

# Executive report

## 2 July 2010

Report of Head of Finance

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To: EXECUTIVE

DATE: 2<sup>nd</sup> July 2010

## Treasury Management – Review of Activity in 2009/10

### Recommendation(s)

- (a) *to note the return on cash invested during 2009/10 and the balances of the funds at 31 March 2010.*
- (b) *to note the prospects for the return on investments in 2010-11*
- (c) *to consider any comments made on the report by Audit and Governance Committee at its meeting on 30 June 2010.*

### Purpose of Report

- 1.1 The Vale Council's Treasury Management Policy requires a report to be made on treasury management performance in the previous financial year. It is also required by the CIPFA Treasury Management Code of Practice as embodying sound financial management.
- 1.2 This report details the Council's cash investment performance in the financial year 2009/10 and highlights any treasury management issues. The return on investment property is included in the 2009/10 Revenue Budget Out-turn report which is on the agenda for Executive in September.

## Strategic Objectives

- 2.1 The report helps us to achieve our strategic objective of managing our business effectively by providing transparency and demonstrating effective management of our investments. The income from the investment portfolio contributes to the revenue budget.

## Background

- 3.1 This report outlines the performance over the last financial year of those funds managed in-house and those managed by *Investec Asset Management*, the Council's appointed investment manager. The Fund Manager's performance is reviewed by *Butlers*, the Council's investment adviser. In addition, the report presents Members with a general overview of the current situation in the investment market.

### In-house Investment Performance

- 3.2 At the beginning of 2009/10 cash managed in-house totalled £2.7m. During the year the maximum invested at any time was £20.5m and the total of investments made (turnover) was £162m. In-house investment income in the year amounted to £128,103 on an average balance of £11.94m - an average return of 1.07%. At 31 March 2010 the cash managed in-house totalled £0.59m
- 3.3 It was necessary to borrow £2m at 0.48% for 17 days at the end of the year and another £0.7m at 0.4% for 2 days in order to cover a temporary cash flow shortage. This was well within the authorised borrowing limit of £5m agreed in the annual Treasury Management Strategy.
- 3.4 It is difficult to set targets for this sort of operation which aims to maximise returns within the constraints of security, liquidity and flexibility. Some measure of achievement can be obtained by looking at the rates achieved compared to a benchmark. *Butlers* use the widely published 7-day LIBID rate (London Inter-bank Bid rate – the rate at which a bank is willing to borrow from other banks) although this has become very erratic in the current economic circumstances.

#### In-house investment performance against benchmark.

Rate of return:	2007/08	2008/09	2009/10
In-house investment team	5.93%	4.84%	1.07%
7 day LIBID	5.72%	3.60%	0.37%
LIBID exceeded by:	0.21%	1.24%	0.70%

- 3.5 The Council only holds funds to meet its daily cash-flow requirements and also invests the council tax and business rate receipts for a short temporary period until they are due to be paid over to precepting authorities or central government. The weighted average life of this council's investments in the year was only 19 days. (The weighted average life is an average of the length of period of investment with a £2m loan

counting twice a £1m loan etc.) The current, restricted availability of suitable counterparties (i.e: the financial institutions to whom we are willing to lend) and the present very low rates available (the costs of lending £500,000 overnight exceeds the income achieved) has meant that it has not been possible to achieve the rates of return seen in previous years. This is common to all local authorities and not just this Council. The market still expects the next movement in rates will be a steady climb so authorities with more funds at their disposal can take advantage of the better rates on offer for longer periods but, of course, will have to be careful who they are dealing with. For comparison the other Oxfordshire districts have been asked for their returns in 2009-10.

### **External Fund Managers**

- 3.6 The performance in 2009/10 is set out below showing the fund manager's return before payment of fees.

Sum Managed at 1.4.2009	£15,115,968
Sum Managed at 31.3.2010	<u>£15,334,221</u>
Increase in value during year (gross)	£ 218,253

The Council's money is held in what is known as a 'cash plus' fund and the manager is allowed to hold a wider range of investments within the constraints that apply to local authorities and the requirement for security mentioned above. This includes certificates of deposit (CDs) and government-issued stock (gilts) which may be held with the intention of making a return, not just from the yield, but from changes in value over a period. For this reason the return above may be unrealised at the year-end and the fund manager is allowed to retain this increase value within the fund until it is needed to be paid over to the council.

- 3.7 The result for *Investec* shown above equates to a gross rate of return (i.e. before fees) of 1.44% (1.31% after fees). References to fees relate to the actual charges made per quarter. In accordance with industry practice the fund manager deducts the fees from the sums held but these are accounted for as a revenue cost by the Council.

#### Investec Performance over 3 years (net of fees)

Rate of return:	2007/08	2008/09	2009/10
Investec Asset Management	5.86%	7.42%	1.31%
7 day LIBID	5.72%	3.60%	0.37%
LIBID exceeded by:	0.14%	3.82%	0.94%
Comparable LA funds average*	5.79%	6.48%	1.37%
Average exceeded/(short) by:	0.07%	0.94%	(0.06%)

- 3.8 The Council's investment advisers (*Butlers*) provide the comparative figures\* and have reported on the state of the market and the performance of the fund manager (*Investec*). They commented that the economic climate meant that performances for the year still suffered from the problems of low and declining yields and interest rates. Extreme volatility meant that the risk of loss from tactical trades in the gilt-edged market was a major deterrent to investment in this area. They point out that some of

the advantages of a segregated fund such as this are top-quality counterparties and good liquidity, which are valuable attributes in the current difficult economic climate.

