Executive

7 August 2009

Report of **Head of Finance** Report No. 30/09

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Wards Affected
All

Treasury Management – Review of Activity in 2008/09

Recommendations

(a) to note the return on cash invested during 2008/09 and the balances of funds at 31 March 2009.

(b) to note the prospects for the return on cash investments in 2009/10

1. Purpose of Report

1.1 The 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 2008/09 and raises any treasury management issues. The return on investment property is included in the 2008/09 Revenue Budget Out-turn report which is also on this agenda.

1.3 Please note that the figures in this report may not tie up exactly with the Statement of Accounts for 2008-09 because there are some minor adjustments to the interest earned in-house to get to the sum credited to the Income and Expenditure Account.

2. Relationship with Corporate Plan

2.1 The report contributes to the Strategic Objective of managing our business effectively by providing value for money services that meet the needs of our residents and service users.

3. Background

3.1 This report outlines the performance over the last financial year of those funds managed in-house and those managed by the Authority's appointed investment manager (*Investec Asset Management*). The review of the Fund Manager's performance is provided by the Council's investment adviser – *Butlers*. In addition it gives Members a general overview of the current situation in the investment market.

In-house Investment Performance

3.2 At the beginning of 2008/09 cash managed in-house totalled £1.83m. During the year the maximum invested at any time was £24.4m and the total of investments made (turnover) was £157.9m. In-house investment income in the year amounted to £592,922 on an average balance of £12.24m - an average return of 4.84%. At the end of March 2009 the cash managed in-house totalled £2.7m

3.3 It was necessary to borrow £3m from 20 March until the end of the year in order to cover a temporary deficit. The rate was 0.4% (annual equivalent).

3.4 It is difficult to set targets for this sort of operation which aims to maximise returns within the constraints of security 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 Interbank 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:	2006/07	2007/08	2008/09
In-house investment team	4.89%	5.93%	4.84%
7 day LIBID	4.97%	5.72%	3.60%
LIBID exceeded /(short) by:	(0.08%)	0.21%	1.24%

The Council only holds funds to meet its daily cash-flow requirements and invests council tax and business rate receipts for a short while until they are paid over to precepting authorities or the government. By carefully assessing cash requirements and using advice from the brokers that we deal with, the in-house team has been able to make a good return on the funds held.

External Fund Managers

3.5 The performance in 2008/09 is set out below showing the fund manager's return before payment of fees.

Sum Managed at 1.4.2008	£17,336,856
Funds repaid during year	£ 3,500,000

Sum Managed at 31.3.2009 £15,115,968
Increase in value during year (gross) £ 1,309,861

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.

3.6 The result for *Investec* shown above equates to a gross rate of return (before fees) of 7.61% (7.42% after fees). All references to fees are 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:	2006/07	2007/08	2008/09
Investec Asset Management	3.97%	5.86%	7.42%
7 day LIBID	4.97%	5.72%	3.60%
LIBID exceeded /(short) by:	(1.00%)	0.14%	3.82%
Comparable L A funds average*	4.29%	5.79%	6.48%
Average exceeded/(short) by:	(0.32%)	0.07%	0.94%

3.7 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 was still marked by phases of volatile and unpredictable behaviour and a lack of liquidity which has made things difficult for fund managers. The atmosphere of fear and suspicion meant that rates on negotiable instruments remained above short-term benchmarks and provided some modest investment opportunities. Investec stayed away from gilts but did invest in some high yielding CDs before interest rates started to tumble. These delivered superior yields and capital appreciation when interest rates fell to historic lows.

Investment Income Review

3.8 The actual investment income achieved in 2008/09 exceeded the original budget forecast by £220,283 (£1.903m to £1.6825m).

Out-turn compared with budget – investment income earned

	Fund manager	In-house team	total
Original budget 2008-09	£1,071,760	£610,740	£1,682,500
Actual out-turn 2008-09	£1,309,861	£592,922	£1,902,783
Out-turn exceeded budget by:	£ 238,101	(£ 17,818)	£ 220,283

This total over budget represents 13.1% of the budget and was mainly due to the good performance of the Fund Manager. Investec was the top performing manager (of comparable funds) in 2008/09. This good performance, partly due to interest rates falling further than expected, will be at the expense of a poorer than expected return in 2009/10 as holdings are replaced by lower yielding instruments. The value of the fund investment remains in the provision of access to quality counterparties and liquidity.

3.9 The investment income calculation for the 2009/10 budget was based on economic predictions in January 2009. In the event interest rates have fallen further than expected. This should mean that the in-house return will be a little worse than expected and the Fund Manager has revised his forecast of the probable return for the year down to 1.75% from 2.75%. This is reflected in the June Budget Monitoring report.

Events during the year

3.10 On 24 September 2008 the Council made an investment of £1m for 30 days with Landsbanki Islands HF, a bank registered in Iceland, which we had used many times and was on our counterparty list rated F1. On 30 September the bank was downgraded and removed from our list and on 7 October the bank went into receivership and was taken over by the Iceland Government. The money has not been repaid at the year-end but we are hopeful of getting most of it back eventually.

3.11 In response to the banking crisis it was decided to tighten the already fairly restrictive lending criteria that we used even further. Steps taken included the following:

- Lending to other local authorities if possible (very rare),
- lending to banks with an F1+ Fitch credit rating if possible followed by F1 banks and then building societies, (F1+ banks generally not interested in our small amounts),
- applying "lowest common denominator" to our counterparty list i.e. any borrower has to cross a threshold from all 3 rating agencies,
- limiting the amount with any borrower to £3m,
- taking account of country credit ratings. This has removed Irish institutions from our list.

The credit rating agencies reacted (some think over-reacted) to the criticism they received when the Icelandic Banks collapsed by tightening their criteria which also removed a number of borrowers from our list. This has made lending very difficult at times.

4. Options

4.1 Not appropriate.

5. Financial, legal and any other implications

5.1 The report gives financial information to help Members manage their services. There is no additional expenditure involved although it raises the prospect of a probably shortfall in investment income in 2009-10.

6. Conclusion

6.1 The return on cash invested was higher than expected in 2008/09 largely due to the good performance of the Council's fund manager. The return in 2009-10 will probably be lower than expected because of the fall in yields to very low levels and continued restrictions on lending affecting the in-house team.

Background Papers:

Treasury Management Policy agreed by Council 19 December 2001
Treasury Management Strategy agreed by the Executive February 2009
Fund manager review published by Butlers 1 May 2009