AGENDA ITEM NO.

TO: **AUDIT AND RESOURCES OVERVIEW AND SCRUTINY COMMITTEE – 21ST JULY 2004**

SUBJECT: **QUARTERLY INVESTMENT AND BORROWING REPORT FOR THE QUARTER TO 31ST MARCH 2004, 2003/2004 ANNUAL TREASURY MANAGEMENT REPORT AND A COMMENTARY ON ETHICAL INVESTMENT ISSUES**

FROM: **FINANCE**

1. PURPOSE OF REPORT

1.1 To report to the Committee the Council's Treasury Management activities for the quarter ended 31st March 2004 in accordance with the requirements of the CIPFA Code of Practice on Treasury Management.

1.2 To report to the Committee upon the Council's Treasury Management activities during the whole of 2003/2004 as required by CIPFA's Treasury Management Code of Practice.

1.3 To comment upon the topic of ethical investment issues and how it might affect this Council.

2. BACKGROUND

2.1 At this Committee's meeting held on the 3rd March 2004 members requested that they receive the Quarterly Investment and Borrowing report for the quarter ended 31st March 2004 which normally would have been circulated to all members of the Council. This is attached as Appendix A.

2.2 The Council is also required to report upon its 2003/2004 Treasury Management performance by 30Th September and it is therefore appropriate to incorporate the annual review within this report which also reports upon the final quarter of that year. This is attached as Appendix B.

2.3 At that meeting the question of this Council's approach towards ethical Investment particularly with regard to smoking and arms issues was also raised. It was agreed that the issue would be dealt with more fully within this report. This is attached as Appendix C.

2.4 With regard to the annual review, the report follows the format used in the Treasury Management Strategy Plan presented to the Executive on 10th March 2003, and comments where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan, a copy of which is attached for reference purposes as Appendix D.

3. POLICY AND BUDGET FRAMEWORK

3.1 Treasury Management has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income and minimise its borrowing interest payable.

4. OUTCOME(S) REQUIRED

4.1 That content of the report be noted.

Roger Wyton,
Principal Accountant.

BACKGROUND PAPERS

Treasury Management Annual Strategy Plan 2003/2004
Various documents from Sector Treasury Services and Invesco.

Areas in District Affected: **All**

Executive Portfolio Area and Holder: Corporate and Strategic Leadership – Councillor R.Crowther

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APPENDIX A

QUARTERLY INVESTMENTS AND BORROWING REPORT FOR QUARTER TO 31ST MARCH 2004

1. INVESTMENTS

1.1 The investments made by the Council during the quarter to 31/03/2004, together with the daily interest earned at the end of the quarter, are shown in Appendix A1.

1.2 The graph shown in Appendix A1 compares the average LIBID (London Inter Bank Bid Rates) for this quarter with the rates which WDC actually achieved. The LIBID rates are an indicator of what the market is prepared to pay for borrowing money from potential investors.

1.3 During this quarter the only In House Investments made were in the fixed up to 3 month area of the money market, the performance being:

Type of Investment:	**No. of Investments**	**Total Interest Earned:**	**Average Duration (Days)**	**Rate of Interest:**
In House Investments - Up to 3 months fixed.	7	£43,897	33	3.8886 %
Benchmark:				
LIBID Rate – 1 month fixed				3.9375 %
LIBID Rate – 3 months fixed				4.0729 %

1.4 The Council continued to use the two business reserve accounts, one held with Abbey National and the other with Bank of Scotland. These accounts paid favourable interest rates on deposits compared to money market investments and our treasury management consultants were advising us to make use of these accounts.

	Average Balance:	**Average Rate of Interest Earned:**	**Total Interest Earned:**
Abbey National.	£2,011,677	3.9583%	£24,011
Bank of Scotland.	£2,122,146	3.9091%	£21,786

1.5 During 2003/2004, the Council was limited to using investment instruments contained within the Approved Investment Regulations. With effect from 1st April 2003 Local Authorities were permitted to invest in triple A rated Money Market

Funds. These funds offer good rates of return, backed by the highest possible security and offer excellent liquidity, i.e. you can deposit / withdraw funds as and when required. During the quarter we continued to use the two Money Market Funds, their performance being:

	Average Balance:	**Average Rate of Interest Earned:**	**Total Interest Earned:**
Aim Global Money Market Fund.	£135,449	3.6878%	£1,218
Standard Life Money Market Fund	£1,977,491	3.7805%	£18,410

2. BORROWING

2.1 During this quarter it was not necessary to undertake any borrowing.

3. DEBT REPAYMENT AND RESTRUCTURING

3.1 On the 2nd March 2004 the Council repaid a £5,000,000 PWLB variable rate loan and thus achieved its ambition of becoming debt free. A small discount was received of £1,630.

4. EXTERNAL FUND MANAGERS

4.1 Invesco Asset Management Ltd, acts as the Council's external cash management agents and £ 10 million is placed with them for investment in a variety of instruments. The market value of the investment portfolio at 31st March 2004 as compared to 31st December 2003, (including interest accrued), is shown in Appendix A1.

4.2 During this quarter, the performance is summarised as:

	Quarter to 31st March 2004	**Quarter to 31st December 2003**
Invesco Average Money Market Investment Rate:	4.0518%	3.7326%
Compares to: In House Average Investment Rate:	3.8453%	3.4358%
Total Invesco Interest Earned in Quarter (including accrued interest)	£71.872	£78,149
Invesco Performance: Invesco Portfolio Return:	0.89%	0.77%
Benchmark: FT Average 3 month LIBID rate (compounded)	1.02%	0.95%

4.3 As at 31^s March 2004 there were no gilts held in the portfolio.

5. BANK INTEREST

5.1 At the beginning of the quarter WDC was paying interest of 4.75%, (Base Rate plus 1%), on overdrawn balances. However, on 5th February 2004 the base rate was increased to 4.00% therefore, increasing our overdraft interest rate to 5.00% for the remainder of the quarter.

5.2 The average cleared bank balance for the quarter ended 31st March 2004 was £24,368 credit, compared to an average of £26,936 credit for the quarter to 31st December 2003.

