Meeting of the Council – 5th December 2005

Report of the Audit Committee

Treasury Management

Purpose of Report

1. To outline treasury activity between April 2004 and September 2005.

Background

2. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund *(WMDAF)* and is responsible for administering capital funding of approximately £245m on the Council's own account and another £232m 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. The Treasury Strategy for 2004/5 forecast that the Council would have sufficient cash investments to cover its revenue and capital expenditure requirements. This forecast proved to be correct and, as a result, there was no need to undertake any new long-term borrowing. This has continued to be the case in the current financial year to date. Whilst it is not anticipated that there will be a need for new borrowing in the near future, the Council will work with its advisers at Sector Treasury Services to identify opportunities to improve its portfolio through debt restructuring.

4. The performance of the Council's investments is largely dependent on movements in short-term *(up to one year)* rates. The average return on the Council's investments for the year 2004/5 was 4.94%. This compares very favourably with the average 3-month LIBID[1] in the same period of 4.70%. The good performance was due in large part to the Council's £10m holding of euro-sterling bonds due to mature in 2006 and earning yields of around 5.4%.

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

Treasury activity on the WMDAF

5. The West Midlands cash-flow position has been different from that of the Dudley fund and it has been necessary to borrow to meet expenditure requirements. In the light of interest rate forecasts from the Council's advisors at Sector Treasury Services, the Council's strategy has been to undertake relatively short-term borrowing during 2004/5 and then borrow again in order to take advantage of lower medium-term interest rates in 2005/6. This strategy has been put into practice by taking the following fixed rate loans from the Public Works Loan Board (PWLB):

Loan taken out	Value	Interest rate	Loan matures
April 2004	£7m	4.55%	September 2005
October 2004	£3m	4.65%	October 2005
May 2005	£2m	4.45%	September 2011
May 2005	£2m	4.50%	September 2012
May 2005	£2m	4.50%	September 2013
May 2005	£2m	4.50%	September 2014

6. Between April 2004 and September 2005, the interest rate for an eight year PWLB loan has ranged between 5.40% and 4.25%, averaging 4.82%. The Council's borrowing decisions compare well against this trend. They have also brought the Council to a position where it 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, the need to borrow in any one year will never exceed £2m. This protects the Council against the risk of having to borrow large sums of money when interest rates are 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 2004/5. In all cases, actual outturn was within the targets and limits set by the Council.

Performance comparisons 2004/5

8. The 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 2004/5

	Dudley	**WMDAF**	**West Midlands average**
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	6.68%	6.75%	6.91%
Investment return rate (the return on investments, ignoring the cost of borrowing)	4.94%	4.50%	4.70%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	7.75%	6.76%	7.44%

9. Dudley has achieved the highest performance of the comparator authorities in terms of the return on investments on its own fund. It is also better than average in terms of the gross average borrowing rate. The less favourable performance in terms of net average borrowing rate results from the current low level of returns being achieved by investors generally and is being addressed through a policy of allowing these investments to run down to the minimal level required to manage day to day cash flow (see 3 above). 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.

10. The Audit Committee, at its meeting held on 26th October 2005, resolved to note the treasury management activity set out in the report and refer it to the Council for approval in accordance with the Treasury Policy Statement and Treasury Management Practices.

<u>Finance</u>

11. 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 in the range £0.8m - £1.0m on our budget for 2005/6. This forecast is based on prudent assumptions and the final outturn may improve beyond this position.

<u>Law</u>

12. 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>

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

Recommendation

14. That the treasury management activity set out in this report be approved in accordance with the Treasury Policy Statement and Treasury Management Practices.

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Chairman of the Audit Committee

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 2004/5

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	515
Operational boundary for external borrowing	459
Outturn - actual maximum external borrowing	434

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	0-5%	4%
12 months and within 24 months	0-5%	2%
24 months and within 5 years	0-15%	8%
5 years and within 10 years	0-25%	11%
10 years and above	50-100%	74%