Report No. DR10049	London Borough of Bromley	Agenda Item No.

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 14th July 2010**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT PERFORMANCE - 4TH QUARTER 2009/10 & ANNUAL REPORT 2009/10**
Contact Officer:	Martin Reeves, Group Accountant (Technical) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Paul Dale, Director of Resources
Ward:	All

1. Reason for report

1.1 This report summarises treasury management activity during the March quarter and includes the Treasury Management Annual Report for 2009/10, which is also required to be reported to full Council. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.12).

RECOMMENDATION(S)

2.1 The PDS Committee is asked to scrutinise the proposed decision by the Resources Portfolio Holder; and

2.2 The Resources Portfolio Holder is recommended to note the actual prudential indicators for 2009/10, approve the Treasury Management Annual Report for 2009/10 and agree that it be referred to Council.

Corporate Policy

1. Policy Status: Existing policy. To seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £4.423m (net) in 2009/10; £2.923m (net) in 2010/11

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.6 fte

2. If from existing staff resources, number of staff hours:

Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 The annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity during 2009/10 and the actual Prudential Indicators for 2009/10. The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003. During 2009/10, the minimum reporting requirements were that the Council receive an annual treasury strategy in advance of the year and an annual report following the year describing the activity compared to the strategy (this report). In practice, the Director of Resources has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year.

Treasury Performance in the Quarter and Year Ended 31st March 2010

3.2 **Borrowing:** There was no borrowing during the March quarter. The following table sets out details of borrowing activity during the period 1st April 2009 to 31st March 2010.

Short-term loans	Principal £m	Ave. Rate %
Balance as at 31/3/09	2.3	0.45
Loans raised 1/4/09 to 31/03/10	9.3	0.35
Loans repaid 1/4/09 to 31/03/10	-11.6	-
Balance as at 31/03/10	-	-

3.3 Only 4 loans were taken out in the whole of 2009/10, all in June 2009, for an average period of 3 days and at an average rate of 0.35%. This compares with the average bank base rate of 0.5% during the year. The maximum permitted total of borrowing at any one time is £30m and Council borrowing peaked at £3.7m in June.

3.4 **Investments:** The following table sets out details of investment activity during the March quarter and over the whole year:-

	March Qtr		Year 2009/10	
Main investment portfolio	**Deposits £m**	**Ave. Rate %**	**Deposits £m**	**Ave. Rate %**
Balance as at 31/12/09	131.5	3.50		
Investments made in Q4 2009/10	61.0	1.48	219.0	1.37
Investments redeemed in Q4 2009/10	-52.5	3.72	-209.0	3.88
Total "Core" Investments 31/03/10	140.0	3.21		
Heritable deposit - frozen	5.0	6.42		
Money Market Funds/Instant Access	2.5	0.85		
Total Investments as at 31/03/10 *	**147.5**	**3.28**		