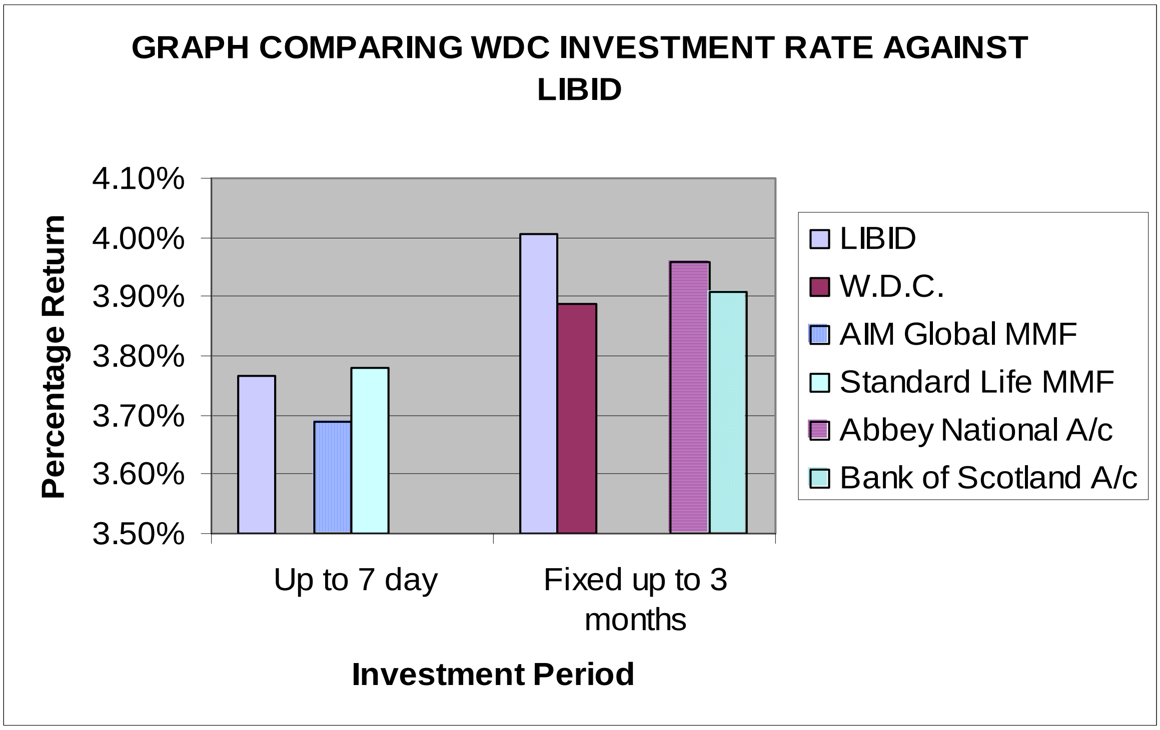
6. EXTERNAL DEBT AND INVESTMENTS

6.1 The total external debt and investment balances at 31st March 2004 and 31st December 2003 are shown in Appendix A2.

APPENDIX A1

INVESTMENTS MADE BY WDC QTR TO 31/03/2004.

	Qtr to 31/03/2004.	Qtr to 31/12/2003.
Total Investments in Qtr:	£12,540,836	£38,508,515
WDC In House Investments at Qtr end.	£840,000	£17,408,000
Daily In House Interest at Qtr end:	£91.99	£1,771.80



INVESCO INVESTMENT PORTFOLIO VALUATION:

	Qtr to 31/03/2004.	Qtr to 31/12/2003.
Treasury Stock:	£0	£1,001,004
Money Market Instruments:	£9,904,220	£8,776,032
Cash and Deposits:	£521,968	£549,117
Market Value at Quarter End:	**£10,426,188**	**£10,326,153**

APPENDIX A2

WDC EXTERNAL DEBT AND INVESTMENT AS AT 31/03/2004.

	DEBT:	**INVESTMENT:**
Bank Balance:	£0	£132,006
Temporary Investments:	£0	£10,840,000
Temporary Borrowing:	£0	N/A
Long Term Loans:	£0	N/A
Totals as at 31/03/2004:	**£0**	**£10,972,006**
Totals as at 31/12/2003:	**£5,000,000**	**£27,990,726**

The reduction of £17 million in the investment balance is as a result of a) the £5 million PWLB loan repaid in March and £12 million natural cash outflows re precepts, NNDR payments to the Government etc at a time when the Council receives little in the way of Council Tax and NNDR cash inflows.

APPENDIX B

2003/2004 ANNUAL TREASURY MANAGEMENT REPORT

1. REVIEW OF INTEREST RATES

1.1 It was stated in the Strategy Plan that the MPC (Monetary Policy Committee) was becoming increasingly concerned about the effects of the weakening UK economy and the economic impact of war with Iraq on the central inflation target of 2.5% and that this would be likely to lead to changes in the Base Rate which started the year at 3.75%. Our Treasury Advisor's central forecast was for Base Rate to remain at 3.75% for the rest of 2003/2004 but that a cut to 3.50% could not be ruled out if the domestic and world economic climate worsened.

1.2 With regard to long term borrowing rates which are linked to gilt yields, the forecast for 2003/2004 was for a continuation of historically very low gilt yields. This translated into opening Public Works Loans Board (PWLB) rates of 1 year 3.625% to 25 years 4.750% with little change expected during the year.

1.3 During the early part of the year fears grew that another Base Rate cut was required as confidence levels recovered slowly post Iraq conflict and there was rising anxiety over the international economy, particularly the Euro zone. Consequently the US Fed Rate was cut to 1% and the Euro zone equivalent was cut to 2% in June 2003. The MPC followed suit cutting the Base Rate to 3.50% in July.

1.4 By the end of July, the US economy recovered strongly and in October, first half 2003 UK economic growth was revised to double the original figures. The MPC responded to this by raising the Base Rate to 3.75% in November, the first increase for four years. This move was intended to cool rampant borrowing and an excessively robust housing market. The bottom of the current interest rate cycle had clearly been reached and therefore rates could be expected to be on the increase from thereon.

1.5 The second increase in the Base Rate to 4% came in February 2004 and was due to three principal factors a) a sharp improvement in the growth outlook with the MPC increasing their 2004 GDP (Gross Domestic Product) projection from 2.7% to 3.5% b) the housing market showing fresh impetus and c) strong consumer spending, increasing household debt and growing confidence levels.

1.6 The US economy also completed its economic recovery during the last quarter of 2003/2004 and this strengthening world and domestic outlook made further Base Rate increases likely during 2004/2005.

1.7 With regard to PWLB interest rates, long term (over 20 years) gilts were much sought after for their 'safe haven' status in the run up to the Iraq war. This increased gilt prices and depressed yields, hence bringing the PWLB lower quota 25-30 year rate down to around 4.5%. Immediately the war started in mid March 2003, gilts lost that status and so long gilt yields rose sharply, pushing the 25-30 year lower quota rate back up to about 4.8% in April before falling back again as low as 4.45% in May on world fears over increasing deflationary risks. These fears rapidly evaporated during quarter three of 2003 so driving up long bond yields in the US and hence the UK. Accordingly, the 25-30 year rate rose back up again and oscillated in a band of 4.70 – 4.95%. During quarter 4 of 2003, the strong rebound of growth in the US pushed this rate higher to 5.00 – 5.05% for much of the quarter. However, in quarter 1 of 2004, the pace of economic growth in the US weakened and fears of a jobless recovery brought the rate back down again to 4.70-4.75%.

1.8 The Council's short term borrowing benchmark is the 7 day LIBOR (London Interbank Offered Rate) which began the year at 3.75% and ended it at 4.1875%.

2. CAPITAL EXPENDITURE AND FINANCING

2.1 The Council's capital programme expenditure for 2003/2004 totalled £10,471,851 and was financed in line with the resources outlined in the Strategy Plan:-

Basic Credit Approvals	£1,795,000
Usable Capital Receipts	£1,734,916
Revenue and Reserves	£5,835,584
External Contributions	£ 305,585
Capital Grants	£ 800,766
	£10,471,851

2.2 Paragraph 3.4 of the Strategy Plan makes mention of the need to review the capital programmes in order to allocate the £1,195,000 credit approvals balance remaining after the original allocation of £600,000 to part fund the Registered Social Landlord programme. In fact, with the need to provide resources in the future in order to meet the Decent Homes Standard and also to position the Council favourably at the start of the new Prudential Capital Finance regime the £1,195,000 was utilised to part fund the landlord element of the Housing Investment Programme.

