Dudley
Metropolitan Borough Council

Meeting of the Council – 7th October, 2013

Report of the Audit and Standards Committee

Treasury Management

Purpose of Report

1. To outline treasury activity during the financial year 2012/13 and in the current financial year up to August.

Background

2. The Treasury Management strategy for 2013/14 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011. The Code recommends that members are informed of Treasury Management activities at least twice a year. This report ensures that the Council is embracing best practice in accordance with CIPFA's recommendations.

3. Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks.

4. 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 £778m on our own account and another £175m 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.

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Treasury activity in 2012/13 on the Dudley fund

5. Our treasury activities were undertaken in the context of the Treasury Strategy Statement 2012/13 approved by Audit Committee and Full Council in February 2012. 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."

6. During 2012/13 our investments averaged around £38 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.61%. The majority of our investments were for less than one month or were in call accounts[1]. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2012/13. Our investment activity for 2012/13 is set out in more detail in Appendix 1.

7. The average value of long-term borrowings in 2012/13 was £543 million. The average rate of interest on these borrowings was 4.11% (reduced from an average rate of 5.33% in 2011-12 due to the £336m of loans taken for Housing Self Financing at an average discounted rate of 3.36% in March 2012). The loans were due to mature on dates ranging from 2014 to 2061. The rate for a 50-year maturity loan from the Public Works Loan Board (PWLB) has fluctuated in 2012/13 between 3.96% and 4.59%.

8. The Council qualifies for borrowing at the "Certainty Rate" (0.20% below the standard PWLB rate) for a 12 month period from 1st November 2012. In April the Council submitted its application to the Department for Communities and Local Government to access this reduced rate for a further 12 month period from 1st November 2013. The"Project Rate" was announced in the Chancellor's Autumn Statement in December 2012 and will be set at 0.4% below PWLB rates but will only be available for single projects identified by Local Enterprise Partnerships.

9. 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.

10. Due to cashflow requirements at the end of 2011/12, it was necessary to undertake one short-term borrowing in March 2012 which matured in April 2012. This loan was for £7m at 0.4% for a duration of 11 days in 2012-13. No new short term borrowing was undertaken in 2012-13. Daily cashflow was managed by the use of call accounts.

Treasury activity in 2012/13 on the WMDAF

11. 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 2012/13. Having consulted with our treasury advisors at Arlingclose, we did not identify any opportunities to improve our position by restructuring of debt.

[1] 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 2012/13

12. We have compared our performance, both for Dudley and the WMDAF, with four of our neighbours in the West Midlands. Two of the neighbours did not send their performance data in time for this report. The results are summarised in the following table:

West Midlands performance comparisons 2012/13

	Dudley	**WMDAF**	**West Midlands average**
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	4.19%	6.41%	4.82%
Investment return rate (the return on investments, ignoring the cost of borrowing)	0.61%	0.29%	1.01%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	4.45%	6.43%	6.02%
Lender's Option Borrower's Option (LOBO)[2] loans as a proportion of all borrowing	2%	5%	17%

13. Our cost of borrowing in 2012/13 was lower than the average and the return on our investments was slightly 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). The cash flow position during the year constrained both our investment and borrowing activities and our policy on investments has been very cautious. The performance figures for the four other councils included in the performance comparisons are detailed individually in appendix 4 in an anonymised format.

14. 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.

15. 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.

[2] 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 2012/13

16. 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 2012/13. In all cases, actual outturn was within the targets and limits set by the Council.

Treasury activity 2013/14 to August

17. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2013/14 approved by Audit Committee and Full Council in February of this year. In that document we anticipated that long term borrowing would be required in the next 12 months due to cash flow need.

18. Our investments up to the end of August have averaged around £62 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.54%. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2012/13. Our investment activity for 2012/13 is set out in more detail in Appendix 3.

19. In July the Monetary Policy Committee (MPC) announced its forward guidance policy which will be centred on a 7% unemployment rate. This is a major change from the erstwhile ‘take each meeting as it comes’ approach. The MPC intends to keep the Bank Rate at the current level of 0.5% (subject to certain constraints mainly around rises in inflation) until the unemployment rate has fallen to a threshold of 7%. This is projected to occur in the third quarter of 2016 therefore there is unlikely to be a base rate rise in the short term, keeping investment yields low.

