

REPORT TO THE OVERVIEW & SCRUTINY COMMITTEE

Report No. 12

Date of Meeting	25th January 2007
Title of Report	Annual Report on Treasury Management 2005-06
Portfolio	Leaders Responsibilities
Link to Corporate Priorities	All
Key Decision	Yes
Executive Workplan Ref	A21
Public Report	Yes

Summary of Report

The Council's Treasury Management performance is reported, but the continued involvement of fund managers to invest funds of the Council is questioned.

Advice given by the Council's Financial Advisers indicate economic trends and market conditions now show that fund managers have minimal scope to add value beyond what can be obtained internally with financial institutions either directly or through a brokering service.

Officer Recommendations

It is recommended that the Executive:

- Follow Option 4 - To terminate our relationship with our Fund Managers, Investec & Invesco & manage the fund totals in-house, in line with the Council's Treasury Management Policy (TMP).**
- Delegate such authority to the Section 151 Officer or their explicitly authorised representative(s) to alter any investment strategies to maximise returns within the guidelines laid down in the Council's TMP.**

Other than those implications agreed with the relevant Officers and referred to below, there are no other implications associated with this report.

Financial Implications	Legal Implications	Community & Environmental Implications	Human Resources Implications	Equality & Diversity Implications
Yes	Yes	No	No	No

Contact Officer(s)	Peter Mundy, Finance Officer 01249-706223 Paul Hawley Chief Accountant 01249-706282	pmundy@northwilts.gov.uk phawley@northwilts.gov.uk
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1. Introduction

- 1.1 In 1995, the Council disposed of its Housing Stock and elected to use three external fund managers to manage the receipts and maximise the returns from investments.

One external fund manager was dropped some years later leaving two fund managers, Investec & Invesco. The balances on the funds at 30 November 2006 were:

Fund Manager	£ million
Investec	11.155
Invesco	10.232
Total	21.387

- 1.2 At its meeting on 20th January 2004, the Council delegated responsibility for the implementation and monitoring of its treasury management policies and practices and for the execution and administration of treasury management decisions to the Responsible Finance Officer. The text is shown below:

“4.2.3 This Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices, approval of an annual strategy and plan in advance of the year, an annual report after its close, and its TMP’s to the Executive; and for the execution and administration of treasury management decisions to The Responsible Finance Officer, who will act in accordance with the organisation’s policy statement and TMP’s and, if he/she is a CIPFA member, CIPFA’s Standard of Professional Practice on Treasury Management.”

Responsible Finance Officer (RFO) = Section 151 Officer or their authorised deputy / representative(s)

2. Performance of Treasury Activities 2005-06

- 2.1 The Council did not enter any borrowing for capital during the year.
- 2.2 Only on one occasion was it necessary for the Council to borrow to meet short-term cash flow needs (£1.25 million).
- 2.3 At the year-end Other Long Term Liabilities, which is the long-term creditor for the PFI contract was £9.31 million.
- 2.4 The external fund managers exercised investments in accordance with the strategy and their assessment of market and economic conditions. For most of the year, the investment managers traded in Certificate of Deposit until late in the financial year when both investment managers predicted interest rates would remain unchanged or lower and that gilt yields would improve. Both fund managers acquired gilts which in hindsight was a poor assessment and a costly option.
- 2.5 The investments made by officers in-house during the year, were in accordance with the Council’s TMP.

2.6 The position at the 31st March 2006 is summarised below

	2005-06 Year End Investments	2005-06 Net Rate of Return	2005-06 Gross Interest	2005-06 Mgt Fee	2005-06 Mgt Fee VAT
Fund Manager					
Invesco	£9,952,114	4.65%	£456,765	£12,188	£2,133
Investec	£10,860,052	4.57%	£493,885	£16,785	£2,937
In-house Deposits	£3,110,000				
Total Investments	£23,922,000				
Average weekly holding	£10,561,290	4.61%	£496,721	£10,000*	
Gross Interest			£1,447,371		
Average Base Rate in 2005/06 **		4.66%			

* A nominal adjustment has been made for internal finance section costs.

** 01/04/05 – 03/08/05 = 4.50%; 04/08/05 – 31/03/06 = 4.75%

2.7 The cost of Sector's financial advisory service to the Council for the year ending 30th September 2006 was £9,975, which is less than 0.69% of the gross interest received.

3. Options

Option 1 - Do nothing.

Option 2 – Terminate our relationship with Investec & transfer the balance to Invesco.

Option 3 - Terminate our relationship with Investec & split the fund balance transferring 50% of the balance to Invesco & managing the other 50% in-house.

Option 4 - Terminate our relationship with both fund managers & manage all balances in-house.

4. Update

4.1 The performance of the two fund managers has been raised & discussed with the Council's Financial Advisers, Sector, to assess the possibility for improved performance by the fund managers or to pursue alternative options.

