AGENDA ITEM NO. 6(6)

POLICY AND RESOURCES SCRUTINY COMMITTEE – 29TH SEPTEMBER 2009

SUBJECT: **TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT – 1ST QUARTER 2009/10**

REPORT BY: **CHIEF EXECUTIVE**

---

1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2009 to 31st July 2009 (July has been included due to the timing of the Committee cycle to provide more up-to-date information).

1.2 To review the Treasury Management Strategy for 2009/2010 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services, which was adopted by the Council on 4th March 2004, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). The Council subsequently approved the detailed TMPs on 27th May 2004. TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's " The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2009/10 were approved by Council on 26th February 2009.

3. LINKS TO STRATEGY

3.1 The report has links to the four basic strategic themes of the Council, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

4. THE REPORT

4.1 Treasury Management

4.2 Borrowing

4.3 Loans administered by Caerphilly CBC

Due to the level of interest rates predicted to be prevalent throughout 2009/10, in particular the difference between long-term borrowing rates and short-term investment rates, it is clearly more advantageous to use internal funding in lieu of borrowing. Therefore the decision was taken, as part of the approved strategy, that no new borrowing would be undertaken in the current year, either to replace maturing debt or to fund the capital programme.

During the period covered by this report, PWLB loans to the value of £3.74m were repaid on maturity.

The portfolio's variable interest rate proportion at 31st July 2009 stood at 18.64%, which is within the Council's determination of 50%.

4.4 Rescheduling

The Annual Strategy provides for the utilisation of debt rescheduling to provide both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.5 Loans administered by Newport City Council

These are non-PWLB loans held by the former Gwent County Council and administered by Newport City Council, which continue on a reducing basis until 2013/2014.

At the start of the financial year the amount outstanding relating to Caerphilly CBC was £332k. During the period covered by this report, repayments totalling £57k were made.

4.6 Investments

4.7 Long-term Investments

The Council currently holds long-term investments to the value of £10m at an average yield of 5.23%.

4.8 Short-term Investments – up to 364 Days

The value of short-term investments at 31st July 2009 was £77.815m and is made up of a spread of investment periods from instant access call accounts to 364 days. The average rate as at 31st July 2009 for these investments was 1.03%, which compares favourably with the target rate, as detailed in the Annual Strategy 2009/10 report to Council on 26/02/09, of 1.00%.

It should be noted that, due to the instability of the Irish economy, which subsequently resulted in the reduction of that country's sovereign rating, it was decided to seek early redemption of a deposit of £6.5m at 6.10% held by the Allied Irish Bank. The request was favourably received and the deposit was repaid in March 2009 at a minimal cost of £6.5k.

Whilst the average rate of the current portfolio exceeds the target rate, the repayment of the deposit with Allied Irish Bank, together with the continued use of the Debt Management Deposit Account Facility (DMADF), whose rates are low (the current portfolio of DMADF deposits has an average rate of 0.325%), is likely to result in the target rate being unachievable (the average rate achieved on new deposits from 01/04/09 to 31/07/09 was 0.36%). On the basis of the current levels of interest rates and available balances, it is predicted that the overall rate that will be achieved will be around 0.75%

4.9 Strategy

For all practical purposes, very little has changed since the Annual Strategy was prepared in January/February 2009.

The Council's Treasury Advisors, Sector, enhanced their Creditworthiness service in April 2009, including both Sovereign Ratings (the rating awarded by the Rating Agencies to the country) and the Credit Default Swap (CDS) rating for each bank/institution where available. A more detailed explanation of the enhanced service is given in ***Appendix 1.***

Due to the effects of the financial crisis, there are few institutions that meet the necessary level of creditworthiness with which we could deposit funds if the decision was taken to move from a position of 'risk aversion' to one of 'risk management'. ***Appendix 1*** highlights the effect of the new ratings on the ability of the Council to find counterparties with whom to deal.

By following the strategy as approved, there will be no short-term deposits outstanding with any institution other than the DMADF and other local authorities by the time this meeting takes place (the final long-term investments will mature in December 2009). The strategy has consequently reduced risk relating to the capital invested but at the cost of interest returns as indicated in 4.8.

In view of the fact that interest rates show no substantial change from the beginning of the year, the continued volatility in the financial markets and the paucity of suitable highgrade counterparties available, no change is proposed to the current strategy at this time.

Members should be aware that there is a potential for the UK to lose its AAA rating due to the amount of Government borrowing needed to stabilise the economy. If this should happen, the Council would need to consider where deposits could be made to ensure the highest level of security.

