

CYNGOR SIR POWYS COUNTY COUNCIL

STRATEGIC BOARD

1st September 2010

REPORT BY: CLLR. TONY THOMAS
SUBJECT: PORTFOLIO HOLDER FOR FINANCE
TREASURY MANAGEMENT REVIEW 2009/10

REPORT FOR: Information

1. Introduction:

- 1.1 The Council's Treasury Management Policy as per the CIPFA Code of Practice requires an annual report on Treasury Management activity to be approved by Board by 30th September.
- 1.2 Treasury Management in this context is defined as:
"The management of the authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Strategy for 2009/10

- 2.1 At the start of 2009/10 the Authority had a Capital Financing Requirement of £190.6m, projected to rise by £7.1m during the course of the next three years to £197.7m. The Authority's external borrowing stood at £170m.
- 2.2 The Authority had no particular requirement to borrow in 2009/10. However, should a need have arisen, the agreed strategy at the start of the year, based on the forecast at Appendix A and following discussions with Sector (the Authority's advisors), was to set a benchmark of 4.00% for borrowing throughout the year.
- 2.3 Pending the issuance of revised CIPFA and statutory investment guidance expected towards the end of the year and, in light of continuing stress on the world banking system, enhanced priority was given to security and liquidity.

The strategy for investments therefore was:

- a) to ensure the security of the Authority's funds
- b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
- c) to achieve the optimum yield after ensuring a) and b) above.

3. Treasury Position

- 3.1 The major issue for Treasury Management in 2009-10 was the huge difference between investment rates and borrowing rates that emerged during the recession. Further to this was the emphasis on mitigating risk by giving heightened preference to security and liquidity as this resulted in the investment portfolio being in investment instruments with lower rates of return but higher security and liquidity.

This compounded the significant fall in total investment income compared to previous years.

- 3.2 In order to balance the impact of the loss in investment income the Authority was mindful of not replacing maturing debt and also the possibility of making premature repayments of debt if circumstances were conducive to this.

As such, net borrowing decreased by £19,370k over the year.
This decrease arose as follows:

	£000s
Decrease in PWLB debt	(10,010)
Increase/Decrease in LOBO debt	NIL
Increase in Investments	(9,360)
	(19,370)

- 3.2 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-09	Borrowing	Investments	Repayments	Balance 31-03-10
	£000's	£000's	£000's	£000's	£000's
PWLB *	129,864	Nil	N/A	(10,010)	119,854
LOBOs *	40,000	Nil	N/A	Nil	40,000
Temporary Borrowing	Nil	2,000	N/A	(2,000)	Nil
Total	169,864	2,000	N/A	(12,010)	159,854
Temporary Investments	(14,845)	N/A	(312,725)	295,365	(32,205)
Long Term Investments	(15,000)	N/A	Nil	8,000	(7,000)
Net Borrowing	140,019	2,000	(312,725)	291,355	120,649

Note: * Public Works Loan Board
Lender's Option Borrower's Option

4. Icelandic Banks

- 4.1 The investment figures above do not include the £4M deposits held in Icelandic banks Glitnir and Landsbanki.

- 4.2 The latest (July 2010) update from the Local Government Association is as follows:-

“The legal cases through which we hope finally to establish local authorities' entitlement to priority creditor status are now being managed through the Icelandic courts. We have been given until September 13 to prepare and file our written submissions related to the test cases selected for Glitnir, and our legal team are on

course to meet this deadline. Regarding Landsbanki, as the winding up board accepted our deposits as priority claims, other creditors have filed their written submissions challenging this decision and our entitlement to priority first. These statements are being analysed by our legal team who are preparing our written submissions in response which must be filed by 3 September. Court hearings to determine how the cases will be managed will take place after both sides' written submissions have been filed. We will have a clearer idea of when the final hearings will take place at that time.

