Annex 1

TREASURY MANAGEMENT AND INVESTMENT STRATEGY REVIEW 2009/10

1.1 Introduction and Background

1.1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 18 February 2010 and this Council fully complies with its requirements. 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 / Council of an annual 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.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

1.1.2 Treasury management in this context 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. "

1.1.3 This annual treasury report covers:

- The Council's treasury position at 31 March 2010.
- Performance measurement.
- The strategy for 2009/10.
- The economy and reality for 2009/10.
- Borrowing and investment rates in 2009/10.
- The borrowing outturn for 2009/10.
- Compliance with treasury limits and prudential indicators.
- Investment outturn for 2009/10

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§ Icelandic investment.

1.2 Treasury Position at 31 March 2010

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

	31st March 2010 £m	Rate/ Return %	Average Life yrs	31st March 2009 £m	Rate/ Return %	Average Life yrs
Variable Rate Funding:						
- Overdraft	£nil	N/A	N/A	£nil	N/A	N/A
Total Debt	**£nil**	**N/A**	**N/A**	**£nil**	**N/A**	**N/A**
Fixed Rate Investments:						
In-House-Cash flow	2.85	0.80	0.01	1.29	1.18	0.01
In-house-Cash flow - Landsbanki	1.00	See para 1.10 below		1.00		
In-House - Core	5.00	6.65	1.23	10.00	6.16	1.27
Fund Managers	16.57	0.73	0.23	14.46	1.66	0.44
Variable Rate Investments:						
- In-House and Externally Managed	Nil			Nil		
Total Investments	**25.42**	**1.87**	**0.41**	**26.75**	**3.26%**	**0.74**

1.3 Performance Measurement

1.3.1 One of the key changes in the revision of the Code in 1996 was the formal introduction of performance measurement relating to investments, debt and capital financing activities. The use of benchmarks for investments is appropriate to a portfolio of our size and these have been well developed and universally accepted.

1.4 The Strategy for 2009/10

1.4.1 The Sector recommended treasury strategy for 2009-10 was based on the view that there was an intensifying global recession which would not only require central bank rates to be cut to unprecedented historically low levels, but could also require further action from central banks to reverse the downward path of economies.

1.4.2 Bank Rate was expected to continue falling from 2.0% in December 2008 to 0.5% in March 2009 and then stay there throughout 2009/10 before starting to rise in the second quarter of 2010. However, there was a downside risk to this forecast if the recession proved even deeper and longer than expected at that time; this would mean that the first rise in Bank Rate would be delayed.

1.4.3 The effect on interest rates for the UK was therefore expected to be as follows:

- Shorter-term interest rates - The “average” City view anticipated that Bank Rate would fall to 0.5% and remain there at the end of 2009 due to the scale of the recession before starting to rise back towards more normal levels in 2010, though it would be 2012 before Bank Rate returned to around 4.5%.

- Longer-term interest rates - The view on longer-term fixed interest rates, 50 years, was that they would remain around 3.90 – 3.95% during 2009/10 with the 25 year rate being about 10 – 15 basis points (bps) higher.

1.4.4 The strategy adopted by the Council based upon the above forecast was to:

- scale back the size of the portfolio managed by the in-house team by transferring funds on maturity to our external fund manager, thereby reducing the level of funds being managed in-house from £10 to £5m at 31 March 2010;

- use 5 to 7 year AAA rated supranational bonds via the external fund manager to improve returns in a low interest environment and as a means of providing certainty of return; and to

- use business accounts, money market funds and short-dated deposits (1-3 months) in order to benefit from the compounding of interest.

1.4.5 The major issue for treasury management in 2009-10 turned out to be the huge difference between investment rates and borrowing rates that emerged during this recession due to: -

- the unprecedented fall in Bank Rate

- the disappearance during the year of the margins over more normal investment rates caused by the credit crunch as the Bank of England’s quantitative easing operations had the desired effect of easing the supply and cost of credit in the economy during 2009.

