36	129
The City of Edinburgh	1	0.2	0.70	26
Clydesdale Bank	2	1.4	0.43	40
DMO Bank of England	42	5.1	0.28	12
Merseyside Police	2	0.1	0.28	18
Nationwide Building Society	32	4.7	0.44	25
Royal Bank of Scotland	4	2.9	1.19	75
Salford MDC	1	0.03	0.40	4
Santander Call account	N/A	0.05	0.80	Call
Bank of Scotland Call account (1)	N/A	0.03	0.75	Call
Bank of Scotland Call account (2)	N/A	3.0	0.75	Call
Yorkshire Bank Call account	N/A	4.1	0.75	Call
Royal Bank of Scotland Call account	N/A	3.5	0.80	Call

The table above includes investments that commenced during 2008/9 and matured in 2009/10. It also includes investments that commenced during 2009/10 and were due to mature in 2010/11.

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 2009/10****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	655
Operational boundary for external borrowing	593
Outturn - actual maximum external borrowing	439

**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%	2%
12 months and within 24 months	0-10%	2%
24 months and within 5 years	0-15%	7%
5 years and within 10 years	0-25%	18%
10 years and above	40-100%	71%

**Investment Activity 2010/11 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	1	0.5	0.30	14
Barclays Treasury Direct	6	3.0	0.45	18
Debt Management Office	1	0.04	0.25	8
Nationwide Building Society	4	1.1	0.33	19
Bank of Scotland Call account	N/A	5.7	0.75	Call
Royal Bank of Scotland Call account	N/A	9.5	0.80	Call
Santander Call account	N/A	8.2	0.80	Call
Yorkshire Bank Call account	N/A	6.4	0.75	Call

The table above includes investments that commenced during 2009/10 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.