MEETING:	**AUDIT COMMITTEE**
DATE:	**28 SEPTEMBER 2009**
TITLE:	**TREASURY MANAGEMENT 2008/09**
PURPOSE:	**CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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1. INTRODUCTION AND BACKGROUND

CIPFA's Code of Practice on Treasury Management was adopted by this Council on 4th March 2003 and this Council fully complies with its requirements. The Code requires that I report on the results of the Council's actual treasury management in the previous financial year against that which was expected. This year, the Audit Committee is asked to consider this report, as a related report was submitted to this committee during the year (the 18 December 2008 meeting).

This report compares our actual performance for 2008/09 against the strategy which was set out for the financial year (approved by the full Council at its meeting of 28/02/2008). The report looks at:

- the current treasury management portfolio position;
- interest rates;
- borrowing;
- debt rescheduling;
- investments; and
- compliance with Treasury Limits.

During the year the Council tendered for Treasury Management Consultancy Services. Three companies were invited to quote, namely Sector (who have provided us with the service for a number of years), Arlingclose and Butlers. Following presentations, Arlingclose was appointed with immediate effect as the Council's new Treasury Management Consultants on 28 January 2009.

2. THE COUNCIL'S CURRENT TREASURY MANAGEMENT PORTFOLIO

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

		31 March 2009		31 March 2008	
		Principal	**Rate**	**Principal**	**Rate**
Fixed Rate Funding	- PWLB*	£121.7m	6.22%	£149.2m	6.13%
	- Market	£16.2m	4.11%	£0.0m	
Variable Rate Funding	- PWLB*	£0.0m		£0.0m	
	- Market	£0.0m		£0.0m	
Total Debt		**£137.9m**	**6.06%**	**£149.2m**	**6.13%**
Investments	- In House	£71.7m	5.1%	£77.1m	5.84%
	- With Managers	£0.0m		£0.0m	
Total Investments		**£71.7m**	**5.1%**	**£77.1m**	**5.84%**

***PWLB – Public Works Loan Board**

3. INTEREST RATES

Treasury management consultants are retained to provide advice on treasury management issues and part of their service is to assist the Council to formulate a view on interest rates.

3.1 The Interest Rate Strategy

Interest rates in the United Kingdom (UK) were expected to be as follows:

- **Short Term Rates** - The Bank of England had cut rates to 5.25% in January 2008. It was expected that there would be a further cut to 5.00% during Q2 2008 and that the base rate would remain at 5.00% until the beginning of 2010.
- **Long Term Rates** - Sector forecast that the 50 year Public Works Loan Board (PWLB) rate was expected to fall marginally from 4.50% in Q1 2008 to 4.45% in Q2 2008 before rising back again to 4.50% in Q3 2009.

3.2 Actual Result

During 2008/09 actual interest rates were as follows:

- **Short Term Rates -** 2008 saw the worst upheaval in credit and financial markets for some decades. The financial crisis reached boiling point following the collapse of Lehman Brothers in September and a few weeks later the Icelandic Banks. Globally, governments had to bailout many banks and financial institutions. House prices slumped by 17.50% during the financial year and unemployment rose to 6.7%. The base rate remained at 5.00% from April until the beginning of October. Then as concerns about the economy and the credit crunch mounted the base rate fell monthly until it hit an all time low of 0.5% in March 2009.
- **Long Term Rates -** The PWLB 49½-50 year rate started the year at 4.43% and ended the year at 4.58%. The high point during the year was 4.84% in January 2009 and the lowest was 3.86% in December 2008.

4. BORROWING

4.1 The Borrowing Strategy for 2008/09

Based upon the prospect for interest rates, the borrowing strategy was to take long dated borrowing towards the end of the financial year. Throughout the financial year variable rate borrowing was expected to be more expensive than long term fixed borrowing. The interest rate expectations provided a variety of options:

- that fixed rate funding would be drawn whilst interest rates were still relatively cheap if it was felt that there was a significant risk of a sharp rise in long and short term rates:
- that long term borrowing would be postponed, and any rescheduling from fixed rate funding into short rate funding would be exercised if it was felt that there was a significant risk of a sharp fall in long and short term rates.

Against this background, caution was adopted with the 2008/09 treasury operations. The Council intended to monitor the interest rate market and adapt a pragmatic approach to changing circumstances.

4.2 Actual Interest Rates and Borrowing Activity for 2008/09

During the year the Council reduced their debt portfolio by repaying £10.8m prematurely. The Council also rescheduled loans worth £16.2m, to lower the long term interest charges paid on its debt.

5. DEBT RESCHEDULING

5.1 The Debt Rescheduling Strategy for 2008/09

The Council's strategy suggested that opportunities may exist for restructuring long term debt to produce savings.

Any rescheduling would take place in order to reduce the Council's overall exposure to the risk of interest rate movements, to lower the long-term interest charges paid on its debt, to smooth the maturity profile without compromising the overall longer-term stability, or to alter its volatility profile (i.e. exposure to variable rate debt).

5.2 Actual Debt Reschduling Activity

Rescheduling opportunities arose in 2008/09, and the Council rescheduled eight loans in July 2008. The Council also prematurely repaid a further two loans in January 2009.

