

By: Director of Finance
To: Governance and Audit Committee – 20 September 2006
Subject: **TREASURY MANAGEMENT ANNUAL REVIEW**
Classification: Unrestricted

Summary: To report on treasury management activity in 2005-06.

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 2005-06 borrowing totalled

Date	Amount	Interest Rate	Period of Loan Years	Source	Type
	£m	%			
4/5/05	20	4.28	40	Barclays	Market LOBO
23/5/05	10	4.45	35	PWLB	
6/10/05	10	4.30	30	PWLB	
21/4/05	10	4.25	30	PWLB	
2/12/05	10	3.78	40	Barclays	Market LOBO
Total	60				

- (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 the second half of 2005 rates moved much lower than expected with a base rate cut to 4.5% in August. This was largely driven by heavy UK pension fund demand for fixed income assets. We took advantage of this with the 3.78% loan in January 2006 and a forward deal for April 2006 of 3.70%. After the December 2005 low, PWLB rates have moved up.
- (4) In December 2005 the PWLB for the first time extended the maximum loan period from 30 to 50 years. To optimise our debt profile we will now borrow beyond 30 years.

4. Debt Restructuring

- (1) As at 31 March 2006 long term borrowing was £882.6m of which £57.9m 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.
- (3) In total we restructured £66.17m of debt and this will save annually £0.3m.
- (4) The aim of re-financing is to remove higher interest loans and secure the re-financing over longer periods. Due to a change in PricewaterhouseCoopers policy on accounting for premiums and discounts the opportunities for re-financing have been reduced but nonetheless a significant amount of re-financing was possible and large savings made.

5. Performance Summary

Overall the average rate of interest paid in 2005-06 reduced from 6.01% to 5.92% and an underspend of £982k was achieved on the total interest cost budget.

INVESTMENTS

6. During 2005-06 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 2005-06 the average daily balance increased to £259m compared with £242m in 2004-05 and £125m in 2003-04. This increase reflects a strengthening of the balance sheet and higher short term cashflows.

8. Duration

- (1) Prior to 1 April 2004 as an Authority with debt we could only invest up to 364 days, the new ODPM Guidelines allowed us to invest for longer periods.
- (2) During the year we undertook a number of deals for over 365 days and these are set out in Appendix 2.
- (3) 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 4.84% against a 7 day LIBID benchmark of 4.54%.

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 benefit from historically low borrowing costs but at the same time 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)	4.78	4.70
Money on Call	4.58	4.56
Money Market Funds	-	4.55
Callable Deposit	5.16	4.94
Externally Managed Funds	-	4.59
Combined Investments	4.84	4.72

The Combined Investments performance was the 11th best of the 90 Councils.

Performance Compared With Peer Group

The peer group consists of 16 Councils. The relative KCC performance was:

	KCC Return %	Average Return %
Cash Managed In-House (< 365 days)	4.78	4.70
Money on Call	4.58	4.62
Money Market Funds	-	4.58
Callable Deposit	5.16	4.96
Externally Managed Funds	-	4.76
Combined Investments	4.84	4.70

The Kent performance was the 2nd best of the 16 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 2005-06

DATE	AMOUNT £	INTEREST RATE %	PERIOD OF LOAN YEARS	MATURITY DATE	SOURCE	TYPE
Old Loans						
14/12/05	8,000,000	4.45	12.91	10/11/2018	PWLB	Maturity
14/12/05	8,000,000	4.45	13.91	10/11/2019	PWLB	Maturity
14/12/05	8,000,000	4.45	14.91	10/11/2020	PWLB	Maturity
14/12/05	6,000,000	4.45	16.16	10/02/2022	PWLB	Maturity
06/01/06	10,000,000	4.05			PWLB	Maturity
06/01/06	471,508.64 (partial repayment)	9.125	8.08	10/02/2014	PWLB	Maturity
10/01/06	1,155,854.48 (partial repayment)	9.125	8.08	10/02/2014	PWLB	Maturity
10/01/06	10,000,000	3.95	5.33	10/05/2011	PWLB	Maturity
10/01/06	10,000,000	4.00	6.33	10/05/2012	PWLB	Maturity
10/01/06	4,500,000	3.85	4.33	10/05/2010	PWLB	Maturity
New Loans						
14/12/05	8,000,000	4.05	50	14/12/2055	Barclays	LOBO (Fixed 13yrs)
14/12/05	8,000,000	4.05	50	14/12/2055	Barclays	LOBO (fixed 14 yrs)
14/12/05	8,000,000	4.05	50	14/12/2055	Barclays	LOBO (fixed 15 yrs)
14/12/05	6,000,000	4.05	50	14/12/2055	Barclays	LOBO (fixed 16 yrs)
6/01/06	10,470,000	4.00	45.5	10/02/2051	PWLB	Maturity
10/01/06	25,700,000	3.69	48	10/01/2054	Barclays	LOBO (fixed to 10/05/2012)

Appendix 2

Investments for longer than 365 days

Counterparty	Principal Amount £	Start Date	End date	Interest Rate %	Call Options
Chelsea BS	5,000,000	06/08/04	06/08/07	5.75	Interest rate falls to 5.15% 08/08/06
Chelsea BS	5,000,000	20/08/05	20/08/08	5.50	Interest rate falls to 5.3% 20/08/06 and 5.15% 20/08/07
Chelsea BS	5,000,000	19/01/05	21/04/08	5.155	None
National Australia Bank	4,000,000	10/12/04	10/12/09	5.00	Annual call- if not called rate increases by 0.25% each year.
Royal Bank of Scotland	5,000,000	04/04/05	04/04/08	5.20	Annual – if not called rate increases to 5.25% 4/4/6 and 5.35% 04/04/07
HSBC	5,000,000	02/06/05	02/06/08	5.07	Semi-annual
Toronto Dominion Bank	8,000,000	01/07/05	01/07/10	5.30	Quarterly
HSBC	5,000,000	18/07/05	16/07/10	5.30	Semi-annual
HSBC	5,000,000	04/08/05	04/08/10	5.35	Semi-annual
Toronto Dominion Bank	4,000,000	05/08/05	05/08/10	5.37	Semi-annual
Toronto Dominion Bank	5,000,000	25/10/05	27/10/08	5.05	Semi-annual
National Australia Bank	5,000,000	03/11/05	05/11/07	4.80	Quarterly
TOTAL	67,000,000				