However, one form of investment, AAA rated Money Market Funds, may potentially be a means of increasing the amount of interest achievable and a brief description of these is also given in ***Appendix 1***

4.10 Sector Treasury Services

Sector were engaged by the Council in 2005, following a competitive tender exercise, to provide treasury management advice from 01/04/05 to 31/03/10 with an option for a further two years. The cost of the service for 2009/10 is £21,271.36 (£22,335 and £23,452 for 2010/11 and 2011/12 respectively if the option is exercised).

Members views are sought on whether the Council should continue to use Sector by exercising the option for the next two years or test the market for other consultants.

4.11 Icelandic Banks

Members are advised that £1,628,258.31 was received on 30th July 2009 in respect of Heritable Bank. This sum represents a first dividend of 16.13% of the total amount outstanding from Heritable of £10,097,065.89.

4.12 CIPFA Treasury Management Code of Practice - Revision

CIPFA is in the process of updating the Code of Practice in the aftermath of the banking crisis and is currently awaiting responses to its consultation document due to be received by 18th

September 2009. The proposed changes are detailed in ***Appendix 2.***

Officers will review operating procedures in light of the new guidance, as and when it becomes available. Members are advised however, that the Council is already operating some of the new proposals in that monitoring reports are presented quarterly and this Committee is responsible for the scrutiny role.

4.13 CIPFA Treasury Management Forum

To ensure that officers have all relevant information from a variety of sources, and especially kept up-to-date with any developments, the decision has been taken to subscribe to the Treasury Management Forum run by CIPFA. This Forum does not give advice on investments.

5. PRUDENTIAL INDICATORS

5.1 Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in ***Appendix 3*** are set at a level in excess of the capital financing requirement.
In the financial year to date, the authority has been operating within the approved limits.

Appendix 4 shows the estimated value of the Capital Financing Requirement as at 31 March 2010 as £246,663m.

5.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management remained unchanged from those previously reported, and are shown in ***Appendix 3***. The authority is currently operating within approved limits.

5.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the authority. These are identified in ***Appendix 4*** attached which currently shows minimal variance from the original budget. However, whilst treasury activity to date has been limited to normal day to day operations, it is clear that the level of investments and the rates of interest achieved to date will impact on the ratio of financing costs to General Fund net revenue stream as updated for additional specified grant approvals received.

5.4 Capital Expenditure and Funding

Capital Expenditure as indicated in ***Appendix 5*** will be subject to amendment once the final position on the slippage from 2008-09 has been agreed, and will be advised in the next quarterly report. At this point, the capital programme remains as approved by Council in February 2009.

6. FINANCIAL IMPLICATIONS

6.1 The premature repayment of the deposit with Allied Irish Bank resulted in the reduction of some £147k in interest for 2009/10. However, due to the payments related to Job Evaluation being delayed, the level of balances has been higher than anticipated and this factor, together with reductions in interest earmarked for specific balances, has resulted in an overall saving of some £139k.

7. PERSONNEL IMPLICATIONS

7.1 There are no personnel implications.

8. RECOMMENDATIONS

8.1 Members are asked to note the report

9. REASONS FOR THE RECOMMENDATIONS

9.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

10. STATUTORY POWER

10.1 Not applicable

Author: A. Morgan – Group Accountant (Revenue Advice and Support)
N. Roberts – Principal Group Accountant (Financial Advice & Support)
Consultees: S.A. Rosser – Chief Executive
N. Barnett – Director of Corporate Services
N. Scammell – Head of Corporate Finance
S. Grant – Finance Manger (Corporate Services)
Cllr. C. Mann – Cabinet Member for Finance, Resources & Sustainability
Cllr. J. Taylor – Chairman, Policy & Resources Scrutiny Committee
Cllr. M. E. Sargent – Vice-Chairman, Policy & Resources Scrutiny Committee

Background Papers:
Treasury Management Working Papers – Accountancy Section
CIPFA “Code of Practice for Treasury Management in the Public Services”
The Local Government Act 2003
Local Authorities (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2004

Appendices
Appendix 1 – Updated Creditworthiness Report/AAA Rated Money Market Funds
Appendix 2 – CIPFA Treasury Management Code of Practice - Revision
Appendix 3 – Treasury Management Prudential Indicators – Prudence
Appendix 4 – Capital Finance Prudential Indicators – Affordability
Appendix 5 – Capital Expenditure and Funding