

## **CORPORATE GOVERNANCE COMMITTEE – 24th JUNE 2010**

### **TREASURY MANAGEMENT 2009/10**

#### **REPORT BY TREASURER**

##### **Introduction**

- 1.1 The Police Authority's approval to Treasury Management is governed by three documents:
  - CIPFA's "Treasury Management in the Public Services: Code of Practice (Fully Revised Second Edition 2009)"
  - Treasury Management Policy Statement: Adopted by the Police Authority annually at the February budget meeting.
  - Treasury Management Practices (TMPs): A detailed set of procedures that ensure compliance with the policy.
- 1.2 The TMPs have been produced, in collaboration with specialist Treasury Management Advisers and are used as a working document by the West Sussex County Council Treasury Management Team.
- 1.3 The Code of Practice requires that an annual report should be made on treasury management activities for the previous financial year and this is set out below.

##### **Annual Report 2009/10**

##### **Background**

- 2.1 The Police Authority continues to be mainly a temporary lender due to its reserves and the timing of grant and precept income. The daily average lending for 2009/10 was £74.0m, £5.2m less than compared with 2008/09 (see Appendix 1). The daily average includes deposits with Heritable Bank and subsequent dividend repayments from the administrator but excludes the 20% impairment recognised in 2008/09 (see note 4).
- 2.2 The Treasury Management Strategy approves occasional temporary borrowing to cover day-to-day cash flow shortfalls, however no temporary borrowing was undertaken during 2009/10. Any daily overdrawn amounts were met from balances held in the Authority's instant access call accounts.

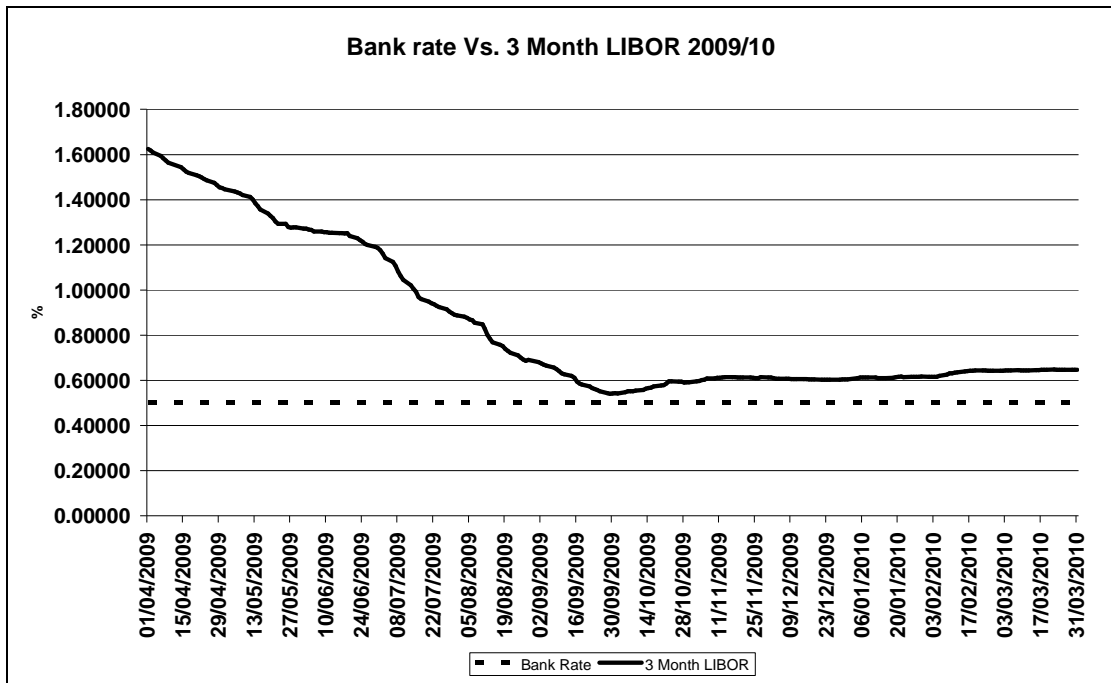
##### **Economic conditions**

- 3.1 Financial markets entered calmer waters in the early stages of the 2009/10 as the worst fears of global depression and bank meltdown subsided. Nevertheless whilst 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.

