Agenda No

AGENDA MANAGEMENT SHEET

Name of Committee	**Cabinet**
Date of Committee	**13 July 2006**
Report Title	**Treasury Management Outturn Report 2005/06**
Summary	This report sets out the outturn of the treasury management process during 2005/06.
For further information please contact:	Phil Triggs Group Manager Tel: 01926 412227 philtriggs@warwickshire.gov.uk
Would the recommended decision be contrary to the Budget and Policy Framework? [please identify relevant plan/budget provision]	No.
Background papers	• CIPFA publication "Treasury Management in the Public Services: Code of Practice and Guidance notes for Local Authorities" • Treasury Management Strategy 2005/06

CONSULTATION ALREADY UNDERTAKEN:- Details to be specified

Other Committees	☐	....
Local Member(s)	☐	
Other Elected Members	☐	....
Cabinet Members	☒	Cllr Cockburn
Chief Executive	☐	....
Legal	☒	Catherine Witham – Legal
Finance	☒	David Clarke – reporting officer
Other Chief Officers	☐	....
District Councils	☐	....

Health Authority	☐	....
Police	☐	....
Other Bodies/Individuals	☐	

FINAL DECISION YES

SUGGESTED NEXT STEPS: Details to be specified

Further consideration by this Committee	☐	....
To Council	☐	....
To Cabinet	☐	....
To an O & S Committee	☐	....
To an Area Committee	☐	....
Further Consultation	☐	....

Agenda No

Cabinet – 13 July 2006

Treasury Management Outturn Report 2005/06

Report of the Strategic Director of Resources.

Recommendation
That Cabinet note the report.

1 Introduction

1.1 Warwickshire County Council fully complies with the requirements of The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (COP) on Treasury Management 2001. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- receipt by the Cabinet of an annual treasury management strategy report for the year ahead and an annual review report of the previous year;
- delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.

1.2 Therefore, under the CIPFA Code, the Cabinet is required to receive a report on the outturn of the annual treasury management activity for the authority. This report ensures compliance with the CIPFA Code.

1.3 Treasury management in the context of this report is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." *(CIPFA Code of Practice)*

1.4 This annual treasury outturn report covers:

2 Council's Current Treasury Position

2.1 The Council raises long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. At 31 March 2005, the Council had £207.4m of long-term borrowing and this had increased to £239.0m by 31 March 2006 as detailed in section A in Table 1.

2.2 At the same time as borrowing for capital purposes, the Council also has an investment portfolio. This consists of the Council's reserves and short-term cash flows. This cash is invested partly by an external cash manager and partly in house. As at 31 March 2005, the Council had £79.6m of cash investments and this had increased to £110.0m as detailed in section B of Table 1.

2.3 The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position at 31 March 2006

	Principal at 31.03.06	Rate/ Return	Principal at 31.03.05	Rate/ Return
A: Fixed Rate Funding	£m	%	£m	%
PWLB	238.9	6.06	207.2	6.38
European Investment Bank	0.1	4.71	0.2	6.27
Total Debt	**239.0**	**6.06**	**207.4**	**6.38**
B: Investments				
In House	75.8	4.60	46.9	4.59
External Managers	34.2	4.58	32.7	4.72
Total Investments	**110.0**	**4.60**	**79.6**	**4.65**

3 Performance Measurement

3.1 One of the key changes in the recent revision of the CIPFA Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in Table 1).

4 Treasury Management Strategy for 2005/06

4.1 Our treasury strategy for 2005/06 was approved by Cabinet on 13 January 2005 and was based on the view of a weakening of the rate of growth of GDP in the UK economy precipitated by a downturn in household spending, in conjunction with a weakening of the housing market. Inflation was expected to rise due to increases in oil and commodity prices which would cause the Monetary Policy Committee to be on alert for second round inflation effects in increases in the prices of goods and services and pay inflation.

4.2 Our forecast for base rate was that there would probably be enough steam in the upswing of the economic cycle to warrant one final increase in base rate to 5.0% in quarter 1 of 2005. After that, the MPC would be on hold until the downswing in economic activity gathered momentum and inflation pressures subsided to enable base rate to be cut to 4.5% by the end of 2005/06.