3. TEMPORARY BORROWING

3.1 The Council managed its cash flow during the year such as to not require any temporary borrowing other than on 1 occasion when 2 loans totaling £6 million were taken out in order to facilitate its long term debt repayment activities. The loans were taken for as short a time as possible and the total interest paid was £9,589. One loan was obtained at below the 7 day LIBOR rate in force at the time and the other was taken at the 7 day LIBOR rate.

4. INTEREST RATE EXPOSURE (BORROWING)

4.1 During the year the Council operated within its borrowing limits as laid down in paragraph 5.3 of the Strategy Plan with the exception of the limit concerning variable interest paid as a % of all interest on borrowings. The limit set in March 2003 for 2003/2004 was 30% and this did not anticipate the accelerated long term debt repayment programme that the Council undertook in 2003/2004 following the advice of our Treasury Advisors. Part of this programme was to take out a variable rate loan with the PWLB for 1 year, this coupled with the total repayment of the Council's long term debt has resulted in the % of variable rate interest paid as a %

of all interest on borrowings for 2003/2004 being 56.52%. When the variable rate loan was taken out in April 2003, the Council's formal approval to the increased variable interest rate percentage should have been sought but unfortunately this was overlooked. This is not considered to be a critical issue as the loan was only for 1 year and the forecast for interest rates did not envisage steeply rising interest rates which could have involved the Council in paying more interest on this loan than it could afford. The Council's total outstanding external borrowings and credit arrangements must not at any one time exceed its Aggregate Credit Limit which at 31st March 2004 was £16,927,380. The Council's total external borrowing and credit arrangements at the same date were £897,648. With effect from 1st April 2004, this requirement has now been replaced by limits imposed under the new Prudential Capital Financing regime.

5. DEBT RESTRUCTURING

5.1 The Council began the year with £12,250,000 long term debt outstanding, £10,250,000 of which was with the PWLB and £2,000,000 with Depfa Bank. Our Treasury Advisors were at that time conducting a review of this external debt in order to determine whether or not the Council's strategy of repaying £2 million a year was still appropriate. The conclusion of the review was that the Council should repay its entire outstanding debt during 2003/2004. The first step was to repay £5,250,000 to the PWLB on the 15th April and to reschedule the remaining £5,000,000 PWLB debt into a 1 year variable rate loan maturing on 15th April 2004. The £2,000,000 Depfa Bank loan was repaid on 18th November 2003.

5.2 The advent of the Prudential Capital Finance regime and changes to the Housing Capital Finance Regulations, particularly in respect of the use of set aside capital receipts from council house sales then made it particularly advantageous to the Council that it should be debt free at the 31st March 2004. Therefore in accordance with advice from our Treasury Advisors, the £5,000,000 PWLB variable rate loan was repaid on 2nd March 2004.

5.3 In the Strategy Plan, the estimated long term interest bill for 2003/2004 was £870,600. The actual for the year following the debt repayment was £278,323. In addition the Council incurred £3,607,412 in respect of premia payable on the early redemption of the debt. However this is 100% rechargeable to the Housing Revenue Account which can then recover it through Housing Subsidy. Therefore the only cost to the authority is the lost interest on the investments used to repay the debt and also to pay the premia. In 2003/2004 this figure was £331,000. It can be seen therefore that the Council saved £261,000 in overall terms by repaying its debt during 2003/2004 as well as positioning itself favourably with regard to taking advantage of the new capital financing regime.

5.4 The actual PWLB quota for 2003/2004 was £2,195,571 compared with £2,247,795 as stated in the Strategy Plan. The Council repaid all of its PWLB debt in 2003/2004 and therefore the quota was not used. As a result of the new Prudential Capital Finance regime, the PWLB quota has been abolished as from 1st April 2004. In future authorities will be able to borrow from the PWLB according to their ability to afford the revenue effects of their borrowings.

6. INVESTMENT STRATEGY AND PERFORMANCE

6.1 The Council conducted its investments in 2003/2004 in accordance with the criteria and counterparty limits defined in the relevant Treasury Management Practice as presented to the Executive on 10th March 2003.

6.2 During the year the in house investments were invested in the Money Markets, Business Reserve Accounts and Money Market Funds.

6.3 A comparison between 2003/2004 actual, 2003/2004 revised and 2002/2003 in terms of in house investment interest returns and interest rates is shown in the table below:-

Year	Average Investment Balance (£)	Interest Received (£)	Interest Rate Achieved (%)	Average Base Rate (%)
2003/2004 actual	13,781,406	501,005	3.6354	3.71
2003/2004 revised	12,535,896	452,075	3.6062	n/a
2002/2003	20,710,238	821,118	3.9648	3.96

6.4 During much of 2002/2003 the Base Rate was 4%. It started 2003/2004 at 3.75%, was reduced to 3.5% in July 2003 and increased to 3.75% in November 2003 and 4% in February 2004. It can be seen that for the majority of the year Base Rate was in the range 3.50 to 3.75% with an average of 3.71% and as investment rates track Base Rate the WDC in house interest rate achieved has been naturally lower in 2003/2004. The lower interest rate has accounted for £45,400 of the total reduction in interest received between the 2 years of £320,113. As mentioned in paragraph 5.3 above a further £331,000 has been accounted for by the Council repaying its debt during 2003/2004. The losses above have been offset by other more general cash flows e.g. increased sale of council house receipts, which have resulted in additional investment income of £56,000.

6.5 An analysis of the investments made by the in house team during 2003/2004 in the Money Markets , Business Reserve Accounts and Money Market Funds together with a comparison with 2002/2003 is shown in the table overleaf:-

INVESTMENTS COMPARISONS 2002/2003 – 2003/2004 **(IN YEAR INVESTMENTS ONLY)**			
Money Markets			
Category	**Turnover** **£**	**Interest Rate** **%**	**Target** **%***
Up to 7 days			
2002/2003	33,350,000	3.82	3.56
2003/2004	60,459,000	3.76	3.42
Fixed up to 3 months			
2002/2003	105,900,000	3.89	3.79
2003/2004	80,500,000	3.65	3.62
Business Reserve Accounts	**Average Balance** **£**	**Interest Rate** **%**	**Target** **%***
Abbey National			
2002/2003	314,000	3.83	3.82
2003/2004	2,800,000	3.69	3.48
Bank of Scotland Instant Access			
2002/2003	204,000	3.50	3.55
2003/2004	1,222,000	3.50	3.48
Bank of Scotland 30 Day Account			
2002/2003	733,000	3.83	3.82
2003/2004	971,000	3.60	3.65
Bank of Scotland Call Account			
2002/2003	N/A	N/A	N/A
2003/2004	725,000	3.84	3.48
Money Market Funds	**Average Balance** **£**	**Interest Rate** **%**	**Target** **%***
AIM Global			
2002/2003	N/A	N/A	N/A
2003/2004	784,000	3.28	3.48
Standard Life			
2002/2003	N/A	N/A	N/A
2003/2004	532,000	3.74	3.48

* Target =
Money Markets - LIBID for appropriate period less 1/16%
Bank of Scotland 30 Day Account - 1 month LIBID
Abbey National and Bank of Scotland Instant Access and Call Accounts – 7 day LIBID
Money Market Funds – 7 day LIBID

6.6 The analysis of Money Market investments shows that the in house team has outperformed the targets in both categories in which investments were made during 2003/2004. This is particularly so in the Up to 7 day category and this was as a result of deliberately placing significant investments overnight when that rate was particularly high.