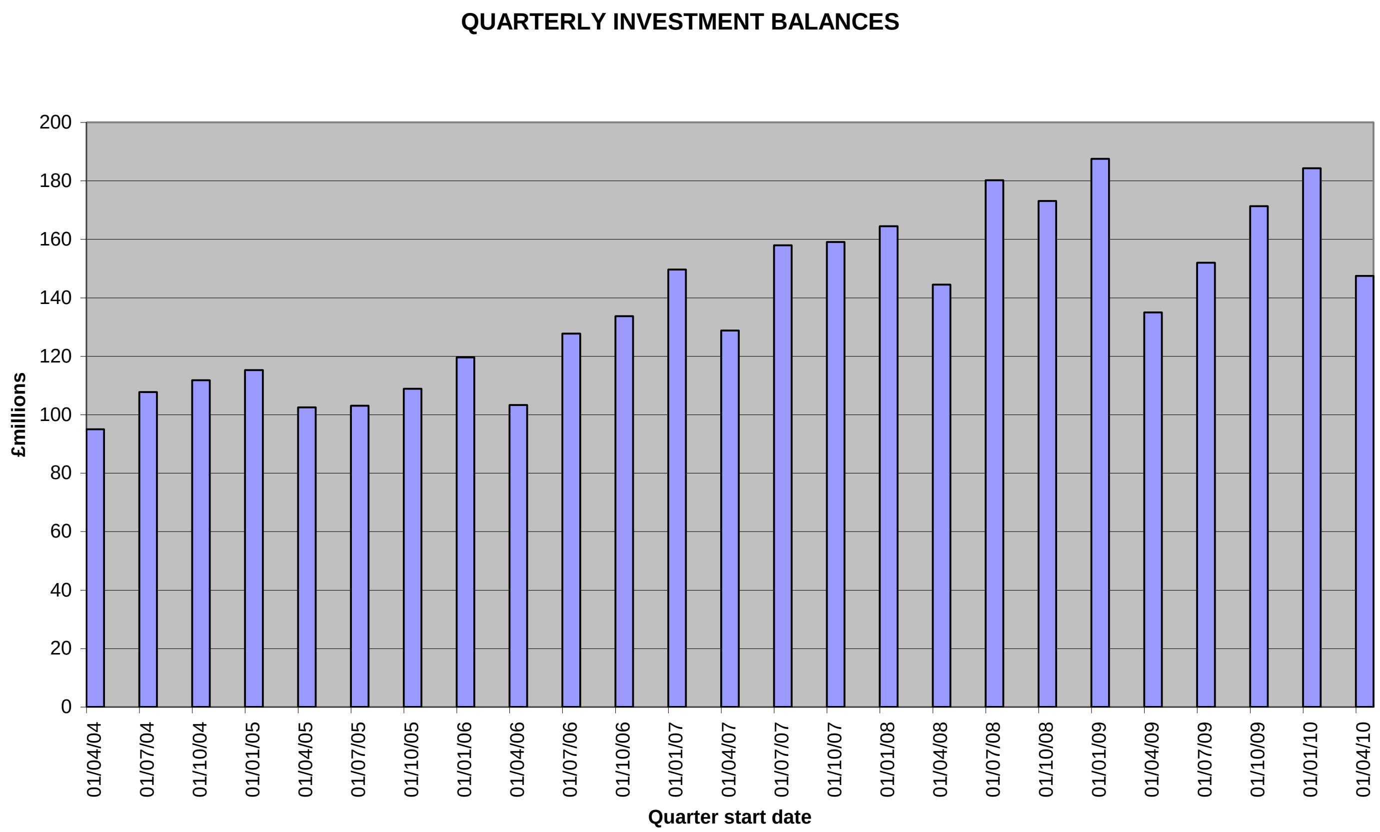
* Includes investment with Icelandic subsidiary, Heritable Bank (see para 3.12 for latest position)

3.5 Details of the outstanding investments at 31st March 2010 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the March quarter was 1.48% which may be compared with the average 3 month LIBID rate of 0.51% and the average 7 day rate of 0.40%. With regard to the whole of 2009/10, an average return of 1.37% was achieved on new investments compared to the average 3 month LIBID rate of 0.72% and the average 7 day rate of 0.42%.

3.6 Base rate has remained at 0.5% since March 2009. Market rates at the beginning of April 2009 stood at around 1.5% for 3 months and 2.1% for 1 year. Similar rates are still available for the longer period, but only with building societies that are no longer eligible counterparties following credit rating downgrades in recent months. Most of the institutions that remain on our lending list at this time are offering around 0.6% for 3 months up to 1.2% for 1 year. Better rates (around 1% for 3 months up to 1.8% for a year) have been available from other eligible counterparties, most notably Lloyds TSB. In February 2010, the Portfolio Holder agreed changes to the Council's investment strategy, which permitted investment for up to 2 years with the largely-government owned Lloyds TSB and Royal Bank of Scotland (since November 2008, investments had been limited to a maximum period of 1 year). In practice, most investments placed during 2009 were for 3 months or for shorter periods in instant access money market funds, but, in consultation with our external advisers, the Director of Resources has taken advantage of longer-term opportunities as much as possible.

3.7 Credit ratings changes, particularly since the Icelandic banking crash in October 2008, resulted in the removal of many of our established counterparties from our lending list and it has since been difficult to identify institutions to place money with. As a result, much greater use has been made of Money Market Funds, which provide a safe haven and instant access, but offer considerably lower interest rates.

3.8 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years.



