

REPORT TO CABINET

Title: **TREASURY MANAGEMENT – ANNUAL REPORT**

Date: 22 October 2009

Member Reporting: Councillor Kellaway

Contact Officer(s): Andrew Brooker, Head of Finance; Tel 01628 796230

Wards affected:

SUMMARY

- 1.1 This report is an update of the Royal Borough's treasury management policy arrangements, as required in the Authority's Treasury Management Policy Statement.
- 1.2 In addition to the Treasury Management Policy Statement, there is also a requirement for an annual report to be made to the Council. This report must cover such areas as the Authority's stewardship of its loan's portfolio, investment decisions made and the performance achieved during the previous financial year, and the broad investment principles and strategy that will be implemented in the future.
- 1.3 Good stewardship of the Council's resources requires a sound treasury management policy particularly with regard to the length for which loans are made. Cabinet is requested to extend the maximum maturity of any loan made from 364 days to 3 years subject to the maximum amount at any time of loans maturing after 364 days is £10 million; this will allow the Council to benefit from the higher rates offered by borrowers for loans with a longer maturity.

2. **RECOMMENDATION: That:**

i) The current sums lent and the positive performance of the Treasury Management function in 2008/9 be noted.

ii) That the Royal Borough extends the maximum period over which it can lend out surplus funds, from the current limit of 364 days to a new limit of 3 years, and that a maximum amount of £10m can be lent to approved counterparties for this duration, in order to maximise returns achieved on its surplus cash as required by the authority's Treasury Management Policy Statement.

What will be different for residents as a result of this decision?
A potential increase in the amount of income that the Authority receives on its investments.

3. Background

Review of 2008/2009.

- 3.1 2008/09 was a year of unprecedented economic uncertainty, as the ongoing financial crisis that began with the “credit crunch” of 2007/08 resulted in a severe global economic downturn. Banks continued to suffer losses incurred from their exposure to US sub-prime mortgages, with billions of pounds of untradeable, or toxic, debt being written off. This resulted in the collapse of Lehman Brothers in the United States, which sent shockwaves throughout the global banking sector. The perception that global banks such as Lehman’s could be allowed to fail was enough to scare off investors, and bank share prices fell dramatically. In the UK, the government effectively nationalised both Royal Bank of Scotland and the newly merged Lloyds TSB and HBOS (Lloyds Banking Group as it became known) in order to avoid the collapse of large sections of the UK banking sector. The Icelandic banking sector collapsed under the weight of un-repayable debt, taking with it millions of pounds worth of deposits from UK local authorities.
- 3.2 The Monetary Policy Committee (MPC) of the Bank of England (BoE) reduced UK interest rates from 5.25% to a year-end level of 0.5%. LIBID¹ rates did fall slightly on the back of this, but they remained significantly above UK base rates for the throughout the year. In normal circumstances base rates and LIBID rates should remain close to one another (in recent months these rates have converged again). With the continued problems in the banking sector and the subsequent negative impact on both house prices and UK economic growth caused by a lack of available credit, the MPC became more focussed on attempting to restore stability and liquidity to the credit markets by lowering interest rates and increasing the money supply via quantitative easing, rather than being concerned about any possible inflationary pressure.
- 3.3 As at 31st March 2009 US interest rates stood at .25%, having fallen from their level of 3.25% a year earlier. This reduction was the Fed’s attempt to restore stability and liquidity to the US credit markets. Euro zone rates were reduced to 1.25% over the course of the year.
- 3.4 Sterling had a poor year, remaining weak against both the dollar and the Euro. This reflected the perception held by investors that the UK was the economy most at risk from the global economic turmoil.

¹ LIBID – London Interbank Bid or Deposit rate – the rate charged by one bank to another for a deposit

3.5 Table 1 shows the movements in interest rates during 2008/09:

<u>Table 1</u>		
<u>Month</u>	<u>Base Rate</u>	<u>364 Day Money</u>
	<u>%</u>	<u>%</u>
April 30 th 2008	5	5.8
May 31 st 2008	5	6
June 30 th 2008	5	6.4
July 31 st 2008	5	6.1
August 31 st 2008	5	5.9
September 30 th 2008	5	6.3
October 31 st 2008	4.5	6
November 30 th 2008	3	3.9
December 31 st 2008	2	2.85
January 31 st 2009	1.5	2.2
February 29 th 2009	1	2.25
March 31 st 2009	.5	2
April 30 th 2009	.5	1.8
May 31 st 2009	.5	1.85
June 30 th 2009	.5	1.8
July 31 st 2009	.5	1.8
August 31 st 2009	.5	1.4

