Item No 8.

By:	Director of Finance
To:	Governance and Audit Committee – 29 June 2007
Subject:	**TREASURY MANAGEMENT ANNUAL REVIEW**
Classification:	Unrestricted

Summary: To report on treasury management activity in 2006-07.

FOR INFORMATION

INTRODUCTION

1. The purpose of this report is to review the main aspects of treasury management activity during the year in accordance with the CIPFA Code of Practice on Treasury Management.

2. Treasury Management is a key aspect of KCC's finances due to:

   (1) The governance and control issues related to the large sums invested and borrowed.

   (2) The criticality of investment income and reducing borrowing costs for KCC's revenue budget.

   This is an area where good management can make a real difference to the Council's finances.

LONG TERM BORROWING

3. Borrowing

(1) In 2006-07 borrowing totalled

Date	Amount £m	Interest Rate %	Period of Loan Years	Source	Type
25/04/06	20	3.7	50	DEPFA Dublin	Market LOBO
31/08/06	10	4.2	48	PWLB	
3/11/06	20	4.1	36.5	PWLB	
6/11/06	10	4.1	41.5	PWLB	
10/3/07	10	4.3	42.5	PWLB	
Total	**70**				

(2) Loans were taken both from the PWLB and the market. The LOBO (lender option, borrower option) have fixed rates for an initial period, after which the lender has the option to increase the rate or we can repay the loan.

(3) Our strategy on borrowing is to spread the borrowing through the year taking advantage of short term fluctuations to borrow advantageously. In 2006-07 there was a rising trend in short term interest rates reflecting strengthening economic activity and rising inflation. The first rise in base rate came in August 2006 with an increase from 4.5% to 4.75% - rates at the end of the year were 5.25%. Long term interest rates (PWLB) broadly followed the upward trend but short term events did create dips and we try to take advantage of these favourable opportunities.

4. Debt Restructuring

(1) As at 31 March 2007 long term borrowing was £952.4m of which £55.5m is attributable to Medway Council.

(2) During the year we were very active in restructuring debt and the work undertaken is summarised in the Appendix 1 and 2.

(3) In total we restructured £124.3m of ‘normal’ debt and this will save annually £505k, and we structured out the stepped LOBO’s totalling £135m freeing up provision of £3.5m making an annual saving of £326k.

5. Performance Summary

Overall the average rate of interest paid in 2006-07 reduced from 5.82% to 5.77% and an underspend of £3,200k was achieved on the total interest cost budget.

INVESTMENTS

6. During 2006-07 we have been able to achieve a substantial improvement in investment returns from 2 main factors:

(1) Improvements in the level of funds available to be invested.

(2) Investing for longer periods.

7. Balances

During 2006-07 the average daily balance increased to £308m compared with £259m in 2005-06 and £242m in 2004-05. This increase reflects a strengthening of the balance sheet and higher short term cashflows.

8. Duration

(1) During the year we undertook a number of deals for over 365 days and these are set out in Appendix 2. We committed substantially more into these arrangements during the year almost doubling the total.

(2) The impact of this strategy on returns will be highlighted when we look at the outcomes of the CIPFA Benchmarking.

9. Performance Summary

The investment return achieved was 4.96% against a 7 day LIBID benchmark of 4.82%.

RISK

10. The Authority has complied with all relevant statutory and regulatory requirements which limit the levels of risk associated with treasury management activities. In particular in our adoption and implementation of the CIPFA Code of Practice for Treasury Management Prudential Code we have ensured that capital expenditure is prudent, affordable and sustainable; and that treasury practices demonstrate a low risk approach.

11. With advice from Butlers, our treasury advisers, we have looked to spread borrowing decisions so that we are not caught out by major unexpected movements. We have continued to borrow at fixed rates utilising long term loans. Short term rates determine investment returns and by their nature are more volatile. We deal directly in the markets on a nearly daily basis and through strict investment limits with counter-parties spread our risk.