Other accounts

3.9 Money Market Funds

The Council currently has 6 Money Market Fund accounts, with Aviva, Fidelity, Prime Rate, Insight, Blackrock and Ignis. The Prime Rate, Blackrock and Ignis accounts were opened during 2009/10 in order to provide a degree of added flexibility and following consultation with our external advisers. In common with market rates for fixed-term investments, interest rates on money market funds have also fallen considerably. In November 2008, Aviva changed the valuation arrangement for its fund, moving from a constant net asset value of £1 per share to a mark-to-market basis (i.e. a variable net asset value). The Director of Resources has not invested in the fund at all since then and will not do so while this valuation arrangement continues, as there is a potential for loss of principal sums. Following the changes to the investment strategy approved by Council in October 2009 and again in February 2010, investments were moved away from money market funds into money market deposits, but we are now once again fully invested with eligible counterparties and the balance of deposits held in money market funds has again increased.

Money Market Fund	Date Account Opened	Ave. Rate 2009/10	Ave. Daily Balance 2009/10	Actual Balance 31/3/10	Actual Balance 15/06/10	Current Rate 15/6/10
		%	£m	£m	£m	%
Prime Rate	15/06/09	1.03	10.7	2.5	15.0	0.85
Ignis	25/01/10	0.64	1.1	-	15.0	0.60
Insight	03/07/09	0.61	4.6	-	-	0.49
Blackrock	16/09/09	0.58	3.4	-	-	0.47
Fidelity	20/11/02	0.62	2.7	-	-	0.40

3.10 35-day Notice Account

During 2009/10, the Council also placed a further £15m in a 35-day notice account with Svenska Handelsbanken (Sweden). An initial deposit of £7.8m was made in July, followed by a further £7.2m in August and the investment earned interest at a rate of 1.25% between 15th July and 31st August before the rate reduced to 1% on 1st September 2009 and then to 0.7% on 1st October. The funds were withdrawn in March 2010 and an average return of 0.82% was achieved in the year on an average daily balance of £9.5m. Since the end of 2009/10, the £15m has been re-invested and is currently earning 0.85%.

3.11 External Cash Management

External cash managers, Tradition UK Ltd and Sterling International Brokers Ltd, were both appointed to manage £10m of our cash portfolio in August 2003. The Portfolio Holder agreed, in February 2010, that the arrangement with one of the two external cash managers, Sterling International Brokers Ltd, be terminated and that their £10m fund be transferred as investments mature to Tradition UK, bringing their total up to £20m. This followed a detailed review of the relative performance of both cash managers and the Council's in-house treasury team. In 2009/10, Tradition UK achieved a return of 4.23% and their returns will be closely monitored in future quarters as the remaining investments previously managed by Sterling mature. Both managers, like the Council's in-house team, have been constrained by strategy changes approved after the Icelandic Bank crisis. Details of externally managed funds placed on deposit as at 31st March 2010 are shown below.

Sum	Start Date	Maturity	Period	Rate
Tradition UK				
£3m	29/08/08	30/09/10	2 years	6.10%
£4m	10/11/09	10/05/10	6 months	0.89%
£2.5m	17/02/10	17/05/10	3 months	1.14%
£5m	17/02/10	17/08/10	6 months	1.35%
Sterling				
£1m *	27/05/08	27/05/10	2 years	6.56% (interest on maturity)
£1m *	10/09/09	10/09/10	1 year	1.35%
£1m *	30/06/09	30/06/10	1 year	2.00%
£2.5m *	09/11/09	09/11/10	1 year	1.20%

* to be reinvested by Tradition on maturity

3.12 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. The administrators, Ernst & Young, have recently declared an improved estimate of the likely return in relation to our claim (from between 75% and 80% to between 79% and 85%, but there is reason to be hopeful for an even better result. An initial dividend of 16.13p in the pound (£820k) was paid to the Council in July 2009 and further dividends of 12.66p (£644k) and 6.19p (£315k) were received in December 2009 and March 2010 respectively. As a result, nearly 35% of our claim has been returned to us so far.

For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in the year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund.

Performance measurement

3.13 Information on performance measurement is reported annually and the data for 2008/09, provided by Butlers, the Council's treasury advisors, was reported at the February 2010 meeting. The 2009/10 results will be reported as soon as they are available.

Actual prudential indicators for 2009/10

3.14 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2009/10 were approved by the Executive and the Council in February 2009 and Appendix 3 sets out the actual performance against those indicators.

Economic Background for 2009/10

3.15 Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, UK GDP data for the first half of 2009 registered its sharpest fall for over 20 years.

3.16 It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more 'normal' behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor US banks continued to fail and the troubles of a number of building societies continued to make the headlines.

3.17 The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle was passed during the third quarter of the year but the return to positive growth proved stubborn; for the UK this would not materialise until the fourth quarter of 2009.