Fund Management Performance 2008/2009

- 3.6 2008/09 ended with the Authority having total of funds under management of £45.02 million, all of which were internally managed and invested in fixed rate short- term loans and cash.
- 3.7 Appendix A shows the spread of the Authority's £45.02 million investments as at 31st March 2009. Appendix B shows the performance of the Authority's funds against the industry standard benchmark - the average 7-day return for 2008/2009 (3.85%). Appendix B also shows the equated book cost of the internally managed funds at each month end.
- 3.8 The equated return for the Authority in 2008/2009 was 4.93%. This represented an out-performance of the average 7-day rate for the year of +1.08%. The in-house portfolio is restricted to investing in fixed term loans and cash deposits with a maximum maturity of 364 days.
- 3.9 The authority made total investment interest returns of £2.67 million, of which £0.39 million was paid to the Berkshire Pension Fund as interest on their loan to the Authority. At 31st March 2009 this loan totalled £7.71 million.

- 3.10 As at 31st March 2009 the Authority's total PWLB²/ LOBO³ loan book was £57.42million, with an average interest rate of 4.96% for the PWLB loans and 4.19% for the LOBO loan. Appendix C shows the Authority's PWLB/ LOBO loan book as at 31st March 2009. During the course of the year a total of £2.9m was repaid on existing loans to PWLB, Barclays and Dexia in the form of principal repayments and interest payments.

Current Strategy

- 3.11 The Authority's current internal investment strategy continues to be to invest money in order to meet known capital, payroll and precept commitments. To achieve this in-house team have been investing money on a short-term basis only, for periods of up to three months.
- 3.12 A small group of officers meet monthly to review the council's approach to investing its cash balances. Given the continuing problems concerning liquidity in the banking sector, the in-house team has adopted a more cautious approach to lending funds to those banks and building societies that appear on our list of authorised counter parties. This safety first approach, adopted by most local authorities reflects (and contributes to, in part) a general feeling of uncertainty in market conditions.

Proposed Extension to Maximum Duration of Fixed Term Loans

- 3.13 The current investment strategy, as laid out in the Treasury Management Policy Statement, is to lend out surplus funds to approved counterparties for periods of up to 364 days.
- 3.14 It is normal for loans of longer periods to attract higher rates of interest, reflecting both the expectation that interest rates will move higher and also the potentially higher risk of default by the borrower (although with the current restricted list of approved counter party default is seen to be a low risk).
- 3.15 In order to take advantage of these higher rates, it is recommended that a maximum amount of £10m be lent out for periods of up to three years.
- 3.16 Before any money is placed for a longer than usual period an informed judgement would be made as to likely future levels of interest rates, as there would be little point in lending money for three years for a total interest return of 3.5% on the amount lent (i.e. income of £35,000 paid after 3 years on a £1 million loan) if the view was that bank base rates were to move to 3% in a few months time. Cabinet is requested to note that base rate is expressed as an annual percentage.
- 3.17 This policy change is designed to provide the investment group with the freedom to place money longer term when conditions are right; there are no proposals to make use of this facility immediately.

² PWLB – Public Works Loan Board

³ LOBO – Lenders Option Borrowers Option – arrangement whereby interest rate remains fixed for an agreed period, at which point Lenders has option to review that rate and if new offer is not acceptable Borrower has option to repay.

4. CONSULTATIONS CARRIED OUT

- 4.1 No formal consultation has been carried out in the preparation of this report, however, as part of their daily activity the Treasury Management team are reviewing market conditions and in discussion with brokers.

5. COMMENTS FROM THE OVERVIEW AND SCRUTINY PANEL

- 5.1 The Panel endorsed the recommendation and were mindful of the flexibility that would be gained from the proposed extension to the maximum duration of fixed term loans. However, it was stressed that the approach should not be seen as a licence to enter into speculative money market trading.

6. IMPLICATIONS

- 6.1 The following implications have been addressed where indicated below.

Financial	Legal	Human Rights Act	Planning	Sustainable Development	Diversity & Equality
✓	N/A	N/A	N/A	N/A	N/A

Background Papers:

None