Meeting of the Council – 12th October, 2009

Report of the Audit Committee

Treasury Management

Purpose of Report

1. To outline treasury activity between April 2007 and August 2008.

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 £384m on our own account and another £220m 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. Our treasury activities in 2008/9 were undertaken in the context of uncertainty about cash flow, particularly the timing and value of any payments in respect of Equal Pay and Job Evaluation. The following transactions were undertaken following consultation with our advisors at Sector Treasury Services Limited:

   - In August and September 2008 we borrowed £30 million from the Public Works Loan Board (PWLB) due to be repaid between 2052 and 2057 at a rate of 4.43%. Those sums were temporarily invested for periods between 7 and 8 months at rates between 5.78% and 5.93%.

   - During February 2009, having revised our cash flow forecasts, we made early repayment of £22.5 million of PWLB loans at rates ranging from 4.1% to 4.875%. This transaction was timed so as to be achieved at a negligible premium. It was funded in the first instance from short-term borrowing at rates between 0.4% and 1.8%.

4. The performance of our investments is largely dependent on movements in short-term *(up to one year)* rates. During 2008/9 our investments averaged around £70 million (with significant day to day variation as a result of cash flow). The average return on these investments was 5.28%, which was

above the average 3-month LIBID[1] in the same period of 4.49%. In the light of the credit crisis we have been particularly cautious with our investments and have on a number of occasions had to place funds with the Debt Management Office (DMO). These investments are in effect with the UK Government and are therefore the most secure option available, but achieve a lower return than would be available with a bank.

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, 2007/8, or 2008/9. 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 2008/9. In all cases, actual outturn was within the targets and limits set by the Council.

Performance comparisons 2008/9

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:

West Midlands performance comparisons 2008/9

	Dudley	**WMDAF**	**West Midlands average**
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	5.52%	6.66%	5.75%
Investment return rate (the return on investments, ignoring the cost of borrowing)	5.28%	5.89%	5.45%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	5.63%	6.66%	5.82%

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

8. In respect of our own funds, we were able to borrow more cheaply than the average for our neighbours but the returns on our investments were lower than the average for our neighbours. Our policy on investments has been cautious in the light of the economic downturn and we have not been exposed to losses as a result of banking failures. The net average borrowing rate shows the combined effect of our borrowing and investment decisions – on this overall measure we performed better than the average for our neighbours. This has not been the case in respect of borrowing on the WMDAF where we are 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.

Training of Members

9. The events of the credit crisis and in particular the widespread local authority exposures to failed Icelandic banks have led the Communities and Local Government Select Committee and the Audit Commission to focus, among other things, on the scrutiny role of elected members and their training to fulfil that role. It is expected that the Chartered Institute of Public Finance and Accountancy (CIPFA) will make it a requirement of its Treasury Management Code that such training is made available to relevant members. The approach of Dudley's officers both before and during the credit crisis has been consistently prudent and Dudley was not one of the authorities exposed to Icelandic banks, but this cannot be taken as a guarantee that the Council will never be exposed to risk in the future. It has been agreed that the Interim Director of Finance will make arrangements for training from external experts for the Cabinet Member for Finance and for the Chairman and other members of the Audit Committee.

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 not forecasting a surplus on our budget for 2009/10.

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 treasury management activity set out in this report be noted.

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Chairman of the Audit Committee

Appendix 1

Prudential indicators relating to treasury management 2007/8

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	538
Operational boundary for external borrowing	473
Outturn - actual maximum external borrowing	445

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	nil
Maturity structure of fixed rate borrowing:-		
under 12 months	0-10%	3%
12 months and within 24 months	0-10%	1%
24 months and within 5 years	0-15%	6%
5 years and within 10 years	0-25%	14%
10 years and above	40-100%	76%