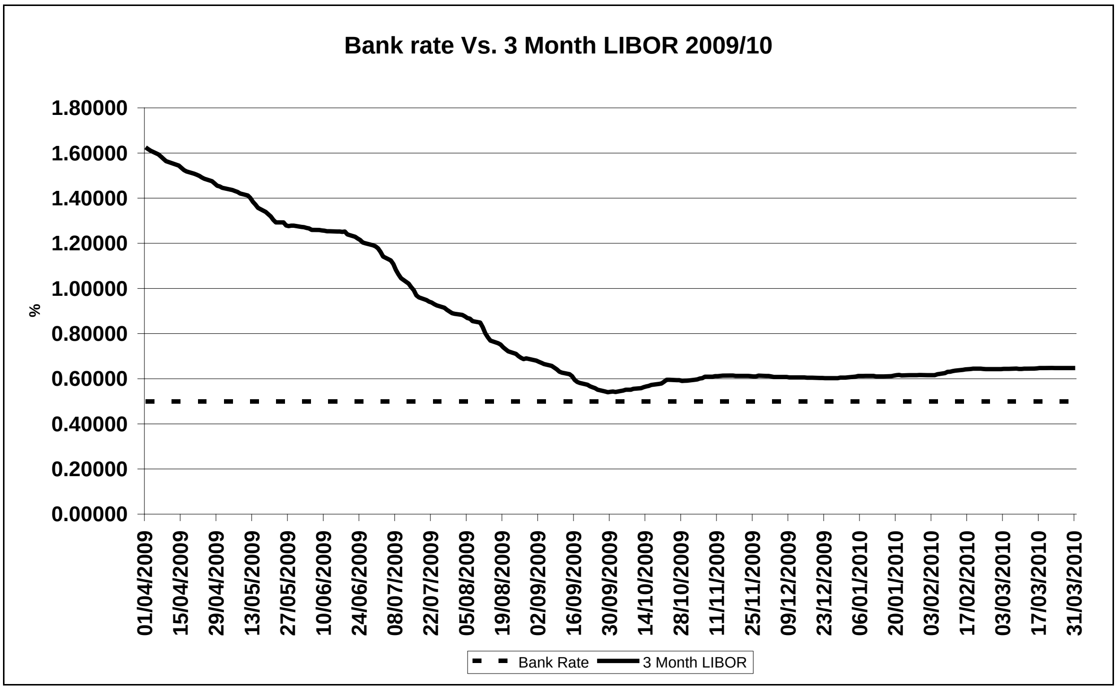
3.18 Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector's striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

3.19 The bias of MPC decisions remained directed towards policy ease throughout the year. As official interest rates had been reduced to near-zero (0.5% Bank Rate) in March 2009, monetary relaxation took the form of the extension of the Quantitative Easing programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November.

3.20 The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between LIBOR and LIBID rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

3.21 Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The Quantitative Easing programme was the principal source of market support. The large-scale purchasing of stock that this element of monetary policy required meant the Bank of England was to absorb virtually all of the year's supply.

3.22 Nevertheless, the programme was not sufficient to drive yields below the low point seen immediately after the inauguration of the QE programme in March 2009. Long-term rates remained generally erratic, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end. Indeed, yields returned to a rising trend once QE drew to a close in January 2010.



Regulatory Framework, Risk and Performance

3.23 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.24 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 These are contained in the body of the report. An average rate of interest of 3.08% was achieved in 2009/10, including 1.37% on all "core" investments actually placed during the year (compared to the budget assumption of 1.75%). The final outturn for net interest on investments and borrowing in 2009/10 was £6.5m against a budget of £4.4m, a surplus of £2.1m. This included £1.6m in respect of outstanding VAT claims payable to the Council and £0.3m in respect of the part-reversal of the impairment adjustment made in 2008/09 on the Council's investment with Heritable.

5.2 With regard to 2010/11, a rate of 1.5% has been assumed for interest on new investments in the 2010/11 revenue budget, in line with the latest estimates provided by the Council's two external treasury advisers. Rates are expected to rise after 2010, however, and the latest financial forecast assumes 2.5% in 2011/12, 4.0% in 2012/13 and 4.5% thereafter. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £0.2m in 2010/11 and £0.4m thereafter. The latest forecast for 2010/11 is that the budget of £2.92m will be achieved.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments Capital Outturn 2009/10 report to Executive 16/6/10 External advice from Butlers and Sector