Chorley Council

Report of	Meeting	Date
Assistant Chief Executive (Business Transformation)	Executive Cabinet	12 February 2009

ANNUAL TREASURY MANAGEMENT REPORT 2008/2009 AND INTERIM REVIEW 2009/2010

PURPOSE OF REPORT

1. To report to members on Treasury Management performance in 2008/09, with particular reference to the Treasury management Strategy, the Investment Strategy and Prudential Indicators, for that year.

2. To review activity, and strategies, in 2009/10

RECOMMENDATION(S)

3. Committee is asked to maintain the investment strategy adopted on 26/2/09.

EXECUTIVE SUMMARY OF REPORT

4. In respect of 2008/09 the report advises that investment earnings exceeded the budget and the performance benchmark. This performance however was overshadowed by the Landsbanki default. There were minor divergences from the prudential indicators. These are explained and commented upon.

5. In 2009/10 investment performance has suffered because desposits have been restricted to either very short term market desposits, or very secure desposits with the Debt Management Office. This cost has been offset by reduced costs of borrowings, leaving the net position little changed.

Review of 2008/9

Introduction

6. The Strategies for 2008/9 were approved by Council on 26/02/08. They set limits on borrowings, commented on the expected movements in interest rates and considered the types of investment activity available to the Council.

7. The exceptional financial turmoil through the autumn led to changes, approved by Overview & Scrutiny Committee on 19/01/09. Finally on 26/02/09 the Strategies for 2009/10 were adopted and these applied throughout the final month of 2008/09.

Investment Performance

8. The original strategies envisaged interest rates falling from 5.25% to 4.75% by the autumn of 2008. These predictions were blown away by the credit crisis which caused rates to collapse to 0.5% in March 2009, and more significantly caused default by Landsbanki with whom the Council had invested £2m.

9. The average daily amount invested during the year was £13.003m earning 5.09%. These figures exclude the Landsbanki loan. The normal benchmark against which investment performance is measured is the 7 day London Interbank Bid Rate (LIBID). This averaged 3.69% throughout 2008/9. The large outperformance occurred because £7m was invested early in the year for periods of up to one year in anticipation of interest rates reducing. In the event they fell by a totally unexpected degree thus increasing the outperformance.

10. Investment interest earned in the year, totalled £625k. This included £43k in respect of the Landsbanki investment for the overdue period to 31/3/09. This is very much a notional figure, being accrued in the period. If this is excluded there is a small surplus over the budget of £575k.

Landsbanki

11. The circumstances of the Landsbanki investment have been fully explored in previous reports. Most recently members were advised that, in compiling its accounts for the year ended 31st March 2009 the Council had made provision for an impairment of 5% in the value of this investment. The Council has also taken advantage of regulations permitting the impact of this charge to be deferred until 2010/11. The latest guidance from the Local Government Association is that a recovery of 83p in the pound is now predicated. In cash terms this reduces the expected repayment from £1.92m to £1.68m, a reduction of £0.24m.

Investment compliance

12. The initial strategy for 2008/9 permitted up to £10m of the Council's desposits to be made for periods in excess of one year. In the event no such desposits were made.

13. To reduce risk the Investment Strategy specified a maximum limit of £2m that could be invested with a single institution. On three occasions during the year this limit was exceeded, on one day by £82k, on another by £5k and on the third by £7k. These breaches occurred because it was not viable to place such small excess amounts with a separate institution. Since the 19/01/09 report, wherever possible, desposits have been restricted to £1m, although the strategy retains a limit of £2m.

14. As a further measure to minimise risk the revised strategies approved the opening of an account with the Debt Management Office (effectively the Government). This has now happened.

Compliance with prudential limits

15. The prudential limits for 2008/9 are set out in Appendix A. The only actual variation from the limits set, was that the borrowings made by the Council were for shorter time spans than planned. The differences, in treasury management terms were not considerable. Furthermore, since the cost of the borrowings now exceed the interest earned on desposits, it is advantageous to repay borrowings in as short a time as possible.

<u>Review of 2009/10</u>

Investment compliance

16. The Investment Strategy for 2009/10 restricts desposits to a narrow range of highly rated institutions, with a maximum duration of either one year or three months, and a maximum deposit of £1m, which can be increased to £2m if alternative placement is not possible.

17. In the first three and a half months of the financial year the Council has placed money with the following institutions

- Overnight in its call accounts with the Abbey, Alliance and Leicester, and the Bank of Scotland. All of these have a AA- long term rating and a support rating of 1

- For periods of up to two months with the Royal Bank of Scotland, the Nationwide and Barclays. All long term rated AA-, Support rated 1.
- In its AAA rated Standard Life Money market Fund
- More recently it has deposited the bulk of its cash with the Debt Management Office (effectively the Government)

A full list of desposits is given at appendix B

Ratings watch

18. The rating agencies assess financial institutions according to four criteria
    - Long Term - this is a benchmark measure of the probability of default
    - Short Term – has a time horizon of only 13 months and thus places greater emphasis on liquidity and the bank's ability to meet its financial commitments
    - Individual Strength – this is an attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support.
    - Support – this is a judgement of whether a bank would receive support from the state or an institutional owner, should it be necessary
19. Currently every institution is on ratings watch, by either Moody or Fitch, for at least one of the above elements. This is almost to be expected given the stresses in the banking system. It justifies the continuing conservative approach to investment.
20. The Councils reaction to this has been to place the bulk of its cash with the DMO.