- A further strong theme has been the major emphasis on mitigating risk by giving heightened preference to security and liquidity at a time when the world banking system was still under stress and pending the issue, later in 2009, of new CIPFA and statutory guidance on investing. This has therefore resulted in more of our investment portfolio being moved into investment instruments with lower rates of return but higher security and liquidity. This has compounded the significant fall in total investment earnings compared to previous years.

1.4.6 The mitigation of risk, including that in respect of counter parties, groups, sovereign states and instruments, as referred to in the bullet point immediately above was addressed through the adoption of amendments to the Treasury Management Strategy Statement and Investment Strategy in September and October 2009.

1.5 The Economy and Reality for 2009/10

1.5.1 During 2009/10 the Monetary Policy Committee (MPC) was focused on helping the economy to turn around from plunging into the deepest and longest recession the UK economy had experienced for many years.

1.5.2 Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year, the MPC also had to resort to extreme measures in terms of pumping liquidity into the economy through quantitative easing by purchasing £200bn gilts and corporate bonds. This had the effect of boosting prices for gilts and corporate bonds and therefore bringing down yields, so also reducing borrowing costs for both the corporate and public sector.

1.5.3 It was notable that the increase in money supply in the economy generated by this programme brought the credit crunch induced spread between Bank Rate and 3 month LIBID (investment rate that depositors could earn) down from 0.95% at the beginning of the financial year to zero during August 2009.

1.5.4 The dominant focus in 2009/10 was on quarterly GDP growth figures. The recession bottomed out in quarter 1 of 2009. There was then major disappointment that the end of the recession failed to materialise in quarter 3 2009 but the fourth quarter of 2009 did then see economic growth return at +0.4%.

1.5.5 Inflation has not been a major concern of the MPC as it fell back below the 2% target level from June to November. However, it did spike upwards to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as this spike was expected to fall out of the inflation index and inflation was forecast by the Bank of England to fall back under target by the end of 2010.

1.6 Borrowing and Investment Rates in 2009/10

1.6.1 At the start of 2009-10, investment rates were enhanced by a substantial credit crunch induced margin. However, the Bank of England's quantitative easing operations had the desired effect of improving the supply of credit in the economy and so these margins were eliminated by half way through the year. Consequently, investment rates fell markedly during the first half of the year

1.6.2 During the year rates moved as follows:

- Overnight rates varied little during the year within a range of 0.38 – 0.49%.
- The 3 month rate fell gradually from a high point for the year of 1.50% on 1.4.09 to reach a low of 0.42% in September before finishing the year at 0.52%.
- The 12-month rate: started the year at a credit crunch enhanced rate of 1.85% and fell steadily until reaching 0.85% in September. Since then it has risen to finish the year at 1.15% as the market looked ahead to when the MPC would have to start raising Bank Rate from its current rate of 0.50%.

1.6.3 A table showing the movements of investment rates during the year is shown below:

	INVESTMENT RATES 2009-10					
	Overnight	7 Day LIBID	1 Month	3 Month	6 Month	1 Year
01-Apr-09	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
31-Mar-10	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
High	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
Low	0.38%	0.38%	0.38%	0.42%	0.61%	0.96%
Average	0.40%	0.42%	0.47%	0.73%	0.94%	1.29%
Spread	0.12%	0.17%	0.51%	1.09%	1.13%	0.97%
high date	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009
low date	09/09/2009	02/10/2009	18/09/2009	29/09/2009	29/09/2009	28/09/2009

1.6.4 Although this authority is debt free it is worth noting that borrowing costs also remained low throughout the year as is illustrated in the table below:

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	PWLB BORROWING RATES 2009/10 for 1 to 50 years								
	1	2	3	4	5	10	25	50	1 month variable
1. 4.2009	0.83%	1.41%	1.89%	2.26%	2.54%	3.36%	4.28%	4.57%	0.80%
31.3.2010	0.83%	1.41%	1.95%	2.45%	2.89%	4.19%	4.67%	4.70%	0.65%
HIGH	1.20%	1.91%	2.48%	2.94%	3.29%	4.42%	4.83%	4.85%	0.80%
LOW	0.68%	1.29%	1.79%	2.20%	2.47%	3.30%	4.07%	4.18%	0.55%
spread	0.52%	0.62%	0.69%	0.74%	0.82%	1.12%	0.76%	0.67%	0.25%
average	0.90%	1.53%	2.08%	2.53%	2.90%	3.93%	4.49%	4.51%	0.63%
high date	09/06/2009	12/06/2009	12/06/2009	24/07/2009	28/07/2009	22/02/2010	22/02/2010	02/06/2009	01/04/2009
low date	16/09/2009	09/10/2009	09/10/2009	02/04/2009	02/04/2009	02/04/2009	09/10/2009	09/10/2009	17/07/2009

1.7 Treasury Borrowing for 2009/10

1.7.1 In accordance with the Treasury Management Strategy borrowing was limited to use of the bank overdraft to support cash flow. Such borrowing was undertaken on a daily basis and was within the £2.0m limit set within the Treasury Management and Investment Strategy adopted by the Council in February 2009.

1.8 Compliance with Treasury Limits and Prudential Indicators

1.8.1 Throughout the financial year the Council operated within the treasury limits and prudential indicators set out in the Council's Treasury Management and Investment Strategy.

1.8.2 These and other prudential indicators relevant to this report are shown at **[Appendix 1]**.

1.9 Investment Outturn for 2009/10

Overall investment strategy

1.9.1 Pending the issuance of revised CIPFA and statutory investment guidance expected towards the end of the year, and in the light of continuing stresses on the world banking system, enhanced priority was given to security and liquidity in order to reduce counterparty risk to the maximum possible extent. Accordingly, some of the internally managed cash flow surpluses and core investment were moved into lower earning externally managed short term investment instruments due to their lower level of counterparty risk.

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Internally managed investments

1.9.2 The Council manages its short term cash flow surpluses and a small proportion of core investments in-house and invests only with those institutions listed in the Council's approved lending list and within the approved sovereign, group, counter party and durational limits.

1.9.3 As a consequence of moving maturing core and cash flow funds available for longer than 3 moths to the external fund manager, the in-house team was left to manage only short term deposits. These were invested principally in call accounts, which offered significantly better returns than short term time deposits and money market funds on an overnight basis, thereby minimising liquidity risk.

1.9.4 Returns achieved on internally managed cash flow and core investments significantly bettered the 7 day Libid target rate of 0.45% by 0.32% and 5.79% respectively. Please refer to paragraph 1.9.9 below for the detailed performance figures for the year.

Externally managed funds

1.9.5 The Council has investments managed externally by Investec Asset Management Ltd. 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 therein.

1.9.6 During the year the continuance of abnormally low interest rates resulted in the duration of the portfolio shortening from 0.44 years to 0.23 years as longer term high coupon CDs matured and were principally initially replaced with shorter term CDs and call account deposits in order to compound returns.

1.9.7 Towards the end of the year it was felt that UK Government Bills offered an opportunity to add value to the fund and as a consequence the fund held just over £7.6m in this instrument at the year end.

1.9.8 The overall return for the financial year was boosted by the unrealised gains brought forward from 2008/09 and exceeded the 7 day Libid benchmark of 0.45% by 1.83%. Please refer to paragraph 1.9.9 below for the detailed performance figures for the year.