Premature debt repayment not linked to refinancing provides a means of reducing the Council's exposure to credit risk, as physical repayment of debt reduces the level of cash available for investment. This may be appropriate where returns on investment are lower than the combination of coupon interest on debt and premiums or discounts incurred on premature redemption.

The following loans were repaid / borrowed :

Loans repaid/rescheduled

Date	Lender	Principal £	Rate %	Period outstanding (years)	(Premia Paid)/ Discount Received £
28/07/08	PWLB	£267,207	10.750%	3	(£22,619)
28/07/08	PWLB	£114,517	10.875%	1	(£7,514)
28/07/08	PWLB	£2,749,000	4.375%	3	£45,887
28/07/08	PWLB	£2,707,000	4.250%	3	£55,008
28/07/08	PWLB	£3,000,000	4.875%	6	£12,654
28/07/08	PWLB	£3,000,000	5.000%	12	(£2,793)
28/07/08	PWLB	£3,854,328	4.750%	15	£85,109
28/07/08	PWLB	£500,000	4.500%	16	£24,842
28/01/09	PWLB	£6,292,000	4.625%	19	(£90,666)
28/01/09	PWLB	£4,500,000	4.350%	22	£149,261
		£26,984,052			**£249,169**

Replacement Borrowing:

Date	Lender	Principal £	Rate %	Period of loan (years)
28/07/08	Barclays	£16,200,000	4.22%	70

The above rescheduling achieved a reduction in the overall debt cost. As a result of new borrowing, maturities during the year and debt restructuring activity, the average rate on the Council's debt changed from 6.13% at 31st March 2008 to 6.06% at 31st March 2009.

The Council's portfolio will continue to be reviewed by Arlingclose for debt rescheduling opportunities.

6. INVESTMENTS

The Council held average cash balances of £88.1m during the year. These represent the Council's Balances and Reserves, working cash balances and also where physical borrowing has been drawn down in advance of capital expenditure being incurred.

The Council manages its investments in-house and invests with the institutions listed in the Council's list of authorised counterparties. The Council invests for a range of periods from overnight up to 1 year (or up to 3 years until February 2009), dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

6.1 The Investment Strategy for 2008/09

Based on the forecast that base rates would peak at 5.25% in Q1 2008 then fall to 5.00% in Q2 2008 and remain at that level until early 2010, the Council sought to lock in longer period investments at higher rates before this fall started for that element of its investment portfolio which represents its core balances.

6.2 Actual Investment Activity in 2008/09

Detailed below is the result of the investment strategy undertaken by the Council during the year.

	Rate of Return Achieved by Gwynedd	**Benchmark Return***
Internally Managed	5.10%	3.53%
Externally Managed	n/a	3.59%

The financial value of the difference between the Council's rate of return and the benchmark return for internally managed funds was £1,401,722 (the above returns do not include investments made in the Heritable Bank, which is dealt with below).

During the year 356 investments were made. The Council's Investment Unit had an internal target of investing 100% of the money in institutions with a credit rating of A- or above. The unit achieved that target in 2008/09. The actual percentages were as follows:

Credit Rating	**Percentage**
AA+	36%
AA	6%
AA-	43%
A+	2%
A	10%
A-	3%
TOTAL	**100%**

Despite the priority given to security of the money (rather than maximising interest received), risks still exist.

In early October 2008 all three of Iceland's major banks (Glitnir, Kaupthing and Landsbanki) collapsed. In the UK, the Financial Services Authority (FSA) put Kaupthing, Singer & Friedlander (the UK subsidiary of Kaupthing) and Heritable Bank (the UK subsidiary of Landsbanki) into administration. The Administrators are seeking to find purchasers for, and will continue to manage, the banks' businesses and loan books to maximize recovery for creditors. The process of administration will determine the extent of any recoverable amount and also the timescale over which any such payments will be made.

This Council had deposits of £4m with the Heritable Bank. The creditor progress report issued by the administrators Ernst and Young, dated 17 April 2009, outlined that the return to creditors was projected to be 80p in the £ by the end of 2013, and the first dividend payment of 16.13p in the £ was paid on 30 July 2009. The Council has therefore decided to recognise an impairment based on it recovering 80p in the £. If relevant economic conditions improve over this period of time (primarily, if property values increase by 2013), it is possible that the final recovery could be higher than that shown above.

As a result of the banking crisis, confidence in the markets was extremely fragile and counterparty risk was at its most elevated. The Council responded by restricting new lending to UK institutions which could avail of the Government's 2008 Credit Guarantee Scheme and with long-term ratings in the 'AA' category. Only eight institutions met this criteria. They were: Abbey National, Barclays Bank, Clydesdale Bank, HSBC Bank, Lloyds TSB Bank and Bank of Scotland (both part of the Lloyds Banking Group), Nationwide Building Society and Royal Bank of Scotland.

All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits.

7. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the limits set out in the Council's Treasury Policy Statement and Treasury Strategy Statement.

8. RECOMMENDATION

The Audit Committee is asked to accept the report for information.