Meeting of the Council – 16th October 2006

Report of the Audit Committee

Treasury Management

Purpose of Report

1. To outline treasury activity between April 2005 and August 2006.

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 £257m on the Council's own account and another £229m 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. In January 2006, in line with the Treasury Strategy, an opportunity was identified to undertake new long-term borrowing from the Public Works Loan Board (PWLB) at historically low interest rates. On 11th January £10m was borrowed at a rate of 3.90% (£5m due to mature in 2052 and £5m due to mature in 2055). On 23rd January a further £10m was borrowed at a rate of 3.70% (£5m due to mature in 2047 and £5m due to mature in 2049). These were the first new[1] borrowings on the Dudley fund since 1997. The rate of 3.70% was the lowest rate ever offered for loans of any duration by the PWLB.

4. On 29th June 2006 an early repayment was made of just under £14m of PWLB loans that were due to mature on various dates between 2008 and 2033 with an average rate of 5.35%. These were replaced with the same value of new loans due to mature on dates between 2052 and 2056 all at a rate of 4.40%. This restructuring was designed so as to spread out the maturity dates of the debt and, as such, reduces the risk inherent in having to replace large amounts of debt at any one time (when interest rates might be unfavourable). It was achieved without incurring a penalty on early repayment and generates ongoing revenue savings.

5. 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 2005/6 was 5.13%. This compares very favourably with the average 3-month LIBID[2] in the same period of 4.54%. The good performance

[1] As distinct from borrowing undertaken to replace existing borrowing as part of a debt restructuring exercise.

[2] 3-month LIBID is a measure of the average return from a 3-month investment on the London money market.

was due in large part to the Council's £10m holding of euro-sterling bonds due to mature in December 2006 and earning yields of around 5.4%.

Treasury activity on the WMDAF

6. On 24th May 2005, £8m was borrowed from the PWLB. Of this, £2m was at a rate of 4.45% and due to mature in 2011. The remaining £6m was at a rate of 4.50% and due to mature on various dates between 2012 and 2014. These borrowing decisions place the Council in a position where it would 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 at any one time (when interest rates might be 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 2005/6. In all cases, actual outturn was within the targets and limits set by the Council.

Performance comparisons 2005/6

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 2005/6

	Dudley	**WMDAF**	**West Midlands average**
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	6.61%	6.71%	7.03%
Investment return rate (the return on investments, ignoring the cost of borrowing)	5.13%	4.73%	4.75%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	7.18%	6.83%	7.51%

9. In previous years comparative data has been received from all of the metropolitan councils in the West Midlands. This year, two of our neighbours have been unable to respond in time for this report. That said, the comparisons that has been received, are encouraging. They show that in general the Council has invested at a better return and borrowed more cheaply than the average for the councils that have provided data. 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 information above was considered by the Audit Committee at its meeting on 21st September, 2006 at which it was resolved that the Council be recommended to approve the recommendation in paragraph 14 below.

Finance

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 of £0.7m on our budget for 2006/7. This forecast is based on prudent assumptions and the final outturn may improve beyond this position.

Law

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.

Equality Impact

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

Appendix 1

Prudential indicators relating to treasury management 2005/6

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	529
Operational boundary for external borrowing	480
Outturn - actual maximum external borrowing	426

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	20%	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	0-10%	2%
12 months and within 24 months	0-10%	3%
24 months and within 5 years	0-15%	7%
5 years and within 10 years	0-25%	15%
10 years and above	40–100%	73%