The next meeting of the Glitnir Informal Creditor Committee meeting will be in September 2010 and the next open creditors meeting is scheduled for 2 December 2010. The next Landsbanki open creditors meeting is scheduled for 23 August 2010. At these meetings, creditors are updated on, and have an opportunity to influence, the way the banks' assets are being recovered for the benefit of creditors. We are continuing provide active input on local authorities' behalf, to ensure that recoveries are maximised and that distributions can begin to be made as soon as possible."

5. Balance Sheet Review

The Authority's advisors carry out an annual balance sheet review following closure of the accounts. This provides, amongst other things, information as to the internal/external borrowing position of the Authority and hence, its future need to borrow. The current review for 2009/10 is currently underway and members will be updated regarding this when the result is available.

6. Debt Rescheduling/Repayment

- 6.1 Our advisors started the year with the expectation that 2009-10 may provide opportunities for rescheduling debt within the PWLB as longer-term rates would be on a rising trend during the year and shorter term rates would be considerably cheaper. However, moving from long term to short term debt would mean taking on a greater risk exposure to having to re-borrow longer term in later years at considerably higher rates.

Alternatively, as bank rate remained low thus realising minimal returns on investments, short term savings could be achieved by internally financing capital expenditure and replacing maturing debt by running down existing cash balances. Consideration could also be given to using cash from investments to repay longer-term debt should rates be favourable to do so. As such, the Authority prematurely repaid £5 million of debt in November 2009. A maturity of £5M in January 2010 was not replaced.

7. Performance Measurement

- 7.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.

In this context, the overall average rate of interest paid on all debt in 2009/10 was 4.39%. This compared with 4.73% in 2008/09.

- 7.3 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month un compounded LIBID rate. This

is in preference to the 7-day un compounded LIBID rate and is in line with Sector's advice, as it reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

- 7.4 In 2009/10 the average rate on external investments achieved was 1.21% compared with the 3 month un compounded LIBID rate of 0.725%. This was achieved (despite the majority of the Authority's investments being in liquid accounts and Money Market Funds) as several investments within the year were ones which had been taken out in 2008 and were running at interest rates of above 6%. The model portfolio supplied by the Authority's advisers achieved 1.72% on long-term investments and 1.16% on short term investments. However, the criteria for investing this model portfolio were less risk averse than the Authority's hence the higher return.

8. Summary Statement of Accounts

- 8.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

9. Prudential Indicators

- 9.1 During the year the Authority operated the treasury limits as approved by Board on 24th March 2009. The Prudential Indicator for treasury management fixed v variable net debt was breached during the year. This was due to fixed investments maturing and not being replaced as fixed investments due to the investment strategy in place. The breach was reported to Board and the indicators were amended accordingly. No other indicators were breached.

10. Treasury Management Policy Statement

- 10.1 Any major changes to the Treasury Management Policy Statement are reported to Board whilst any minor changes are circulated to members via the information bulletin. The Statement is available on the Intranet at:

<http://intranet.powys.gov.uk/index.php?id=4585>

Proposal

It is proposed that Board receives the Treasury Management Review Report.

Corporate Improvement Plan

Not applicable.

Options Considered/Available

Not applicable

Preferred Choice and Reasons

Not applicable

Sustainability and Environmental Issues/Equalities/Crime and Disorder,/Welsh Language/Other Policies etc

Not applicable

Local Member(s)

Not applicable

Other Front Line Services

Not applicable

Support Services (Legal, Finance, HR, ICT, BPU)

Legal consulted. No action required.

Local Service Board/Partnerships/Stakeholders etc

Not applicable

Communications

Communications Team consulted. No action required.

Statutory Officers

Not applicable

Future Status of the Report

Not applicable

Recommendation:		Reason for Recommendation:	
The contents of this report are noted.		Statutory requirement	
Person(s) To Action Decision			
Date By When Decision To Be Actioned:			
Relevant Policy (ies):	Financial Regulations, Treasury Management Policy		
Within Policy:	Y / N	Within Budget:	Y / N
Contact Officer Name:	Tel:	Fax:	Email:
Ann Owen	826327	826290	ann.owen@powys.gov.uk

Background Papers used to prepare Report:

Treasury Management Policy Statement
CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Advisor's Papers

Appendix A:

Strategy for 2009/10

The Sector recommended treasury strategy for 2009-10 (issued in December 2008) was based on the view that there was an intensifying global recession which would not only require central bank rates to be cut to unprecedented historically low levels, but could also require further action from central banks to reverse the downward path of economies.