6.7 The Business Reserve Accounts have generally performed in line with their relevant LIBID rate targets. The Abbey National and Bank of Scotland Call accounts have performed best during 2003/2004 and the Council now utilises only these 2 accounts. The advantage for this Council in using these accounts is that a return equal to Base Rate is guaranteed provided that at least £500,000 is kept in the Abbey National account and £1,000,000 in the Bank of Scotland account. The equivalent LIBID rates would not be achievable through Money Market investments due to the relatively small size of investment that this Council makes and in addition these accounts have enhanced liquidity. Therefore usage of these accounts has been maximised in 2003/2004 where investments have not been required for immediate cash flow purposes.

6.8 During the year the Council used 2 Money Market Funds. Money Market Funds are investment vehicles designed to give the highest rate of security (triple A rated) coupled with instant access to the money and a rate of return better than 7 day LIBID. They are ideal for maximising investment returns from short term cash flow surpluses and have substantially replaced the old “Call” deposits because of the enhanced returns.

6.9 The Council opened an account with AIM Global in July 2003. AIM Global are part of the Invesco organisation. This money market fund although not the best performing was chosen because it offered one of the latest cut off times for investments to be made which was thought to be an advantage so that we could invest receipts from council house sales which normally are credited to our account from mid morning onwards and also because it is allied to Invesco who manage our external cash fund. However it underperformed quite significantly compared with the majority of other funds and the late cut off time was not utilised. Therefore a second fund was opened with Standard Life in December 2003 who were consistently one of the best performers with regard to returns and this has proved to continue to be the case with this fund outperforming the target by 0.26%.

6.10 The Council employs Invesco to manage a £10 million cash fund which during the year was invested in cash deposits, certificates of deposit (C.D’s), gilts and Supranational Bonds (bonds issued by such institutions as the European Community and International Reconstruction and Development Bank).

6.11 The return on the Invesco portfolio is analysed in the table overleaf:-

	2002/2003		2003/2004	
	Cash Return £	**Interest Rate %**	**Cash Return £**	**Interest Rate %**
Cash Deposits and C.D.'s	408,626	4.30	343,129	3.67
Gilts and Supranational Bonds	29,460	8.08	89,255	7.42
Total return	438,086	4.44	432,384	4.10

6.12 The Strategy Plan anticipated a return of 3.90% on the Invesco portfolio which has been achieved.

6.13 Invesco has been the Council's cash fund manager since 1993. The benchmark rate against which the fund is measured is the FT Average 7 day LIBID rate (compounded) which for the year is 3.59%. The portfolio return on this basis is 3.37%. Since 1993 the investments managed have achieved a 5.80% return against the benchmark which stands at 5.54% for the same period. The portfolio also has a target return of 110% of the benchmark over a 3 year rolling period. The benchmark on this basis is 3.91% and the portfolio return is 4.29% which equates to 109.7% of the benchmark.

6.14 The portfolio return also takes into account the capital loss incurred during the year on the Gilts which is one reason why the portfolio return of 3.37% is less than the 4.10% referred to in the table in 6.11 which takes no account of capital loss and looks just at straightforward interest returns on individual investments.

7. BROKERS PERFORMANCE

7.1 The performance of the brokers that WDC uses to place its investments has been measured against the rates available in the market on the day that investments were placed in order to ensure that WDC is obtaining a reasonable rate given the size of deposit that WDC normally places. The analysis shows that in general, the brokers underperformed the market rate in the short dated deposits area, typically overnight. However in respect of longer deposits e.g. 1 month, the brokers bettered the market rate. It is unlikely that a significant number of deals will be done through brokers in 2004/2005 so the underperformance in short dated deposits is not seen as an issue.

8. PERFORMANCE MEASUREMENT

8.1 In addition to the in house local benchmarks referred to in the table in paragraph 6.5 above and the benchmarks Invesco are measured against as outlined in paragraph 6.13, the Council participates in the CIPFA Treasury Management Benchmarking Club which enables us to benchmark ourselves on a national basis against councils of a similar size in terms of treasury management activity.

8.2 This report has normally been compiled in September when the final Benchmarking Club report has been received. A draft report in respect of our 2003/2004 performance has been received and used to provide the figures shown in the tables below. It is stressed that this is a draft report and the figures are subject to checking and amendment where appropriate. In addition, as stated above it is our practice to benchmark ourselves against similar authorities in terms of treasury management however this part of the benchmarking exercise has yet to be completed and for the purposes of this report the 2003/2004 benchmark shown is in fact the average of all participants in the club. It is anticipated that the final report will be available during early August when we will be able to see and report back on our performance against authorities who more accurately reflect our scale of treasury management. It should also be noted that although in the Strategy Plan the aim was to benchmark on a quartile basis, in actual fact the results have been produced on an average basis and will continue to be so produced in future years.

8.3 The benchmarking club performance indicators included in the Strategy Plan were:-

Table A

Investment Management costs per £1m invested **(aim to be in lowest quartile)**			
	2003/2004 estimate	2003/2004 Club Average	WDC Performance
Total In House Cost	£1,441	£730	£2,890
In House Staff Costs	£790	£420	£1,300
Fund Managers Costs	£1,278	£1,680	£1,300

8.4 Table A shows that the total in house cost per £1m invested was double what we estimated it would be in the Strategy Plan and four times higher than the club average. Staff costs were also significantly higher per £1m invested than either the estimate or the club average whilst the cost of employing Invesco was close to the estimate and significantly cheaper than the club average.

8.5 It is too early to make an accurate analysis of these results but an initial interpretation seems to suggest that the reason the overall and staff costs are so high is that although the total cost and staff costs are not much higher than those used in the estimate, the average funds invested in 2003/2004 are approximately half (£6.9m against £12.7m in 2002/2003) of those invested in 2002/2003. This is as a direct result of the debt repayment policy previously referred to and which would not have been anticipated when the estimate was prepared. Two other issues are also worth noting here a) that a certain amount of time must be devoted to treasury management on a daily basis e.g checking bank balances, calculating cash flows, choosing the best investment vehicle etc no matter what level of investments the Council has and b) for a greater part of the year the in house investments were significantly higher that the £0.8m invested at the year end and therefore would have required significant resources to manage in order to achieve the best possible return. The average balance of £6.9m used in the benchmarking club report to produce the cost per £m invested is derived from the opening and closing investment balances and takes no account of this latter factor. Analysis with the club average is not possible until the raw data is received in August which will then give further information of what each authority has included in its treasury management costs. It may be as well that when compared with our group of authorities rather than against the whole club our cost is not so high. The fund manager cost comparison with the club average is not suprising as the WDC performance has been consistently better over the years and reflects the good deal that WDC received from Invesco when the agreement was signed in 1993.