CIPFA BENCHMARKING

12. KCC participates in the CIPFA benchmarking group for Treasury Management along with around 90 other Authorities.

13. The key results on investments are:

Performance Compared with All Members

	KCC Return %	Average Return %
Cash Managed In-House (< 365 days)	4.84	4.87
Money on Call	4.79	4.82
Money Market Funds	-	4.67
Callable Deposit	5.23	5.10
Externally Managed Funds	-	4.15
Combined Investments	4.96	4.84

Once again we have beaten the average return by the same amount as last year 12 basis points. Many authorities use External Fund Managers and from the table it is clear that once again they delivered very poor returns.

We do not yet have CIPFA data on our peer group councils but this will be provided when we have the results.

The Combined Investments performance was the 9^{th} best of the 90 Councils.

14. Local authorities can invest in a wide variety of financial investments and higher returns are linked to higher risk. All the investments undertaken by KCC have had a guarantee of the capital invested. So the performance achieved has been with very low risk financial investments.

RECOMMENDATION

15. Members are asked to note this report

Nick Vickers
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APPENDIX 1

Debt Restructuring 2006 -07

Rescheduling opportunities were taken on 5 May, 29 June, 11 August. The first exercise was to partially repay a high coupon loan in a bundle with loans earning discount to offset premium incurred. The second was to restructure PWLB maturity loans to a lower coupon market LOBO loan. The third restructured PWLB loans to like at lower coupon rate.

DATE	AMOUNT £	INTEREST RATE %	REMAINING PERIOD OF LOAN YEARS	MATURITY DATE	ANNUAL SAVING	SOURCE	TYPE
Old Loans							
05/05/06	2,477,993.05 (partial repayment)	9.125	7.77	10/02/14	67,798.24	PWLB	Maturity
05/05/06	4,000,000	4.5	18.77	10/02/24	12,586.56	PWLB	Maturity
05/05/06	10,000,000	4.5	19.77	10/02/25	32,003.58	PWLB	Maturity
05/05/06	8,000,000	4.5	21.01	10/05/26	15,575.49	PWLB	Maturity
05/05/06	20,000,000	4.5	21.52	10/11/26	39,065.03	PWLB	Maturity
05/05/06	15,000,000	4.5	22.7	10/02/28	29,526.62	PWLB	Maturity
05/05/06	5,000,000	4.5	23.52	10/11/28	9,885.68	PWLB	Maturity
05/05/06	10,000,000	4.5	24.52	10/11/29	19,882.97	PWLB	Maturity
29/06/06	5,000,000	4.875	15.87	10/05/22	27,565	PWLB	Maturity
29/06/06	5,000,000	4.875	16.37	10/11/22	27,565	PWLB	Maturity
29/06/06	15,000,000	4.75	19.37	10/11/25	73,878	PWLB	Maturity
11/08/06	341,464.63 (Partial)	9.125	7.50	10/02/14	14,329	PWLB	Maturity
11/08/06	14,500,000	4.75	19.01	10/08/25	59.972	PWLB	Maturity
New Loans							
05/05/06	25,000,000	4.35	45.5	10/05/2051		PWLB	Maturity
05/05/06	25,000,000	4.35	46.5	10/05/2052		PWLB	Maturity
05/5/06	24,400,000	4.35	47.5	10/05/2053		PWLB	Maturity
29/06/06	25,000,000	4.27	50	29/06/2056		Barclays	LOBO
11/08/06	14,800,000	4.2	40.5	10/02/47		PWLB	Maturity

Restructuring of Stepped LOBO Loans:

Arrangements have been made to restructure existing stepped rate LOBO loans. This is pre-empt the proposed changes to accounting regulations for stepped loan instruments and to make savings against the longer-term stepped interest rates.