Bank Rate was expected to continue falling from 2% in December 2008 to 0.5% in March 2009 and then stay there throughout 2009-10 before starting to rise in the second quarter of 2010. However, there was a downside risk to this forecast if the recession proved even deeper and longer than expected at that time. This would mean that the first rise in Bank rate would be delayed.

The effect on interest rates for the UK was therefore expected to be as follows:-

- **Shorter term interest rates** – the “average” City view anticipated that Bank Rate would fall to 0.5% and remain there at the end of 2009 due to the scale of the recession before starting to rise back towards more normal levels in 2010, though it would be 2012 before Bank Rate returned to around 4.5%.
- **Longer term interest rates** – the view on longer term fixed interest rates 50 years was that they would remain around 3.90 – 3.95% during 2009-10 with the 25 year rate being about 10-15 basis points higher.

Appendix B

Statement of Accounts
Treasury Management

	2009/10	2008/09
	£	£
Employees	229,282	215,940
Transport	380,836	465,299
Supplies & Services	202,361	199,845
Interest Paid	7,339,746	8,670,713
Debt Management Expenses	4,038	18,899
Gross Expenditure	8,156,263	9,570,696
Interest Received	637,596	2,989,088
Gross Income	637,596	2,989,088
Net Expenditure	7,518,667	6,581,608

Appendix C

The Economy and Interest Rates:

During 2009/10 the Monetary Policy Committee (MPC) was focused on helping the economy to turn around from plunging into the deepest and longest recession the UK economy had experienced for many years.

Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year, the MPC also had to resort to extreme measures in terms of pumping liquidity into the economy through quantitative easing by purchasing £200bn gilts and corporate bonds. This had the effect of boosting prices for gilts and corporate bonds and therefore bringing down yields, so also reducing borrowing costs for both the corporate and public sector.

It was notable that the increase in money supply in the economy generated by this programme brought the credit crunch induced spread between Bank Rate and 3 month LIBID (investment rate that depositors could earn) down from 0.95% at the beginning of the financial year to zero during August 2009.

The dominant focus in 2009/10 was on quarterly GDP growth figures. The recession bottomed out in quarter 1 of 2009. There was then major disappointment that the end of the recession failed to materialise in quarter 3 2009 but the fourth quarter of 2009 did then see economic growth return at +0.4%.

Inflation had not been a major concern of the MPC as it fell back below the 2% target level from June to November. However, it did spike upwards to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as this spike was expected to fall out of the inflation index and inflation was forecast by the Bank of England to fall back under target by the end of 2010.

PWLB BORROWING RATES 2009/10 for 1 to 50 years									
	1	2	3	4	5	10	25	50	1 month variable
1.4.2009	0.83%	1.41%	1.89%	2.26%	2.54%	3.36%	4.28%	4.57%	0.80%
31.3.2010	0.83%	1.41%	1.95%	2.45%	2.89%	4.19%	4.67%	4.70%	0.65%
HIGH	1.20%	1.91%	2.48%	2.94%	3.29%	4.42%	4.83%	4.85%	0.80%
LOW	0.68%	1.29%	1.79%	2.20%	2.47%	3.30%	4.07%	4.18%	0.55%
spread	0.52%	0.62%	0.69%	0.74%	0.82%	1.12%	0.76%	0.67%	0.25%
average	0.90%	1.53%	2.08%	2.53%	2.90%	3.93%	4.49%	4.51%	0.63%
high date	09/06/2009	12/06/2009	12/06/2009	24/07/2009	28/07/2009	22/02/2010	22/02/2010	02/06/2009	01/04/2009
low date	16/09/2009	09/10/2009	09/10/2009	02/04/2009	02/04/2009	02/04/2009	09/10/2009	09/10/2009	17/07/2009