- 3.2 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 UK building societies continued to make the headlines.
- 3.3 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.
- 3.4 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.
- 3.5 The bias of the Bank of England's Monetary Policy Committee 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 2009 was followed by two further boosts, £50bn in August and £25bn in November.
- 3.6 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 inter-bank lending 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.
- 3.7 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.
- 3.8 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.



## Heritable Bank

- 4.1 The Police Authority had three deposits with Heritable Bank totalling £6.8m when Heritable was taken into administration in October 2008 following the failure of its Icelandic parent company, Landsbanki. An original claim of £6.844m was submitted to the administrators Ernst & Young in November 2008, which included interest accrued at date of Heritable entering administration (£44,828).
- 4.2 During 2009/10 the administrator Ernst & Young declared three interim dividend payments to the Authority representing 34.98% of the total claim. Payments received have been used to reduce the loan principal outstanding; interest adjustments if appropriate will be made when the final settlement total is known. The position with regard to Heritable investments at 31 March 2010 is summarised below:

|   | <b>£'000</b> |
|---|--------------|
| Original investment   | 6,800        |
| 1st dividend received 30 July 2009 (16.13 pence in the £)   | -1,104       |
| 2nd dividend received 18 December 09 (12.66 pence in the £) | -866         |
| 3rd dividend received 30 March 2010 (6.19 pence in the £)   | -424         |
| <b>Balance to recover (excluding 2008-09 impairment)</b>    | <b>4,406</b> |
| 20% Loan impairment recognised in 2008/09 accounts          | -1,360       |

- 4.3 In January 2010 the administrators revised upwards their estimated return to non-preferential unsecured creditors. Current projections indicate a base rate of return to creditors of 79 to 85 pence in the pound (previously 70 to 80 pence) and a stressed case return of 63 to 73 pence in the pound (previously 55 to 70 pence). The administrator has further declared a fourth interim dividend with the actual repayment amount to be notified to the Authority in July 2010.
- 4.4 During 2009/10 the Authority paid £1,424 to the Local Government Association in support of their continual efforts to ensure maximum recovery for all Local Authority deposits in failed Icelandic banks.

### Investment Performance

- 5.1 The original estimate of investment income for the year was £1.268m, representing an average interest rate of 1.75% on an assumed average portfolio of £84.7m, less a £0.2m transfer to the PFI reserve.
- 5.2 Actual investment interest received was £0.883m, of which £0.147m has been transferred into the PFI reserve. This represents an overall investment return for 2009/10 of 1.19%, which exceeded the Standard Life Money Market Fund benchmark of 0.58% by 0.61%.
- 5.3 The investment income deficit as compared with the original budget is summarised in the table below:

|   | <b>£'000</b> |
|---|--------------|
| Original Budget   | 1,268        |
| Lower average investment portfolio than budgeted (at 1.75%) | -188         |
| Lower rate of return than assumed budgeted rate (-0.556%)   | -412         |
| Lower than budgeted transfer to the PFI reserve             | 68           |
| <b>Actual Interest received (less PFI transfer)</b>         | <b>736</b>   |

- 5.4 The total interest received by the Authority in 2009/10 (£0.910m) includes car loan interest of £21,006 and other miscellaneous interest of £6,122.

### Investment Activity

- 6.1 During 2009/10 the Authority operated four instant access call accounts with UK-regulated banks, where funds were deposited and withdrawn without notice and balances achieved a daily rate of return higher than the Bank of England base rate. Approval was given to re-use both the Alliance & Leicester and Clydesdale accounts on the basis that daily monitoring of the parent banks was maintained (National Australia Bank and Banco Santander respectively) and that all funds could be withdrawn without notice if market indicators demonstrated increased risk.
- 6.2 The total interest received from instant access call accounts in 2009/10 amounted to £126,282 representing an average interest rate of 0.78% (see below).

