MEETING:	**AUDIT COMMITTEE**
DATE:	**27 SEPTEMBER 2010**
TITLE:	**TREASURY MANAGEMENT 2009/10**
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. It is considered that the Audit Committee is the appropriate body to consider this report.

This report compares our actual performance for 2009/10 against the strategy which was set out in February 2009, for the financial year (approved by the full Council at its meeting of 26/02/2009). The report looks at:

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

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 2010		31 March 2009	
		Principal	**Rate**	**Principal**	**Rate**
Fixed Rate Funding	- PWLB*	£121.3m	6.38%	£121.7m	6.22%
	- Market	£16.2m	4.11%	£16.2m	4.11%
Variable Rate Funding	- PWLB*	£0.0m		£0.0m	
	- Market	£0.0m		£0.0m	
Total Debt		**£137.5m**	**6.13%**	**£137.9m**	**6.06%**
Investments		£59.5m	1.48%	£71.7m	5.1%
Total Investments		**£59.5m**	**1.48%**	**£77.1m**	**£71.7m**

***PWLB – Public Works Loan Board**

3. INTEREST RATES

ArlingClose Limited our 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 1.0% in February 2009. It was expected that the base rate would remain at 1.0% until Q2 2010, when it was expected to rise gently until it reached 4.0% in Q1 2012.
- **Long Term Rates** – The 50 year Public Works Loan Board (PWLB) rate was expected to remain around the 3.8-3.9% levels until Q2 2010 when it was forecast to rise to 4.0%. The rate was then expected to rise gradually to 5.0% by Q1 2012.

3.2 Actual Result

During 2009/10 actual interest rates were as follows:

- **Short Term Rates –** 2008 had seen the worst upheaval in credit and financial markets for some decades and the economic recession and the severe downturn in growth extended into early 2009. The depth of the recession was evident by the 5.9% year-on-year fall in Gross Domestic Product recorded at the end of the second quarter of 2009. In order to stimulate growth the Bank of England maintained the base rate at 0.5% throughout the year. The Bank also tried to revive the economy through its £200 billion Quantitative Easing (QE) Programme. The increased supply of money into the system due to QE did not translate into an increase in the movement of money in the system as banks were still unwilling to lend and consumers were unwilling to lend at pre-crisis levels. Companies and households on the whole reduced rather than increased their levels of debt. However, signs of a recovery were finally evident in the final quarter of 2009 with growth registering at 0.4% for the quarter. The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by high unemployment. Cuts in public spending and tax increases were finally becoming inevitable.
- **Long Term Rates -** The PWLB 49½-50 year rate started the year at 4.53% and ended the year at 4.69%. The high point during the year was 4.85% in June 2009 and the lowest was 4.18% in October 2009.

4. BORROWING

4.1 The Borrowing Strategy for 2009/10

During the year it was expected that the base rate would be at a historical low. This gave authorities an opportunity to review their strategy of undertaking external borrowing. For authorities with investments in excess of their borrowing requirement, the potential merits of internal borrowing had to be considered. With long term borrowing rates expected to be higher than investment rates, many authorities were expected to avoid all new borrowing.

Based on the prospect for interest rates, the Council's strategy for the year was to run down its investments which had the benefit of reducing exposure to credit risk.

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 2009/10.

The Council decided not to borrow long-term monies to finance its capital spending. Instead it decided to internally borrow and in doing so reduced treasury risk by running down its investments. The Council recognises that utilising investments in lieu of borrowing clearly has a finite duration and that future borrowing will be required to support capital expenditure. This will be kept under review in 2010/11.

5. DEBT RESCHEDULING

5.1 The Debt Rescheduling Strategy for 2009/10

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).

Debt rescheduling became more challenging after the introduction by the PWLB of a separate, lower set of repayment rates in November 2007. This increased the costs associated with the premium payable and diminished the discount receivable, thus reducing the cost savings achievable.

5.2 Actual Debt Reschduling Activity

As there were no opportunities in 2009/10, the Council did not engage in any debt rescheduling during the year.

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

6. INVESTMENTS

The Council held average cash balances of £79.1m (ranging from £55m to £105m) during the year. These represent the Council's Balances and Reserves, working cash balances of the Council and the Pension Fund 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, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

6.1 The Investment Strategy for 2009/10

Based on the forecast that base rates would remain at 1% until Q2 2010, the Council decided to avoid locking into longer term deals while investment rates were at historically low levels.The Council would therefore keep its investments short term. For its cash flow generated balances, the Council would seek to utilise its business reserve accounts and short-dated deposits (over night to three months) in order to benefit from the compounding of interest.

6.2 Actual Investment Activity in 2009/10

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	1.485%	0.3895%

*** The benchmark for internally managed funds is the 7 day LIBID rate (uncompounded) source from the Financial Times.**

The financial value of the difference between the Council's rate of return and the benchmark return for internally managed funds was £903,023 (the above returns do not include investments made in the Heritable Bank, which is dealt with below).

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.

During the year 504 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 AA- or above. The unit achieved that target in 2009/10. The actual percentages were as follows:

Credit Rating	**Percentage**
AAA	0%
AA+	0%
AA	2%
AA-	98%
A+	0%
A	0%
A-	0%
TOTAL	**100%**

These credit ratings range from AAA (gilts) through A, B, C down to D (credit default).

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

As previously reported this Council had deposits of £4m with the Heritable Bank. The latest creditor progress report issued by the administrators Ernst and Young, outlined that the return to creditors was projected to be 85p in the £ by the end of 2012. Heritable Bank's administrators have already paid four dividends to creditors:

16.13 pence in the £ on 28 July 2009;
12.66 pence in the £ on 18 December 2009;
6.19 pence in the £ on 30 March 2010;
6.27 pence in the £ on 16 July 2010.

So far the Council has received a return of £1,657,867 from the administrators. Of course the actual loss by 2012 could be more or less than predicted. If the economic situation improves and property values in particular increase, there could be no loss at all.

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 Management Strategy Statement.

8. RECOMMENDATION

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