4.3 The US Fed was expected to continue its policy of a gradual increase in the Fed rate (still only 2.25% at the beginning of 2005) as the economy continued to expand at a robust rate, though less strongly than in 2004. The Eurozone growth rate was expected to improve, but only weakly, and so the European Central Bank was therefore forecast to leave rates unchanged at 2.0% for probably most of 2005/06 until the economy showed some stronger signs of stirring. Inflation in all three areas was expected to be well contained.

4.4 The effect on interest rates for the UK was therefore expected to be that the peak of growth in the UK, US and world economies had passed in 2004 and that moderating growth rates in 2005 would lead to only a slight decrease in the UK base rate from an average of 5.0% in 2006 to reach about 4.75% by the end of 2007. The view on long-term fixed interest rates was that long-term PWLB rates would be fairly stable around the 4.75% level for most of the financial year (equivalent to a long term gilt yield of approximately 4.60%).

5 The economy and investment rates in 2005/06

5.1 The Base rate started 2005/06 at 4.75%, having been unchanged at this level since August 2004. It fell to 4.5% in August 2005 and remained at that level for the rest of the year. The strong growth of consumer expenditure and housing prices in 2004 became positively anaemic during 2005 though the housing market did pick up to recover a bit later in the year and in quarter 1 2006.

5.2 High oil prices and major increases in utility prices reduced spending power and negatively impacted sentiment. Claimant count unemployment increased each month during the year while manufacturing output was actually in recession for the first two quarters of 2005 before staging a late recovery. GDP growth picked up from a low point of 1.7% y/y in Q2 to 2.3% in Q1 2006, i.e., still slightly below the long-term average growth rate of about 2.5% p.a.

5.3 With regard to long-term interest rates, the PWLB 25-30 year rate started the year at 4.75% and fell to a low of 3.85% before rising back to a new peak of 4.25% at the end of the year. Fifty-year gilts were launched in 2005 and on 7 December 2005, the PWLB introduced new PWLB borrowing maturity periods longer than 25–30 years and up to a maximum of 45–50 years. This longest band started at a rate of 4.20% (compared to 4.30% for 25-30 year borrowing) and the rate bottomed at 3.70% in late January 2006 before ending the year at 4.15%.

6 Borrowing outturn for 2005/06

6.1 The Council undertook PWLB borrowing totalling £31.7m during 2005/06. Details are as follows:

Date Commenced	£	Rate %	Period
06/05/2005	10.0m	4.60	6 May 2005 to 31 Mar 2032
16/05/2005	5.0m	4.55	16 May 2005 to 31 Mar 2031
21/11/2005	8.0m	4.30	21 Nov 2005 to 30 Sep 2028
21/11/2005	8.7m	4.25	21 Nov 2005 to 30 Sep 2025
Total	**31.7m**	**4.42**	

As comparative performance indicators, the average PWLB 25-30 years maturity loan interest rates for 2005/06 was 4.35%.

7 Compliance with Treasury Limits and Prudential Indicators

7.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Treasury Management Strategy.

7.2 Table 2 compares actual performance against the 2005/06 borrowing limits and shows that all treasury activity was conducted within the set limits.

Table 2: Actuals Compared with Strategy Limits 2005/06

	Limit	Actual
Authorised Limit for External Debt	£264,507,000	£239,428,663
Upper Limit for Interest Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	25%	0%
Upper Limit for total principal sums invested for over 365 days	£0	£0
Maturity Structure of Fixed Rate borrowed during 2005/06		
Under 12 months	0-20%	0%
12 months and within 24 months	0-20%	0%
24 months and within 5 years	0-60%	0%
5 years and within 10 years	0-100%	0%
10 years and above	0-100%	100%

7.3 Full details of the prudential indicators set for 2005/06 and the results for the year are shown in **Appendix A**.

8 Investment Outturn for 2005/06

8.1 The Council manages its short-term cash balances in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2005/06.

Table 3: Investment Outturn 2005/06

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed	£67.2m	4.60	4.54
Externally Managed	£34.2m	4.58	4.99

8.2 Because of the short-term nature of in-house investments, the performance target is lower than that set for the external cash manager. The target for in house investments is to earn the average 7-day investment rate. During 2005/06 in house investments out-performed the 4.54% target by achieving a return of 4.60%.

