AGENDA ITEM NO. 6(3)

POLICY AND RESOURCES SCRUTINY COMMITTEE – 19TH JANUARY 2010

SUBJECT: TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT – 2ND QUARTER 2009/10

REPORT BY: DIRECTOR OF CORPORATE SERVICES

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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 August 2009 to 30th November 2009.

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 (TMP's). 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 crosscutting 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 £74k were repaid on maturity.

The portfolio’s variable interest rate proportion at 31st October 2009 stood at 18.67%, 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. No repayments were made during the period covered by this report.

4.6 Investments

4.7 Long-term Investments

The Council no longer holds any long-term investments. The final investments totalling £10m were repaid on 8th December 2009.

4.8 Short-term Investments – up to 364 Days

The value of short-term investments at 30th November 2009 was £68.555m and is made up of a spread of investment periods from instant access call accounts to 364 days. The average rate as at 30th November 2009 for these investments was 0.27%, which compares unfavourably 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 the average rate reflects the fact that the majority (£44.44m) of the current portfolio is deposited with the Debt Management Office at rates averaging 0.25%.

On the basis of the current levels of interest rates and available balances, it is predicted that the overall rate that will be achieved for 2009/10 will be around 0.75%.

4.9 Strategy

In the previous quarter’s report (Appendix 1) presented to this Committee on 29/09/09, Members were appraised of the enhancements that Sector had made to their Creditworthiness reporting procedures which became operative from April 2009. Since then, a further review has been carried out and an updated version is currently before Capita's Risk Assessment Group for approval (Sector is part of the Capita group). It is anticipated that the revision will be rolled out to clients by 18/12/09. A summary of the proposed changes is shown in ***Appendix 2***.

Recent reports indicated that the UK Credit Default Swap level was 84 which was some 20 points over the benchmark. There is also some speculation/suggestion that the UK AAA rating could be at risk due to the amount of outstanding debt and subsequently the UK has been placed on Negative Outlook since May 2009.

Clearly, the Council's current risk averse strategy of only placing deposits with the UK Government could now been seen as more risky than previously. As a result, and in the light of the emphasis of the new CIPFA Treasury Management Code of Practice on managing risk, and in particular the need for diversification to spread the risks, there is a need to consider changes to the strategy which would involve moving a substantial part of the deposits held in the DMO into other institutions based on their creditworthiness. The main areas for consideration would include Money Market Funds (see ***Appendix 1***), Banks meeting the highest practical credit rating (including the Sovereign rating of the country) and multi-lateral development banks (e.g. European Investment Bank – AAA rated)

4.10 <u>Sector Treasury Services</u>

Members' views were previously sought with regard to the contract currently in place with Sector for the provision of Treasury Management advice.

However, whilst Sector's Letter of Engagement includes an extension clause for an optional period of two years, further investigation into the actual contract awarded by Caerphilly indicates that the contract was awarded for a five-year period only.

Therefore, procurement processes are being implemented in order to have the new service in place from 1st April 2010. A draft copy of the proposed specification is shown in ***Appendix 3*** upon which Members' observations would be welcome.

4.11 <u>Icelandic Banks</u>

Members are aware 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. A further dividend of £1,278,231 has been received on the 18th December 2009.

Members are advised that the Winding-up Board of Landsbanki have made a decision to afford priority status to local authority deposits.

4.12 <u>CIPFA Treasury Management Code of Practice - Revision</u>

The new Code of Practice, and associated guidance notes, has now been published and officers are reviewing operating procedures in light of the new guidance. A brief overview of the changes to the Code are detailed in ***Appendix 7***.

It is intended that officers will arrange a seminar/workshop on the operational implications of the Code in the near future.

As a result of one of the recommendations of the new Code, that Councils should make use of general information in making Treasury Management decisions, it may be necessary for the Council to subscribe to other sources of market information. This may include such areas as the Bloomberg website. Clearly there would be a charge for the 'professional' access to such a site, which it is understood may cost in the region of £24k per annum.

In addition to the new TM Code, CIPFA has also more recently issued a revision to the Prudential Code. It is also understood that Welsh Assembly Government is due to consult on changes to its Investment Guidance in the near future. Officers will report on the implications/content of both documents at a later date.

4.13 Banking Tender

The current contract for banking services, with Co-operative Bank plc, commenced in April of 2005 for a five-year period and as a result, the contract was due to be re-tendered to take effect from April of this year. However, due to the continued volatility in the financial sector, particularly banking services, proceeding with tendering for this service may have a detrimental impact on the number of potential tenderers applying for the Authority's business. Officers feel that it would be more prudent to extend the current arrangement for a further period of one year, to give the market time to stabilise prior to tendering the new service. Unfortunately no extension option exists within the current arrangement, although relevant officers and the Co-Operative Bank have held meetings to discuss the possibility of the extension. Therefore a formal report will be presented in due course requesting that standing orders be suspended to progress with the one-years contract extension.

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 4*** 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.

As a result of the introduction of the International Financial Reporting Standard for the year ending 31/3/11 (which has impacts upon the year ending 31/3/10) the Authority will need to change the treatment of Private Finance Initiative assets (PFI). These changes will impact upon the Capital Financing figures and the Minimum Revenue Provision policy that is currently approved. These changes will be reported upon once the asset valuations are received and the accounting adjustments calculated.

Appendix 5 shows the estimated value of the Capital Financing Requirement as at 31 March 2010 as £246,871m.

5.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management remained unchanged from those previously reported, and are shown in ***Appendix 4***. 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 5*** 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 6*** 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 has been updated for the new Awards and the Section 106 monies.

6. FINANCIAL IMPLICATIONS

6.1 Due to the payments related to Job Evaluation being delayed, the level of balances has been higher than anticipated. However, due to the level of interest rates achieved, as indicated in paragraph 4.8, there is likely to be a shortfall in interest income of some £48k

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 Local Government Acts 1972 and 2003.

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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 – Money Market Funds
Appendix 2 – Updated Creditworthiness Report
Appendix 3 – TM Consultancy Specification
Appendix 4 – Treasury Management Prudential Indicators – Prudence
Appendix 5 – Capital Finance Prudential Indicators – Affordability
Appendix 6 – Capital Expenditure and Funding