Investment performance 2009/10

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1.9.9 The actual results for the three parts of our portfolio are summarised in the table below:

	Average investm't £m	**Investm't income achieved £**	**Gross rate of return**	**Net rate of return**	**Benchmark return**
Internally Managed Cash Flow	£5.6m	£39,800	0.77%	N/A	0.45%
Internally Managed Core Investments	£9.1m	£566,800	6.24%	N/A	0.45%
Externally Managed Core Investments	£18.9m	£428,850	2.28% inclusive of unrealised gains b/f	2.13%	0.45%

1.9.10 It was pleasing to note that in such a difficult environment over the course of the year a return of £1.035m (including unrealised gains b/f from 2008/09) was achieved against an original estimate of £0.90m and a revised estimate of £0.93m.

1.10 Icelandic Bank Defaults

1.10.1 This authority continues to have a defaulted £1m cash flow Landsbanki investment frozen in Iceland. The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed into receivership and the U.K. Government is working with the Icelandic Government to help bring this about. At the current time, the process of recovering assets is still ongoing with the Administrators.

1.10.2 The Local Government Association is continuing to coordinate the efforts of all UK authorities with Icelandic investments and members will be periodically updated via the Finance and Property Advisory Board and the Audit Committee on the latest developments.

1.10.3 The Government, the National Assembly of Wales and the Scottish Parliament have all issued regulations to allow local authorities to delay recognising any loss on these investments that may eventually be incurred until the financial year 2010-11. This authority was given the option to make an application for capitalisation of losses but because of the adequacy of Reserves considered that it was not necessary to do so.

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1.10.4 Costs associated with the recovery process amounted to £2,700 for the year. This figure was in line with expectations and was funded from existing budget provision.

TABLE 1: PRUDENTIAL INDICATORS	**2008/09**	**2009/10**	**2009/10**
Extract from budget and rent setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	£3,687	£4,709	£3,941
HRA (applies only to housing authorities)	N/A	N/A	N/A
TOTAL	**£3,687**	**£4,709**	**£3,941**
Ratio of financing costs to net revenue stream			
Non - HRA	**-14.22%**	**-6.24%**	**-7.27%**
HRA (applies only to housing authorities)	N/A	N/A	N/A
Net borrowing requirement			
brought forward 1 April	£Nil	£Nil	£Nil
carried forward 31 March	£Nil	£Nil	£Nil
in year borrowing requirement	**£Nil**	**£Nil**	**£Nil**
Capital Financing Requirement as at 31 March			
Non – HRA	£Nil	£Nil	£Nil
HRA (applies only to housing authorities)	N/A	N/A	N/A
TOTAL	**£Nil**	**£Nil**	**£Nil**
Annual change in Cap. Financing Requirement			
Non – HRA	£Nil	£Nil	£Nil
HRA (applies only to housing authorities)	N/A	N/A	N/A
TOTAL	**£Nil**	**£Nil**	**£Nil**
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**

Increase in council tax (band D) per annum	£0.31	£0.40	£0.40
Increase in average housing rent per week (housing authorities only)	N/A	N/A	N/A

TABLE 2: TREASURY MANAGEMENT INDICATORS	**2008/09**	**2009/10**	**2009/10**
	actual	**original**	**actual**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt -			
borrowing	£2,600	£5,000	£305
other long term liabilities	£Nil	£Nil	£Nil
TOTAL	**£2,600**	**£5,000**	**£305**
Operational Boundary for external debt -			
borrowing	£2,600	£2,000	£305
other long term liabilities	£Nil	£Nil	£Nil
TOTAL	**£2,600**	**£2,000**	**£305**
Actual external debt	**£Nil**	**£Nil**	**£Nil**
Upper limit for fixed interest rate exposure > 1 year at year end	**£6,400**	**£5,000**	**£2,500**
Upper limit for variable rate exposure < 1 year at year end	**£19,700**	**£18,700**	**£22,700**
Upper limit for total principal sums invested for over 364 days at year end	**£6,400**	**£5,000**	**£2,500**

Maturity structure of new fixed rate borrowing during 2009/10	upper limit	lower limit

under 12 months	100%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%