### **Investment Income Review**

- 3.9 The actual investment income achieved in 2009/10 was well below the original budget forecast by £0.445m (£0.791m to £0.346m) although it was ahead of the revised forecast done February 2010 by £8,356.

#### **Out-turn compared with budget – investment income earned**

	Fund manager	In-house team	total
Original budget 2009-10	£ 512,400	£ 279,000	£ 791,400
Actual out-turn 2009-10	£ 218,253	£ 128,108	£ 346,361
Out-turn short of budget by:	£ 294,147	£ 150,892	£ 445,039

The actual return achieved was 43.8% of the budget and this was due to the fact that interest rates dropped to (and then have held at) an historic low; this was not anticipated when the budget for 2009/10 was being drawn up in January 2009.

### **Events during the year**

- 3.10 This has been a much quieter year for the council. The Bank of England (BoE) reduced its Base Rate to 0.5% (the lowest rate on record) in March 2009 and has held it at that level since. This has seen a corresponding drop in both LIBOR (the London Inter-bank Offered Rate) and the LIBID. The Government's Debt Management Office (DMO) is offering rates at about 0.25%. As a comparison, if the Council had invested its surplus funds with the safer DMO investment facility, the total return for the in-house investments would have been less than £25,000, which is about one quarter of that actually achieved (note: these comparator figures exclude interest from investments made in 2008/09 that matured in 2009/10 and deposits on call with money market funds).
- 3.11 The Council still holds a fixed-term deposit of £1m with Landsbanki, one of the Icelandic banks in administration. Recovery of these investments by public authorities is being pursued as a group action by the LGA through the Icelandic courts and the Council is still anticipating to receive a substantial proportion of this deposit (and accrued interest) back.

### **Forward look to 2010/11**

- 3.12 The outlook for Treasury in 2010/11 is similar to the previous year. Markets are continuing to remain volatile and unpredictable. Economic recovery is likely to be slow, and correspondingly, the BoE Monetary Policy Committee (MPC) is unlikely to risk jeopardising the "green shoots" through interest rate changes. That said, recent increases in the level of the Consumer Price Index (CPI) above the target 2.0%, may see the base rate increase in the near future. Analysts are predicting the rate to increase around the middle of the financial year. LIBOR and LIBID have shown signs of steadily increasing in the recent months.
- 3.13 The effect of rising rates will mean that the rate of return on investments for the Council would be better than 2009/10. A series of short-term investments will always

do better in a market with rising interest rates – this will suit the Council's in-house investments.

- 3.14 The estimate of investment income for the 2010/11 budget was based on economic predictions in January 2010, which had the BoE base rate rising to 1.5% by the end of the year - current indications are that this may not happen and the fund manager has consequently revised his forecast of the probable return for the year down to 1.5% from 2.0%. This will also mean that the in-house return will be a little worse than expected.

## Options

- 4.1 Not applicable as this is an information report, however it recommended that there are no changes to the Treasury Management process.

## Financial Implications

- 5.1 The report gives financial information to help Members oversee the treasury management function. The budgeted net income for 2010/11 is £489,900 and whilst there is no additional expenditure involved, the report raises the prospect of a continuing shortfall in investment income in 2010-11 against this budget. This will be reflected in the in-year budget monitoring reports.

## Legal Implications

- 6.1 Other than the current litigation regarding the Icelandic Bank deposit which is being administered by the LGA, there are no legal implications to this report.

## Risks

- 7.1 Treasury investments are made using the following principles (listed in order of priority):
- Security – certainty of return of the principal invested.
  - Liquidity – the principal is returned at the time required for effective cashflow management.
  - Yield – the Council achieves the best return on investment as possible without unnecessary exposure to risk.
- 7.2 Treasury Management Practices lay down good practice to follow in order to reduce the level of risk involved in the treasury activities as much as possible; however, with the volatility of the markets, there will always be an element of exposure to risk. To reduce risk to its absolute minimum would mean that the level of return on investments will impact upon the revenue income of the Council.

## Other implications

- 8.1 None – information report.

## **Conclusion**

- 9.1 The return on cash invested was considerably lower than initially anticipated in 2009/10 due to the sustained very low interest rates – the outturn position was very close to that expected during budget monitoring revisions. It will remain difficult to achieve the budgeted return in 2010-11 if interest rates do not rise over the year as market analysts were predicting in January 2010, and market conditions continue to restrict the available counter-parties the in-house team can lend to – this has been reflected in the lower budget set for 2010/11.

## **Background Papers**

- Treasury Management Policy agreed by Council 19 December 2001
- Treasury Management Strategy agreed by the Executive February 2010
- Fund manager review published by Butlers 7 May 2010