Table B

Investment Return expressed as a % **(aim to be in highest quartile commensurate with the capital risk)**			
	2003/2004 estimate	2003/2004 Club Average	WDC Performance
Fixed Investments	3.65%	3.73%	3.66%
Call Investments	3.75%	3.69%	3.66%
Money Market Funds	n/a	3.49%	3.47%
Externally Managed Funds	3.90%	3.20%	4.08%
All investments	n/a	3.60%	3.83%

8.6 Table B shows that in respect of in house investments the Council's return is slightly below average which is pleasing given that the club average will include returns from Council's with much larger investment portfolio's than ours. Again the comparison with similar sized treasury management functions may be more illuminating.

Table C

Overall Cost of Treasury Management **(aim to be in lowest quartile)**			
	2003/2004 estimate	2003/2004 Club Average	WDC Performance
	£73,300	Not available	£81,000

8.7 Table C shows that the overall cost of this Council's Treasury Management function rose by £7,700 when compared with the cost in the estimate. This was mainly due to the £10,000 fee paid to Sector our Treasury Advisors for the special debt restructuring report which ultimately lead to this Council becoming debt free. The £10,000 has been offset by other savings leading to the net overall increase of £7,700. When the Benchmarking Club raw data is received in August it will be possible to see how we compare with similar authorities although past experience has shown that few record time spent on treasury management as accurately as we do therefore comparisons may not be as informative as they might have been.

9. BANKING

9.1 The Strategy Plan made reference to the need to retender this Council's banking requirements during 2003/2004. Unfortunately due to other priorities and work constraints this was not possible and will now be undertaken during 2004/2005. HSBC, the Council's bankers will continue to provide its banking requirements in the meantime at the previous level of charges.

10. THE EURO

10.1 The Strategy Plan required that the treasury management function should continue to keep itself informed and identify all procedures, systems and records which would be affected by the changeover to the Euro, should it ever happen. This the function has done by attending the quarterly Euroforums organised by IPF (an arm of CIPFA) and by participating in a pilot project run by HM Treasury to produce "Best Practice" Euro Changeover Plans which can be utilised by other councils.

11. EXTERNAL TREASURY MANAGEMENT ADVISORS

11.1 The Strategy Plan made mention of the need to retender for this service. SECTOR the incumbents proved to be successful and were reappointed on a three year contract commencing January 2004 at £6,000 for year 1, £6,500 for year 2 and £7,000 for year 3.

APPENDIX C

ETHICAL INVESTMENTS

1. INTRODUCTION

1.1 This Council has never had a policy on ethical investment and the following document draws on material supplied both by Sector and Invesco in order to give a flavour of what ethical investments are and how they might affect Warwick District Council.

2. WHAT ARE ETHICAL INVESTMENTS?

2.1 Ethical investment means placing funds and selecting investments in a manner that reflects an Authority's ethical values. Generally, 2 sets of criteria are drawn up – negative and positive values whereby investments are to be avoided or encouraged. Examples could be :

Positive	Negative
Positive Environmental Policy	Pollution Convictions
Community Involvement	Poor Human Rights Record
Equal Opportunities	Nuclear Power

This is a contentious area, as a negative criteria for one Authority may be positive for another. For example in an area where jobs and investment are dependant upon a military presence or the existence of a nuclear power plant it could be argued that these should be supported by the Authority.

3. ETHICAL INVESTMENTS FOR LOCAL AUTHORITY CASH SURPLUSES

3.1 Although ethical investment has been a consideration to be borne in mind by authorities administering pension funds for some time, it has been less of an issue for those authorities like Warwick which only have cash surpluses to invest. The old Approved Investment regulations and now the Annual Investment Strategy severely restricts the types of investment vehicles that can be used and effectively eliminates the purchase of stocks and shares which traditionally have been investment vehicles subject to ethical issues e.g. nuclear power, arms manufacturers and which have caused pension fund authorities some difficulties.

3.2 The Council's current Annual Investment Strategy permits investment either in house or by Invesco in the following vehicles:-

UK Government Debt Management Agency
Deposits with UK Government, Nationalised Industries, Public Corporations and other Local Authorities
Deposits with Banks and Building Societies
Money Market Funds

Certificates of Deposit issued by Bank and Building Societies
Gilt edged Securities issued by UK Government
Eligible Bank Bills
Treasury Bills
Supranational Bonds
Sterling Securities guaranteed by HM Government

3.3 Each of the above has its own problems when assessing their ethical nature as we shall see:-

a) UK Government

The Council can invest with the Government through a number of the above vehicles which provide a good rate of return with the utmost security and UK Gilts are a vehicle used frequently by Invesco to enhance the return on our cash fund. However a significant proportion of government expenditure goes on armaments, nuclear power and road construction. In addition, whilst not condoning the practice the Government generates significant tax revenue benefits from the smoking habit. It can be seen therefore that ethically there is a question to be asked.

b) Banks and Building Societies

It is theoretically possible for an authority to select institutions which have a specific policy on ethical investments, assuming of course that both parties have similar views on what is ethically sound. However, it is common practice for banks with cash surpluses to lend to other banks with a cash requirement. Therefore although the authority has placed their funds with an institution that meets its requirements, it is perfectly possible that their funds are being used by another institution for activities that are not approved. Some banks have policies that prohibit the direct lending of funds to companies and governments of dubious ethical nature, yet inter-bank lending does occur and so funds may be utilised indirectly. Operating a lending list based partly on ethical values would also limit the Council's flexibility to invest its funds as for instance the Co-Op Bank whilst having strong ethical values does not meet the required minimum level of counterparty credit rating and is therefore deemed to be more of a risk from the capital security point of view than say some of the Swiss banks who a few years ago were embroiled in a controversy concerning stolen nazi gold. It should also be pointed out that putting a large proportion of an Authority's cash surplus out with an institution that has strong ethical values is not advisable, as funds should be spread amongst a wide range of institutions to further reduce credit risk as the security of the capital is paramount in placing any Council investment.

c) Money Market Funds

Money Market Funds are a relatively new investment vehicle and one which the Council has gained significant benefit from since it began using them in 2003/2004. They offer triple rated A security with a potential return in excess of that which we could get elsewhere for money deposited up to 7 days. Money Market Funds are a pooled investment vehicle, that is the fund consists of a spread of investments such as deposits, corporate bonds, securities etc with varying interest rates and degrees of maturity. There is an ethical issue here as the fund will invest in corporate bonds which are issued by major international corporations some of whom may be involved in activities which are not approved of by this Council. Given the spread of investments within the fund it is likely that exposure to unethical activities is very limited and in any case impossible for the Council to control without totally withdrawing from this type of investment.

d) Supranational Bonds

Supranational Bonds are used by Invesco to add value to our cash fund. These are triple A bonds issued by organisations such as the European Investment Bank, World Bank and International Bank for Reconstruction and Development. These institutions are active in aiding the redevelopment of the third world but by doing so they could be said to be helping to ruin the natural habitat such as rain forests and aiding unsavoury regimes by investing in that particular country and thereby indirectly helping that regime to stay in power.

4. LEGAL ISSUES CONCERNED WITH PLACING ETHICAL INVESTMENTS

4.1 Every decision taken by a Council should comply with the so called “Wednesbury Principles”. They should :

1. Have regard to all relevant matters which the authority is bound to consider.

2. Exclude from its considerations matters which are irrelevant.

3. Not come to a decision that is “so unreasonable that no reasonable Authority could have ever come to it.”

From the above we can see that the Council owes a duty to the taxpayer to deploy the financial resources available to it to the best advantage – a point made by Lord Diplock in the case of Bromley LBC v Greater London Council (1982). Whilst the security of the investment is paramount, this clearly indicates an obligation to obtain the best possible financial return from investments which may be available, but offers the Council discretion to choose how those investments can be made. The Authority clearly must not reach an investment decision so unreasonable that no reasonable Authority could have been expected to make it.