4.2 Sector have analysed the performance against the measure of the 7 day LIBID (London Inter Bank Bid) rate as follows:

	LIBID	Performance (Net)	Under
Invesco			
2002-03	3.72%	4.57%	
2003-04	3.60%	3.13%	-0.47
2004-05	4.61%	4.67%	
2005-06	4.64%	4.65%	
2006-07 to November	3.16%	2.82%	-0.34
2006-07 projection	4.85%	4.54%	-0.31
	LIBID	Performance	Under

Investec		(Net)	
2002-03	3.72%	5.32%	
2003-04	3.60%	2.72%	-0.88
2004-05	4.61%	4.71%	
2005-06	4.64%	4.57%	-0.07
2006-07 to November	3.16%	2.72%	-0.44
2006-07 projection	4.85%	4.43%	-0.42

4.3 The earlier years' performances were measured against an enhanced LIBID (London Inter Bank Bid rate). Invesco was 5% above and Investec 10%.

4.4 The position for the eight months ended 30th November 2006 is summarised below.

	2006-07 Investments @ 30/11/06	2006-07 Net Rate of Return	2006-07 Gross Interest	2006-07 Mgt Fee	2006-07 Mgt Fee VAT
Fund Manager					
Invesco	£10,233,650	4.24%	£291,408	£8,402	£1,470
Investec	£11,155,016	4.07%	£305,297	£8,794	£1,539
In-house Deposits	£9,100,000				
Total Investments	£30,488,666				
Average weekly holding	£7,596,800	4.46%	£233,410	£7,500*	
Gross Interest			£830,115		
Average Base Rate in 2006/07 **		4.64%			

* A nominal adjustment has been made for internal finance section costs.

** 01/04/06 – 03/08/06 = 4.5%; 04/08/06 – 08/11/06 = 4.75%; 09/11/06 – 30/11/06 = 5.00%

The stated net rate of return by the investment managers is given in paragraph 4.2 but has been annualised in the above table for comparative purposes.

4.5 A capital receipt has been received this week from the disposal of the Cattle Market and is expected to generate additional interest income of £97,000 during the remainder of this financial year. This is in addition to outturn position reported in the Month 8 monitor.

4.6 Sector stated "The performance of your fund managers along with all other managers have had a bad time of it over the last three years, this has been mainly due to a rising rate environment but also their strategies and interest rate views have been wrong. North Wiltshire District Council has around £21 million managed externally and this represents 2/3rds of your investment balances. It is our view that this is the wrong mix especially considering that cash rates are offering 5.34% for two years at present." (December 2006)

4.7 The under performance by the fund managers in 2006-07 is due to electing to go to the gilt market resulting in a loss of revenue to the Council in the region of c£60,000.

4.8 The fund managers are entitled to management expenses based on the value of the funds. In 2006-07 the management expenses are expected to total £28,000.

4.9 There is no penalty for closing an account with the fund managers.

- 4.10 Current market conditions indicate that fixed term deposit rates are competitive. Some smaller building societies will accept funds for a fixed term at variable rates after 3 months linked to the LIBOR (London Inter Bank Offered Rate). As at 30th December 06, parcels of £2 million could be invested at 5.50% for 364 days. This compares to the current Bank Rate of 5%.
- 4.11 Investments, currently held by fund managers, handled internally would need to be made for extended periods to keep administrative time / costs to a minimum.

5. Financial Implications

- 5.1 The interest income generated from investments is an important component to the Council's Budget. Interest from investments in 2006-07 has been budgeted at £1.274.7 million. (Forecast outturn £1.332 million)
- 5.2 Internal investment income varies from year to year. Significant financial transactions will raise or lower the internal cash holding and gives the opportunity for longer term investments at preferential rates. In April 2005, Spring Quarry was disposed of for £3.8million and in January 2007 the sale of the Cattle Market enables the Council to make further investments.
- 5.3 Internal interest received in 2004-05 was £303,117; 2005-06 £496,721 and in 2006-07 was projected at £350,000 but can now be increased to £447,000.
- 5.4 Poorer than expected returns mean that despite base rate rises the Council may not meet its budgeted income target (see Month 8 Budget Monitor).
- 5.5 By terminating our arrangements with fund managers, we will save in the region of £28,900 per annum. Increased staff costs of circa £5,000 & bank charges of £1,000 per annum will produce a net saving to the Council of £23,900.
- 5.6 One of the weaknesses of our existing arrangements is the lack of flexibility Officers have, to respond to investment opportunities / market changes e.g. termination of fund managers, without formal consultation & approval from the Executive.

For example, a ¼% improvement in yield on a £10 million investment will generate circa £2,080 per month additional interest. If it takes a month to get Executive approval this interest is lost given due process delay. Delegated authority to the Section 151 Officer would mean we maximise our potential investment returns by avoiding such delays.

6. Risk Analysis

- 6.1 Market and economic forces will always impact on the earnings that can be achieved. The risk of losses through decision making and volatility should be measured against security of the investment and its predictability.
- 6.2 All investments made in-house by the RFO or their authorised representative(s) will be made in accordance with the Council's investment management strategy. The tighter & more risk averse the policy, the less likely the risk of loss. The investment management strategy is currently being reviewed & will be the subject of a further report to Executive before the end of this financial year.

Appendices:	<ul style="list-style-type: none"> • None
Background documents Used in the preparation of this Report:	<ul style="list-style-type: none"> • Invesco & Investec Reports • Sector Reports & advice

Previous Decisions Connected with this Report

Report	Committee & Date	Minute Reference
Annual Report on Treasury management 2004-05	Executive 13 October 2005	10