| <b>Call Account</b>      | <b>Average Balance<br/>£'000</b> | <b>Interest Received<br/>£</b> | <b>Rate of Return<br/>%</b> |
|--------------------------|----------------------------------|--------------------------------|-----------------------------|
| Alliance & Leicester (i) | 5,233                            | 41,863                         | 0.80                        |
| Bank of Scotland Plc     | 2,111                            | 17,947                         | 0.85                        |
| Clydesdale Bank (ii)     | 790                              | 6,320                          | 0.80                        |
| NatWest Bank             | 8,021                            | 60,152                         | 0.75                        |
| <b>Total</b>             | <b>16,155</b>                    | <b>126,282</b>                 | <b>0.78</b>                 |

(i) Approval from September 2009

(ii) Approval from March 2010

- 6.3 No surplus cash was deposited in Money Market Funds in line with the Authority's approved Treasury Management Strategy (2009/10).
- 6.4 No temporary borrowing was undertaken during the year to cover cash shortages. All daily overdrawn balances were met from funds recalled from the Authority's instant access call accounts.
- 6.5 The Authority's Treasury Management Strategy and Prudential Indicators approved in February 2009 allowed for £15.0m of the Authority's total portfolio to be invested for longer than one year. Due to the prevailing market conditions no approval was given to place new investments for periods longer than six months. As a consequence the Authority had no long-term investments at 31 March 2010.
- 6.6 Appendix 1 summarises investments at 31 March 2010 and performance achieved during the year against the Standard Life Money Market Fund rate benchmark. Appendix 2 shows the spread of investments by type of borrower and the rate of return against both the benchmark and base rate in graphical format.

### **Long-Term Borrowing**

- 7.1 In line with the Prudential Code the Authority continues to undertake long-term borrowing through the Public Works Loan Board (PWLB) to finance part of the capital programme. However no new loans were arranged during 2009/10 as a consequence of slippage on the Authority's capital programme. The Authority's total long-term debt remains £4.5m at 31 March 2010. Interest payable to the Public Works Loan board amounted to £201,250 in 2009/10, representing an average interest rate of 4.47%

**RECOMMENDED** – that the report be noted.

RICHARD HORNBY  
Treasurer

Contact: John Eagles, Deputy Treasurer  
Tel No: 01243 777292  
E-mail: john.eagles@westsussex.gov.uk

## Appendix 1

### TREASURY MANAGEMENT 2009/10

#### PROFILE AND RATE OF RETURN

Amount Invested: Average portfolio for year £74.0m (£79.2m in 2008/09).

Permitted Investments: Term up to 6 months.

Cash deposits with approved organisations as set out in the 2009/10 Treasury Management Strategy Report.

Maximum limit with one organisation £10m.

#### Investment Profile:

| As at 31 March:        | <u>2010</u> |          | <u>2009</u> |           |
|------------------------|-------------|----------|-------------|-----------|
|                        | £m          | %        | £m          | %         |
| <u>Deposits:</u>       |             |          |             |           |
| UK Banks               | 20.0        | 31       | 24.0        | 36        |
| UK Banks-Call Accounts | 29.8        | 46       | 1.3         | 2         |
| UK Building Societies  | 10.0        | 16       | 34.1        | 51        |
| Local Authorities      | 0.0         | -        | 0.8         | 1         |
| Heritable Bank (*)     | <u>4.4</u>  | <u>7</u> | <u>6.8</u>  | <u>10</u> |
| Total                  | 64.2        | 100      | 67.0        | 100       |

(\*) Excludes impairment recognised in 2008-09 accounts

#### Performance:

|                        | <u>2009-10</u> | <u>2008-09</u> |
|------------------------|----------------|----------------|
| Actual rate of return: | 1.19%          | 5.17%          |
| Benchmark rate:        | 0.58%          | 4.49%          |
| Exceeded benchmark by: | 0.61%          | 0.68%          |

#### Investment Income Including PFI Reserve:

|                 |         |         |
|-----------------|---------|---------|
| Original Budget | £1.268m | £2.568m |
| Outturn Budget  | £1.408m | £3.656m |
| Actual          | £0.910m | £4.359m |

TREASURY MANAGEMENT 2009-10

SPA IN-HOUSE INVESTMENTS