5. CONCLUSION

5.1 Whilst the idea of ethical investments for Local Authority cash surpluses is, in theory, a good one, as we have seen above it is virtually impossible to carry out in practice without severely restricting the Council’s freedom to invest and obtain the best possible return given the need to protect the security of the investment. Investment interest is an important part of the Council’s budget and a significant drop in its investment income would have a corresponding impact on the Council Tax. For every £50,000 reduction in interest received, the Band D equivalent Council Tax would have to rise by £1.

5.2 However, if at a later date the Council should decide that it wishs to pursue an ethical investment policy, it will first be necessary to agree what ethical issues should form the basis of that policy and then work with both our Treasury Consultants and Invesco to define new counterparty lending lists and what investment vehicles can be used. As already outlined, this will potentially reduce investment income and also increase credit risk by possibly weakening the Council's minimum counterparty credit rating criteria in order to be able to place investments with a restricted number of counterparties.

APPENDIX D

ANNUAL STRATEGY PLAN 2003/2004

1. GENERAL

1.1 This part of the report outlines the strategy that the Council will follow during 2003/2004. Its production and submission to the Executive is a requirement of the C.I.P.F.A. Code of Practice on Treasury Management in the Public Services.

1.2 The suggested strategy for 2003/2004 in respect of the treasury management function is based upon the officer's view on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisers.

1.3 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

a) increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

b) any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2 INTEREST RATE FORECASTS FOR 2003/2004

2.1 The ability to forecast the movement of interest rates is fundamental to successful investment and borrowing strategies. The Council's advisers provide information which is compiled by experienced economists who have a proven track record. Part a) of this paragraph provides an overview and framework within which the outlook for both short and long term rates will be discussed.

a) Prospects for Interest Rates

The United States

In 2001, the United States went through three quarters of recession which was compounded by the terrorist attacks of 11th September. The strong rebound in quarter 1 of 2002 was short lived and faded away in quarter 2. Despite stronger growth in quarter 3, growth in the rest of 2002 and in 2003 is expected to be comparatively weak. As America is the engine house of the world economy, this weak growth has also depressed Eurozone and world growth and trade. The sharp fall in share values as a result of the exposure of corporate accounting scandals in the US during the first half of 2002, and heightened fears of war with Iraq since then, have dented the confidence of US consumers, and so consumer expenditure, which is the main driving force of the US economy.

Recent comments by Alan Greenspan, chairman of the Federal Reserve Board (the American equivalent to the Governor of the Bank of England) have given some hope for optimism that the American economy is beginning to pick up but it is too early to tell whether or not the pick up is likely to be permanent.

The Eurozone

The Eurozone is the other major economic block with which the UK trades. Over the last 12 months the Eurozone economy has come under increasing strain from the effects of the one size fits all policy with regard to its version of our Base Rate which currently stands at 2.75%. The larger economies of Germany and France are clearly in need of much lower interest rates in order to stimulate their flagging economies, indeed Germany is likely to enter a significant period of recession and unemployment is now at a 5 year peak of 11.1% of the work force. As Germany is the world’s third largest economy and the major driving force of the Eurozone economy its problems clearly have a significant impact on trade both in and out of the Eurozone by the UK. However, the smaller economies such as Ireland require a higher base rate in order to stifle excessive consumer demand and reduce the risk of increased inflation.

The situation is further compounded by the Eurozone growth and stability pact which limits the amount by which a Government can run a deficit on its budget to no more than 3% of Gross Domestic Product. For Germany and France this poses a problem as a traditional approach to dealing with a recession is to increase public expenditure to compensate for decreases elsewhere within the economy. France has already indicated that it is potentially going to breach the pact. Germany has taken steps to try and stay within the 3% but ideally would like to exceed the 3% in order to boost its flagging economy. The pact therefore acts as a major constraint on any potential expansion of the Eurozone economy. This has been recognised and there may be future attempts to loosen the terms of the growth and stability pact but in the near term all this adds up to the fact that any boost to the world economy during 2003 is unlikely to come from the Eurozone.

The United Kingdom

By contrast , the UK economy has been relatively insulated from the problems experienced by other major economies over the last 18 months or so largely on the back of strong consumer demand, a rampant housing market and increasing public sector expenditure. Therefore growth in the economy has been at least 2.0% over this period which whilst not at the trend rate of 2.5% has still been reasonably healthy. This has enabled the Monetary Policy Committee (MPC) to maintain Base Rate at 4% for the 14 months to January 2003 which is historically low.

However there are now signs of strain appearing in the economy. For some time the economy has been a two speed one in which manufacturing has been in or near recession due to the depressed global demand whereas the consumer led part of the economy has been roaring ahead due to the reasons outlined in the previous paragraph. It is now becoming apparent that the housing market is now beginning to cool as the South East which originally had been the catalyst for the boom is now experiencing little or no growth at all. Although there is still little sign of consumer expenditure ameliorating, the latest services sector survey came in with the third fall in a row which points to a slowdown in the economy. Manufacturing surveys confirm that the sector is still contracting and is likely to head into its third recession in five years. In addition, consumer sentiment has been hit by the sharp decline in share prices which has had both a physical and mental impact. The mental impact is simply one of a loss of confidence whilst the physical impact comes from not receiving as much from their insurance and savings polices as expected and this therefore undermines their spending power.

All of this clearly means that the outlook for the UK economy is for a period of weaker growth with little inflationary pressure. Indeed weaker growth is likely to lead to decreases in prices and although there is no likelihood of deflation actually becoming a problem (unlike Germany and Japan) it will be increasingly difficult for the MPC to hit its central target of 2.5% inflation per year without changes to the Base Rate.

b) Short term interest rates

The key to short term interest rates (364 days and less) is the Base Rate. In a totally unexpected move the MPC cut the Base Rate to 3.75% on 6th February 2003. Previously it had been assumed that the strength of the housing market, consumer spending and personal borrowing together with an inflation rate slightly in excess of the 2.5% central target would mean that Base Rate would remain at or around 4% for the foreseeable future.

Clearly the MPC are now concerned about the effects of the weakening economy and the economic impact of war with Iraq on the central inflation target and have stated that they needed to make this cut in order to keep inflation up to the 2.5% central target two years ahead.