20. On-going stress in financial markets and numerous credit rating downgrades have led to local authority lending lists being severely restricted in recent years. In order to mitigate this situation, a Custodian account was opened with King and Shaxson in 2012 which wills allow the Council to diversify its strategy by buying up Treasury Bills, Certificates of Deposits (CD’s) and UK Government Gilts. However, the vast majority of the Council’s investments continue to be made as short term deposits or call accounts at UK banks with the highest credit ratings or the UK government’s Debt Management Office.

21. The average value of long-term borrowings up to the end of August has been £541.9 million. The average rate of interest on Dudley’s loans is 4.11%. The maturity dates for the loans range from the current year to 2061. It has not as yet been necessary to undertake any new long-term borrowing in the current year, but we are monitoring interest rates and cash flow closely. We continue to anticipate that action may be required before the financial year end.

22. 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.

23. There has been no change to the position on the WMDAF.

24. The Audit and Standards Committee at its meeting held on 19th September,2013, considered this matter and agreed the recommendation set out in paragraph 28 below.

Finance

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

Law

26. 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

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

Recommendation

28. That the treasury management activity outlined in this report be noted.

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Chair of the Audit and Standards Committee

Appendix 1

Investment Activity 2012/13

Counterparty name	Number of investments	Average value £ million	Average rate %	Average duration (days)
Barclays Treasury Direct	24	5.60	0.39	17
Debt Management Office	77	8.66	0.25	6
Nationwide Building Society	7	3.22	0.40	15
Bank of Scotland Call Account	N/A	10.00	0.75	Call
Santander	N/A	0.54	0.80	Call
Nat West	N/A	1.27	0.80	Call
HSBC	N/A	7.90	0.32	Call
Yorkshire Bank	N/A	0.01	0.75	Call
Salford MDC	1	0.50	11.25	Matures in 2020

The table above includes investments that commenced during 2011/12 and matured in 2012/13. It also includes investments that commenced during 2012/13 and were due to mature in 2013/14.

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.

Appendix 2

Prudential indicators relating to treasury management 2012/13

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	983.0
Operational boundary for external borrowing	876.0
Outturn - actual maximum external borrowing	737.0

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.

	Indicator	Outturn
Upper limit for fixed interest rate exposure	100%	98.2%
Upper limit for variable rate exposure	10%	1.8%
Upper limit of principal maturing in any one year for sums invested for over 364 days	£10m	nil
Maturity structure of fixed rate borrowing:-		
under 12 months	0-10%	2.0%
12 months and within 24 months	0-10%	1.2%
24 months and within 5 years	0-15%	5.4%
5 years and within 10 years	0-25%	15.1%
10 years and above	40-100%	76.2%

Appendix 3

Investment Activity 2013/14 to August

Counterparty name	Number of investments	Average value £ million	Average rate %	Average duration (days)
Barclays Treasury Direct	14	10.50	0.39	21
Debt Management Office	22	10.25	0.25	13
Nationwide Building Society	10	13.53	0.40	29
Bank of Scotland Call Account	N/A	15.56	0.75	
HSBC	N/A	11.44	0.32	
Nat West	N/A	0.01	0.80	
Santander	N/A	0.05	0.80	
Yorkshire Bank	N/A	0.01	0.75	
Salford MDC	1	0.5	11.25	Matures in 2020

The table above includes investments that commenced during 2012/13 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.

Appendix 4

West Midlands performance comparisons 2012/13

	Council					
	Dudley	**WMDAF**	**A**	**B**	**C**	**D**
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	4.19%	6.41%	4.44%	4.42%	4.98%	4.5%
Investment return rate (the return on investments, ignoring the cost of borrowing)	0.61%	0.29%	0.56%	0.71%	1.76%	2.15%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	4.45%	6.43%	5.61%	4.64%	5.11%	9.89%
Lender's Option Borrower's Option (LOBO) loans as a proportion of all borrowing	2%	5%	16%	20%	6%	51%