8.3 Reserves and long-term cash balances are placed with an external cash manager, Investec, who invests in a wide range of investment instruments. The fund management agreement between the Council and the Fund Manager defines the limits for maximum weighting in gilts/bonds and maximum duration of the fund. Counterparty criteria and exposure limits are also pre-defined within the agreement.

8.4 Investec's performance target is to out-perform the 7-day investment rate by 10% of the benchmark rate. During 2005/06, Investec achieved a return of 4.58%. This below its target of 4.99% (7-day investment benchmark rate of 4.54% + 10% of the benchmark).

8.5 Our treasury advisors, Sector, provided the following review of Investec's performance in 2005/06:

"Investec's return for the year was 4.58% net of fees against a 7 day LIBID benchmark + 10% target of 4.99%. This represents an underperformance of 0.41% for the financial year 2005/06 and is a disappointing return. Investec entered the year with a tactical position in gilts, which they added to in April 2005 and May 2005 as yields fell. With hindsight, they sold too soon as yields continued to fall. However, a profit was made on the three purchases of bonds. Investec undertook another tactical trade in June 2005 just before yields fell sharply and, again, a profit was made. A further tactical trade was made in November 2005 and, again, yields fell and they made a profit.

Investec had a 50% weighting against the view that the base rate would remain at 4.50% and a 40% weighting against the view that base rate would be cut. Even if rates had stayed the same, Investec felt that yields had risen too much, mainly driven by international factors such as rising rates in the US and the EU which were pushing yields up in both those economies and this has the effect of pushing UK yields up as well. It was thought that eventually this would be reversed and yields would fall or base rate would be cut which would drive yields down again. Based on this view, Investec built up a strategic position in gilts in January 2006. However, yields rose continually thereafter. In May 2006, they sold their 30% holding in three tranches resulting in the fund underperforming by nearly 30bp in the March 2006 quarter alone."

8.6 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

9 Debt Rescheduling for 2005/06

9.1 No debt rescheduling was undertaken in 2005/06.

DAVID CLARKE
Strategic Director, Resources
Shire Hall
Warwick
June 2006

APPENDIX A: PRUDENTIAL INDICATORS

Affordability and Prudence Indicators

PRUDENTIAL INDICATOR	**2004/05**	**2005/06**	**2005/06**
1) Affordability and Prudence Prudential Indicators			
	Actual **£000**	**Original (as per 2005/06 budget)** **£000**	**Actual** **£000**
Incremental impact of capital investment decisions Increase in council tax (band D) per annum	**10.08%**	**11.81%**	**12.41%**
Ratio of financing costs to net revenue stream	**3.44**	**3.88**	**3.60**
Capital Expenditure	**75,887**	**95,735**	**78,370**
Net borrowing requirement *			
brought forward 1 April	178,210	207,391	207,881
carried forward 31 March	207,881	234,950	239,428
in year borrowing requirement	**29,671**	**27,559**	**31,547**
Capital Financing Requirement as at 31 March	**193,576**	**229,798**	**215,050**
Annual change in Capital Financing Requirement	**22,402**	**36,222**	**21,474**

Treasury Management Indicators and Limits

PRUDENTIAL INDICATOR	2004/05	2005/06	2005/06
2) Treasury Management Prudential Indicators			
	Actual £000	**Original £000**	**Actual £000**
Authorised limit for external debt:			
Borrowing	253,551	282,079	263,907
Other long term liabilities	18,000	18,000	600
TOTAL	**271,551**	**300,079**	**264,507**
Operational boundary for external debt:			
Borrowing	211,293	235,066	219,923
Other long term liabilities	15,000	15,000	500
TOTAL	**226,293**	**250,066**	**220,423**
	%	**%**	**%**
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	**100**	**100**	**100**
Upper limit for variable rate exposure Net principal re variable rate borrowing/investments	**25**	**25**	**25**
Upper limit for total principal sums invested for over 364 days	**£0**	**£0**	**£0**

Maturity structure of fixed rate borrowing during 2005/06	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%