TREASURY MANAGEMENT

1 SUMMARY

1.1 This report seeks authority for the appointment of treasury management advisors and a process that will lead to the appointment of a fund manager.

2 BACKGROUND

2.1 In the management of its finances, the Council borrows money and invests cash surpluses. Most borrowing tends to be long term in-line with permissions issued by the Government to both undertake capital expenditure and borrow to finance that expenditure.

2.2 Although Local Authorities have options, all Rochford's long term borrowing is from the Public Works Loans Board (PWLB). The Board is prepared to make loans to the Authority within annual quotas. Although loans reflect market conditions, these are usually the best available rates and most Authorities, who have a need to borrow, make use of their PWLB quota.

2.3 Legislation allows the Authority to make investments with a large number of counterparties authorised by the Bank of England. Investments can be through loans, certificates of deposits, gilts etc. Investments must have a maturity of less than a year.

3 THE CURRENT POSITION AT ROCHFORD

3.1 At 31 March 2000, the draft accounts sheet shows the following

Description	£M
Borrowing – PWLB	15.4
Investments	9.1
Interest Paid	1.4
Interest Received	0.5

3.2 It can be seen from the above that Treasury Management is a significant issue in relation to financial management. The sum invested represents the total of reserves, fund balances for General Fund, Housing Revenue Account and Collection Fund, capital receipts in hand and the affect of debtors and creditors. It also includes the Provision for Credit Liabilities which is a cash backed fund for the repayment or avoidance of debt.

3.3 As previously mentioned long term borrowing by Rochford is from the PWLB. The above balance represents sums currently outstanding on the basis of funding decisions taken over the last 20 years.

3.4 Investments made by the Authority must be in line with the Treasury Management policies approved by the Council. The main aspect of this policy is the authorised lending list. The current list is shown at Appendix A. The list has been drawn on a restrictive basis in order to minimise risk to the Authority. This risk is either in the failure of one of the counterparties or a reduction in the capital value of the investment. With regards the latter, this Authority currently invests in UK based loans; usually at fixed interest for fixed periods. The Authority therefore does not have a risk to the capital value of its investments.

3.5 Borrowing decisions tend to be taken once a year when a new loan is required by the PWLB. Weekly rates are graphed to try to identify the most advantageous date for the Authority to take the loan.

3.6 Investments do not tend to be based on a reading of the market but based on cash-flow management. The cash-flow for the Authority for the year is broadly mapped and funds are released to provide for major liabilities e.g. precept payments, salary runs etc. When it can be seen that there is money available for these liabilities, funds are invested to the next date when funds are required.

3.7 We currently monitor our investment performance against the inter-Bank one month rate. There are problems with this comparison in that the inter-Bank market deals with amounts considerably in excess of our usual dealing size.

4 BEST VALUE

4.1 The review of Treasury Management is a Best Value requirement for 2000/01.

4.2 Clearly, the Authority will still have the need to borrow and invest its surplus funds. Looking at the existing process within Rochford, the strengths of the existing system are:-

- It is relatively safe for the Authority in that the lending list limits risk.
- It is easy to administer as investments are mainly fixed interest loans for fixed periods. Again with a limited lending list the counterparties are well-known to the Authority.
- It can be managed without the need for significant technical information relating to the money market and the economy.

4.3 The weaknesses of the current system are:-

- This approach does not maximise investment returns for the Authority.
- Although performance is measured, it is a crude measurement. Fund performance is a very sophisticated process.

4.4 In terms of Best Value, we therefore have a function that has to be undertaken. It is being managed effectively within the process that is easy to administer and is low in risk. What we do not have is a system that maximises the return for the Authority and can be tested against other fund performances.

5 WAY FORWARD

5.1 In order to address these weaknesses, the solution is to move the fund management to a professional basis.

5.2 In order to gain information and access possible costs, preliminary discussions have been held with Prebon Financial Consulting. This is a division of Prebon Marshall Yamane Ltd. They are Financial Consultants who currently have around 50 Local Authority clients dealing with Treasury Management. The company tailor the services to each of these Authorities to deliver the financial service required.