The interest futures market is already pricing in another cut of 0.25% by June 2003. Our treasury management adviser’s central forecast is now for 3.75% for the rest of this year but that a cut to 3.50% cannot be ruled out if the economic situation worsens both internationally and domestically. Current money market short term interest rates, having already priced in another 0.25% cut, are in the range of 3.69% for 1 month to 3.52% for 12 months. It is unlikely that there will be much deviation from these current rates for much of 2003/2004.

c) Long Term interest rates

Long term interest rates both for investments and borrowings are linked to the performance of the Government Gilt market. Public Works Loans Board (PWLB) rates are currently at remarkably low levels(1 year 3.625% to 25 years 4.750%) and are likely to stay there whilst share prices remain depressed and there is the threat of war with Iraq. Also over the past year we have seen various accounting scandals and a much more realistic view of likely earnings in the telecoms and high tech sectors. In addition because of the steep fall in share prices, various life insurance companies have been forced to sell equities in order to improve their solvency. The combination of these factors has led to a so called “flight to quality” whereby investors seek to invest in vehicles which are seen to be rock solid investments unaffected by economic factors or company malpractices . They sell equities and purchase Government bonds (Gilts), the natural effect of this is drive the price up and the yield down. Because of this a consistent rise back to neutral levels of interest rates (around 5%) looks unlikely. The forecast therefore for 2003/2004 is for a continuation of historically very low gilt yields. However one factor which could lead to an increase in gilt yields and therefore long term interest rates is the increase in public expenditure initiated over the past two years by the British Government. In order to pay for this expansion the Government assumed a rate of growth in the economy which would have generated additional tax revenues thus limiting the need to issue gilts. This rate of growth appears to be optimistic so in order to continue with the expansion, the Government will have to issue additional gilts which could have the effect of dragging gilt prices down and therefore yields up.

The Council does not borrow externally to finance its capital programme as long term borrowing rates are currently in excess of investment rates by a margin of at least 1% therefore it is more economical to use internal resources such as set aside capital receipts which otherwise might have been externally invested. However, long term interest rates do have an impact on its debt management programme in determining when debt restructuring might take place and the levels of premiums due on the redemption of debt.

3 **CAPITAL EXPENDITURE AND FINANCING STRATEGY**

3.1 The Council is able to finance its capital programme in the following ways:-

a) By the use of its Basic and Supplementary Credit Approvals (permission to borrow to finance capital expenditure). For 2003/2004 these amount to £1,795,000. It is intended to use these credit approvals to part fund the Council's capital expenditure from set aside capital receipts as opposed to actual external borrowing.

b) From Usable capital receipts. It is anticipated that there will be significant capital receipts from the sale of Council Houses and significant General Fund capital receipts available in 2003/2004 from sales of property assets currently in progress.

c) From revenue or reserves.

d) From external contributions.

e) From capital grants. For 2003/2004 these include disabled facilities improvement grants and also grants towards the E Government Initiative and the Communities against Drugs Project.

3.2 The Council's proposed 2003/2004 General Fund capital programme amounts to £7,328,800. It is currently intended to finance this as follows a) capital receipts £5,747,000 b) contributions from revenue and reserves £1,055,772 and c) external contributions amounting to £526,028.

3.3 The Council's 2003/2004 expected Housing Investment Programme amounts to £6,438,028 and currently will be financed as follows a) £600,000 Credit Approvals b) £120,000 capital grants c) £806,000 capital receipts from the sale of council houses and repayment of mortgage advances and d) £4,912,028 from revenue and reserves.

3.4 It will be noted that after the use of £600,000 credit approvals on the Housing Investment Programme, some £1,195,000 remains to be allocated. It is intended to carry out a major review of the Council's capital programmes early in 2003/2004 and the allocation of the £1,195,000 will be made then.

3.5 As part of the Local Government modernisation initiative, work is currently being undertaken by CIPFA on behalf of the ODPM (Office of the Deputy Prime Minister) to produce a Prudential Code for Capital Finance. This is intended to replace the current practice of the Government controlling the amount Councils can borrow by the issue of annual credit approvals. The emphasis in the future will be on Council's determining for themselves how much they can borrow by reference to the affordability of the revenue costs of that borrowing.

3.6 This will be done by reference to a set of Prudential Indicators which will be specific to each authority and are likely to include such indicators as a) a limit on the amount of external debt both in total and raised during the year and b) a percentage limit on the total revenue cost of borrowing (principal and interest repayments) as a proportion of the total raised by way of Government Grants such as Rate Support Grant and National Non Domestic Rates added to the Council Tax income.

3.7 This may result in the Council having more borrowing resources to fund its future capital programmes but the earliest the new arrangements are expected to commence is 1st April 2004. The Government will also retain a power to enable it to control the overall limit of Local Government borrowing if its feels that it is necessary in order to control the macro economic climate.

3.8 The second exposure draft of the new code is expected in the spring with the final version to be published in the Autumn. It will be necessary during that period to carry out an exercise to assess the potential impact on the Council's capital programme financing strategies as well as to assess the impact on the Council's revenue budget so that the necessary adjustments can be made during the budget setting process for 2004/2005.

4. TEMPORARY BORROWING

4.1 The Council will continue to engage in short term borrowing (up to 364 days) when necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. It may also be necessary to undertake short term borrowing to assist in any debt restructuring exercise undertaken. In each case, wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable.

5. INTEREST RATE EXPOSURE (BORROWING)

5.1 Section 45 of the Local Government and Housing Act 1989 requires the Council to fix each year a) the overall borrowing limit, b) a maximum amount of short term borrowing within the overall borrowing limit and c) the maximum proportion of interest on borrowing which is subject to variable rate interest.

5.2 Part IV of the Local Government and Housing Act 1989 requires the Council to manage its affairs so that at any one time its total outstanding external borrowings and credit arrangements do not exceed its Aggregate Credit Limit. In simple terms the Aggregate Credit Limit includes allowances for a) any temporary borrowing in respect of both revenue and capital b) The Council's outstanding obligations from previous capital investment and C) the amount by which the Council's approved investments and cash balances exceed its usable capital receipts.

5.3 At its meeting on 10th February, the Executive recommended to Council the following borrowing limits for 2003/2004. :-

Overall Borrowing Limit	£30,000,000
Short Term Borrowing Limit	£20,000,000

That the proportion of total amount of interest payable by the Council at a variable rate of interest be 30%.

It is expected that these limits will be ratified by the Council at its meeting on 26th February 2003.

6. DEBT RESTRUCTURING

6.1 At the present time, the Council's long term debt is split between the Public Works Loans Board (PWLB) and DePfa bank and the outstanding debt at 1st April 2003 will be £12,250,000 comprising £10,250,000 PWLB fixed interest loans and a £2,000,000 fixed interest loan with DePfa bank. The majority of these loans are repayable at maturity. Currently, the estimated total fixed interest bill for 2003/2004 is £870,600.

6.2 It is estimated that the PWLB quota (the amount the Council can borrow from the PWLB to finance long term debt or for restructuring debt) for 2003/2004 will be £2,247,795. This is available for either part funding of the Council's 2003/2004 capital programme or debt restructuring purposes.

6.3 There are two purposes to debt restructuring, the first being the smoothing of the debt maturity profile in order to ensure that the level of maturing debt in any one year does not cause financing problems. The second concerns the ability to take advantage of interest rate changes in order to minimise the amount of interest payable.

6.4 As part of the strategy to ensure that the General Fund bears as little of the external borrowing interest payable as possible, the Financial Strategy incorporates the effect of repaying £2m long term debt in each year. Sector, our Treasury advisers are currently undertaking a review of the Council's debt in order to determine whether or not this strategy is still appropriate. The outcome of the review will be factored into the next revision of the Financial Strategy due early in 2003/2004. The results of any debt restructuring exercise will be reported to Members.