Investment Returns

21. The investment returns currently available are shown in the following table

	Money Market	DMO
Overnight	0.35%	0.25%
1 month	0.40%	0.25%
3 months	0.70%	0.30%
6 months	0.95%	0.35%
1 year	1.25%	N/A

22. This shows to what extent secure desposits (i.e. those of a short duration, and those with the DMO) generate a reduced return. The Council has had an average of £7m invested in the first quarter. It can be seen that the cost of pursuing a very restrictive investment policy is to reducing earnings by at least 0.5%. But over the quarter this amounts to only £9k.

Borrowing

23. The Treasury Strategy advised that any long term borrowing would probably be deferred because of the unattractiveness of holding cash in the current low rate, heightened risk, environment. The Council still has cash balances, averaging £7m in the first quarter of the year, and it is currently thought that it will be towards the end of the financial year before further borrowing will be necessary.
24. As an alternative strategy, consideration has been given to whether some of the current cash surplus should be used to prematurely repay borrowings. This would, in the short term, give an advantage, since the interest saved would exceed the interest earnings foregone, but in the long term, by bringing forward the day when additional borrowing would be required, any advantage will be lost. It will not therefore be pursued.

Budget position

25. The budget assumed higher rates of borrowings, with consequential higher balances available to invest, and higher interest rates. Despite the actual position being very different, the net budget position is little changed. This is shown in the following table:

	Budget	Current Forecast	(Saving)/Cost
	£'000	£'000	£'000
Interest payable	248	134	(114)
Interest receivable	(145)	(19)	126
Net cost	103	115	12

26. This shows that by deferring borrowing, interest costs have fallen by £114k. This has the knock on effect of reducing the cash available to invest. The fall in investment earnings has been heightened by the deep decline in rates of interest. The net cost is £12k.

REASONS FOR RECOMMENDATION(S)

(If the recommendations are accepted)

27. It is recommended that the investment strategy adopted on 26/2/09 be maintained.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

28. None.

CORPORATE PRIORITIES

29. This report relates to the following Strategic Objectives:

Put Chorley at the heart of regional economic development in the Central Lancashire sub-region		Develop local solutions to climate change.	
Improving equality of opportunity and life chances		Develop the Character and feel of Chorley as a good place to live	
Involving people in their communities	✓	Ensure Chorley Borough Council is a performing organisation	

IMPLICATIONS OF REPORT

30. This report has implications in the following areas and the relevant Corporate Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal		No significant implications in this area	

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There are no background papers to this report.

Report Author	Ext	Date	Doc ID
Gary Hall	5480	27 July 2009	Annual Treasury Management Report

Appendix A

Prudential Indicators

1. Operational Limit for external debt

   This is the expected, or most likely, figure for external borrowings and other long term liabilities. It links to the planned capital programme. It was not exceeded in 2008/9

	2008/09	2008/09
	Approved limit	Actual 31/03/09
	£'000	£'000
Borrowings	9,880	4,669
Other long term liabilities	120	14
	10,000	4,683

   The amount borrowed was initially £7m, but repayments during the year reduced this to £4.683m

2. Authorised limit

   This represents an outer boundary of likely events which "whilst not desirable, could be afforded but may not be sustainable". This limit was set at £14m

3. Maturity Structure of the Council's Borrowings

	Lower Limit	Upper Limit	Outturn
	£'000	£'000	£'000
Under 12 months	0	988	2,366
12-24 months	0	988	2,367
2-5 years	0	2,964	2,267
5-10 years	0	4,940	
Over 10 years	0	9,880	
			7,000

   The above table analyses the maturity structure of the initial £7m borrowed, not the balance as at 31/3/09.

   The duration of borrowing was less than that envisaged in the plan with loan periods varying between 2 and 5 years. The decision was also taken to repay loans by equal instalments and this further shortened the maturity profile. The subsequent collapse in interest rates has proved this decision to be beneficial, since the savings by early repayment exceed the earnings obtainable had the cash been retained until the final maturity of the loan.

Appendix B

Desposits 2009/10

	£m	Rate	from	to
Term Deposits				
RBS	1.0	1.26 %	1/4/09	1/6/09
Nationwide BS	2.0	0.35 %	15/4/09	22/4/09
Nationwide BS	2.0	0.35 %	22/4/09	29/4/09
Nationwide BS	2.0	0.75 %	29/4/09	29/5/09
Barclays	2.0	0.5%	15/5/09	15/6/09
Debt Management Office	6.16	0.35 %	15/6/09	15/7/09
Debt Management Office	Lesser amounts	0.25 %	overnight	

Call accounts

Up to £2m has been invested in the call accounts overnight. Since the Debt Management Office Account was opened deposits have been reduced to a maximum of £1m

Standard Life Money Market Fund

In the period 1/4/09 to 20/4/09 £2.045m was invested. This exceeded the £2m limit only because of the difficulty in placing sums elsewhere. Subsequently the limit has not been exceeded .