Date	Principal Amount £	Interest Rate	Stepped Interest Rate	Step Date	Maturity Date	Lender
Old Loans						
29/01/07	15,000,000	4.5	5.02	30/07/09	29/07/2039	Barclays
20/02/07	25,000,000	4.55	4.99	20/08/11	20/08/2043	Barclays
20/02/07	25,000,000	4.65	4.99	20/08/12	20/08/2044	Barclays
26/03/07	15,000,000	3.85	4.99	25/03/08	25/03/2033	Dexia
26/03/07	25,000,000	3.85	4.99	25/03/08	27/03/2034	Dexia
30/03/07	20,000,000	4.75	5.05	30/09/08	30/09/2034	Barclays
20/04/07	10,000,000	3.85	4.99	20/04/08	20/04/2033	Dexia
New Loans						
29/01/07	15,000,000	4.87	n/a	n/a	29/01/2066	Barclays
20/02/07	25,000,000	4.84	n/a	n/a	20/02/2067	Barclays
20/02/07	25,000,000	4.84	n/a	n/a	20/02/2067	Barclays
26/03/07	15,000,000	4.31	n/a	n/a	25/03/2065	Dexia
26/03/07	25,000,000	4.34	n/a	n/a	25/03/2065	Dexia
30/03/07	20,000,000	4.92	n/a	n/a	30/03/2066	Barclays
20/04/07	10,000,000	4.30	n/a	n/a	20/04/2065	Dexia

APPENDIX 2

Longer Term Investments

Currently we have **£124m** invested for periods over 364 days (as per Prudential indicators).

Counterparty	Principal Amount £	Start Date	End date	Interest Rate %	Call Options
Chelsea BS	5,000,000	06/08/04	06/08/07	5.15	None – interest rate decreases annually
Chelsea BS	5,000,000	20/08/05	20/08/08	5.30	None – interest rate decreases annually
Chelsea BS	5,000,000	19/01/05	21/04/08	5.155	None
HSBC	5,000,000	02/06/05	02/06/08	5.07	6 monthly
HSBC	5,000,000	18/07/05	16/07/10	5.30	6 monthly
HSBC	5,000,000	04/08/05	04/08/10	5.35	6 monthly
HSBC	5,000,000	05/09/05	07/09/09	4.95	6 monthly
Toronto Dominion Bank	4,000,000	05/08/05	05/08/10	5.37	6 monthly
Toronto Dominion Bank	5,000,000	25/10/05	27/10/08	5.05	6 monthly
HSBC	5,000,000	06/10/06	06/10/09	5.62	1st year fixed then 6 monthly
National Australia Bank	5,000,000	03/11/05	05/11/07	4.80	Quarterly
National Australia Bank	4,000,000	12/12/05	14/12/09	5.25	6 monthly
Citibank NA	5,000,000	04/04/06	06/04/10	5.33	6 monthly
Coventry Building Society	5,000,000	03/05/06	05/05/09	5.43	None
EBS Building Society	5,000,000	18/05/06	18/05/11	6.02	6 monthly
HBOS	5,000,000	18/08/06	18/08/11	5.40	Annual – interest rate increases if not exercised.
National Australia Bank	6,000,000	15/03/07	15/03/11	6.26	Quarterly
RBS	5,000,000	12/01/07	12/01/11	8.84/3.00	Tied to 6 month LIBOR within 0-5.75% otherwise 3%. 6 month calls
HSBC	5,000,000	19/01/06	19/01/10	5.13	6 monthly
HSBC	5,000,000	03/07/06	01/07/11	5.52	Annual call, annual interest
HSBC	5,000,000	06/12/06	06/12/09	6.17	Tied to 6 month LIBOR within 0 - 6.25% else 0% interest
Newcastle Building Society	5,000,000	12/04/06	14/04/09	5.18	None
National Australia Bank	5,000,000	05/03/07	07/03/11	5.85	Quarterly
Landsbanki Islands	10,000,000	01/02/07	01/08/08	6.00	None
Total	**124,000,000**				