6.5 A recent announcement by the Government means that with effect from 1st April 2003, the Council will no longer be reimbursed by the Housing Corporation for all the advances it makes to Housing Associations in pursuit of its Social Housing Programme, The monies received from the Housing Corporation are 100% set aside to repay debt. This development has the potential to affect the Council's debt restructuring programme but at this stage it is too early to tell exactly what impact there will be or what the effect is likely to be in terms of any additional costs/ savings to either the General Fund or Housing Revenue Account. The issue is further clouded by the uncertainty surrounding the replacements for Credit Ceilings and Minimum Revenue Provision which will follow the introduction of the Prudential Code for Capital Finance and which have a significant bearing on debt restructuring decisions.

7. INVESTMENT STRATEGY.

7.1 The Council either through its internal treasury function or its external investment agents, Invesco Asset Management Ltd., will continue to invest in the Money Markets such cash surpluses as arise on a day to day basis. The investments will be in line with the criteria in the relevant Treasury Management Practice and subject to the counterparty limits defined therein. In deciding to invest the ultimate objective will be to maximise the return whilst safeguarding the capital sum and avoiding cash flow problems.

7.2 The Council has both core (i.e. investments which are not needed for payment of debts) and cash flow driven investments. It is normal practice to invest cash flow driven money to known dates where large debts such as precepts, NNDR etc. have to be paid out. However in the current climate of low investment interest rates, the treasury management function will have to more actively manage not only the core investments but also the cash flow driven investments in order to maximise the return to the Council without significantly increasing the exposure to risk. This will be done by utilising new investment vehicles such as the Abbey National and HBOS Business Reserve Accounts which offer significant mark ups over the going money market rate for an equivalent investment period. These accounts will be subject to the same limits as all other similar counterparties. In addition more use will be made of overnight deposits in the money market whenever there are favourable rates. The treasury management function will also make use of triple A rated Money Market Funds which give a return at least comparable with normal temporary deposits but offer better liquidity.

7.3 The Council's current counterparty limits for suitably credit rated banks and Building Societies is £3 million. £1 million of this in respect of the banks is reserved for Invesco's investments leaving £2 million for the in house team to invest. It has become noticeable over the last year or so that the in house team find it increasingly difficult to obtain a decent interest rate on investments of less than £1.5 million each. With a £2 million investment limit this means that effectively each counterparty is limited to one in house investment at any one time. Although the Council has an extensive lending list, only a limited number of counterparties will take deposits of the typical size (£1m to £1.5m) that the Council has available to lend at any one time. An increase in the counterparty limit to £4 million for all counterparties outlined in TMP1 with the exception of Category B Building Societies (which would remain at £1 million for six months) would enable better returns on the Council's investments by enabling us to place two £1.5 million investments with each counterparty, each of which would attract a better interest rate than two similar £1 million investments with only a minimal increase in risk as described in 7.4.

7.4 The Council's investment portfolio averages between £30 to £35 million at one time. The current £3 million limit therefore means that any one counterparty has no more than 11.6% of the portfolio at any one time. In fact the current portfolio is £32,150,000 and the Council's exposure to any one of the 28 counterparties currently invested in ranges from 0.13% to 10.89%. An increase to £4 million would mean that the maximum exposure that the Council has to any one counterparty would rise to around 13.3% which is considered to be acceptable. In practice given the diversity of the portfolio it is likely that only a few counterparties will have the full exposure limit at any one time. It is recommended therefore that the counterparty limit is raised from £3 million to £4 million for those counterparties described in 7.3.

7.5 The portfolio will be managed so as to reduce its vulnerability to sudden changes in interest rates (particularly downwards) to a minimum acceptable level although the use of overnight deposits and to a lesser extent Money Market Funds will need to be taken into account as these vehicles are more liable to fluctuating interest rates than the traditional fixed temporary deposit.

7.6 As mentioned in paragraph 7.1, Invesco have been appointed as the Council's external investment agents, and they will receive a fee equivalent to 0.125% per annum on the average value of the Managed Fund during the period in respect of which the fee is payable (subject to a minimum of £7,500 per annum) payable on a quarterly basis. In addition, the Council will pay all brokerage and dealing commissions, VAT and stamp duty, incurred by Invesco in managing the fund.

7.7 Invesco have stated that they expect to achieve a 3.90% rate of return on the portfolio for 2003/2004. It is expected that this will be achieved through the use of cash, Money Market instruments (such as Certificates of Deposits), Gilts and Supranational bonds.

8. <u>BEST VALUE</u>

8.1 The Council participates in the C.I.P.F.A. Treasury Management Benchmarking Club and its investment performance is benchmarked against a number of comparable authorities in the following areas:-

a) Investment management costs per £1m invested split between i) total cost (2003/2004 estimated to be £1,441) ii) staff costs (2003/2004 estimated to be £790) and iii) external costs (fund managers costs which are estimated to be £1,278 in 2003/2004). The aim is to be in the lowest quartile for cost.

b) Investment returns split between i) fixed investments (2003/2004 expected return 3.65%) ii) call investments including Business Reserve Deposit Accounts (2003/2004 expected return 3.75%) and iii) externally managed funds (2003/2004 expected return 3.90%). Here the aim is to be in the highest quartile for return commensurate with the capital risk.

c) Overall cost of treasury management (in 2003/2004 estimated to be £73,300). Again the aim is to be in the lowest quartile.

d) The internal treasury function will also seek to achieve an average rate of return 1/16th% below the LIBID (London Inter Bank Bid Rate) average for comparable investment periods (e.g. up to 7 day, 1 to 3 months, 3 to 6 months and over 6 months).

e) The Invesco cash management fund is required to outperform the Financial Times 7 day LIBID rate compounded weekly with a target return of 110% of the benchmark over a 3 year rolling period.

9. BANKING

9.1 The Council has decided to tender for its banking services at least every 5 years. The current contract with HSBC expires on 1st February 2004. It will therefore be necessary during 2003/2004 to undertake a re tendering exercise. Since the present tender was negotiated there have been considerable changes in the way banking services have been provided with a move away from “traditional” branch based services to those provided electronically. The Council has always in the past made it a condition of the tender that the successful bank must have a branch centrally located in Leamington Spa. The advent of electronic banking, the Council’s own E Government agenda and the relocation of the Council’s main office to Riverside House may mean that this pre requisite is no longer valid. Telephone and E banking may also produce potential cost savings for the Council as well as provide an enhanced service for its customers. In addition, during the life of the next tender, the Euro may become a reality in the United Kingdom. These factors will be fully considered when choosing the Council’s banking partner.

10. THE EURO

10.1 The Treasury has commenced its assessment of the five economic tests which require to be passed before the United Kingdom can progress further towards membership of the Euro. The announcement as to whether the tests have been met will be made by June 2003. Should these tests be met and the subsequent referendum approve applying for membership of the Euro there will be a need to commence planning for the impact on the Authority and in this particular case, treasury management. Therefore the treasury management function will continue to keep itself informed and identify all procedures, systems and records which would be affected by the changeover to the Euro. Should the Euro be adopted the treasury management function will produce a changeover plan and commence whatever preparation work is required during 2003/2004.

11. EXTERNAL TREASURY MANAGEMENT ADVISERS

11.1 The present contract with SECTOR runs until April 2004. Therefore it will be necessary to commence work on the re tendering for this service to the Council during the currency of this strategy.