Agenda Item No. 5

Audit Committee – 20th September 2007

Report of the Director of Finance

Treasury Management

Purpose of Report

1. To outline treasury activity between April 2006 and August 2007.

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 £300m on our own account and another £225m 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. During 2006/7, having consulted with our advisors at Sector Treasury Services Limited, we restructured debt on three separate occasions:

- 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 achieved without incurring a penalty on early repayment and generates ongoing revenue savings.

- On 30th November 2006 we repaid £19.5m of Public Works Loan Board (PWLB) loans due to mature between 2013 and 2019 with an average rate of 9.28%. We replaced these with the same value of new PWLB loans due to mature between 2052 and 2056 at a rate of 4.10%. This restructuring generates revenue savings after allowing for premiums on the early repayment of debt.

- On 31st March 2007 we repaid £20m of Public Works Loan Board debt, earning a discount of £2.7m. Having considered cash flow and interest rate forecasts, we did not replace these loans. Action in relation to these particular loans was delayed until the end of the year as we were waiting to receive new government regulations clarifying in particular the accounting treatment of discounts. These new regulations were received on 7th March 2007.

4. The performance of our investments is largely dependent on movements in short-term *(up to one year)* rates. During 2006/7 our investments averaged just under £58m (with significant day to day variation as a result of cash flow). The average return on these investments was 5.07%. This was a little better than the average 3-month LIBID[1] in the same period of 5.0%.

Treasury activity on the WMDAF

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

Prudential indicators

6. 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 2006/7. In all cases, actual outturn was within the targets and limits set by the Council.

Performance comparisons 2006/7

7. 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:

[1] 3-month LIBID is a measure of the average return from a 3-month investment on the London money market.

West Midlands performance comparisons 2006/7

	Dudley	WMDAF	West Midlands average
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	4.78%	6.73%	6.47%
Investment return rate (the return on investments, ignoring the cost of borrowing)	5.07%	4.96%	4.89%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	4.65%	6.74%	6.92%

8. The message from these comparisons is that we have been able to borrow more cheaply and invest at a better return than our neighbours. It should be noted that the very strong performance on the Dudley fund is, in part, a one-off effect of the discount of £2.7m that we received on 31st March 2007 (see paragraph 3). That said, the ongoing underlying performance still compares well with that of our neighbours. It should also 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.

<u>Finance</u>

9. 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 £1m on our budget for 2007/8. This forecast is based on prudent assumptions and the final outturn may improve beyond this position.

<u>Law</u>

10. 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.

<u>Equality Impact</u>

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

Recommendation

12. 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.

…………………………………………..

Mike Williams
Director of Finance

Contact Officer: Bill Baker
Telephone: 01384 814802
Email: bill.baker@dudley.gov.uk

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 2006/7

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	535
Operational boundary for external borrowing	469
Outturn - actual maximum external borrowing	428

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	30%	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%	3%
12 months and within 24 months	0-10%	3%
24 months and within 5 years	0-15%	6%
5 years and within 10 years	0-25%	14%
10 years and above	40–100%	74%