5.3 For Rochford, there are four key areas where the consultants can assist the Authority:-

- Treasury Management Strategy and Procedures
- The selection and strategy for a Cash Fund Manager
- Performance Monitoring of the Cash Fund Manager
- Debt Management Advice

5.4 The cost of this service, based on a five year contract (which can be terminated after three years) is £6,750 per annum. There is an additional one off fee of £3,500 for the selection process of a Cash Fund Manager. The fee for an appointed Cash Fund Manager is estimated at around £12,500.

5.5 As can be seen from the above, the service is not cheap with the first year fees around £22,750 reducing to £19,250 for subsequent years. What we will obtain for this however is a professionally based Treasury Management function. The figures shown earlier in this report showed that Rochford's Treasury Management is a significant part of financial management. The decisions on borrowing are important in that they tend to be focused on a single decision made within a year and have an effect on the Authority for the next, say, 25 years. The financial impact is however not that significant as in Rochford's position, the cost of external debt is charged to the Housing Revenue Account. Here a significant percentage is met by housing subsidies. At the moment, higher loan costs equate to higher subsidies and lower costs equate to lower subsidies. There is therefore a light exposure to interest rate decisions.

5.6 The Authority still has to demonstrate that it has made reasonable decisions in respect of borrowing and advice that will in future enable us to borrow for say, ¼% lower than would normally have been the case will produce a saving of £2,500 per year on a loan of £1M. In addition, there is the possibility that the subsidy rules could be amended to remove or alter the relationship of cost of loans and subsidy as shown above.

5.7 Current rules allow the relevant costs in relation to Treasury Management to be recharged to Housing. Subsidy is however only payable on a Government-controlled total.

5.8 Investment income is a direct credit to the General Fund. It is expected with the employment of professional fund managers the current investment returns can be increased. This increase will come from the following:-

- The Fund Manager will use market information and professional expertise to adjust the timing of decisions on investments.
- The Fund Manager will have access to investment opportunities that are not open to the Authority direct. For example, many counterparties will have minimum transaction levels of say £10M and above.
- The Fund Manager will, with the authority of the Council, invest in a wider range of investments from those currently authorised thereby attracting higher returns.

5.9 The range of investments is a key part of the future policy. Reference was made to the existing list of Authorities' counterparties (Appendix A). The list is comprised of household names deemed to be safe. The list does not cover the many financial organisations authorised by the Bank of England who have a higher credit rating than those currently authorised. It also does not include the Government itself.

5.10 The Authority needs to determine the right balance between risk and return. It has to be remembered that our current risk is low risk, not no risk.

5.11 With the professional approach to cash management, it will be expected that there will be additional returns on investments made. On a total investment of around £7M, an additional return of ½% is worth £35,000 as additional income to the General Fund.

6 THE FUTURE PROCESS

6.1 This report is the first of a series of reports dealing with Treasury Management. If Members approve the appointment a firm of Financial Consultancy, the process will be as follows:-

- To draw up a specification and enter a tendering process in order to appoint a firm of consultants.
- To review strategic planning and produce the Treasury Management Strategy Report and Policy Statement
- To review the Authority's Treasury Management Practices and Procedures
- To undertake a health check using CIPFA's Code of Practice as a benchmark.
- To produce a specification for the appointment of a Cash Fund Manager together with the suggested criteria for investment policies. These policies will include the criteria for counterparties (credit ratings etc) the percentage of investments to be authorised in gilts and sterling certificates of deposits etc.
- Officers will then report back to this Committee to obtain authorisation to these parameters within which the Cash Fund Manager will operate.
- The consultants will then produce a list of appropriate Cash Fund Managers and Officers will then reduce this list through discussions with Consultants to a shortlist of say, four. Officers will then interview the shortlisted Managers and appoint a Fund Manager.
- All processes will be amended to deal with the new basis of investments.
- The consultants will produce ongoing reports monitoring the effectiveness of the appointed Fund Manager and keep the Authority up to date on issues affecting Treasury Management.
- The performance of residual in-house investments will be compared against the appointed Fund Manager.
- Treasury management performance will be reported to Members as now.

7 RESOURCE IMPLICATIONS

7.1 Full year fees are estimated at around £22,800 in the first year and £19,300 thereafter. Although reductions in the cost of debt are anticipated, they currently do not have an impact on the General Fund. Additional income to the General Fund of around £35,000 per annum is possible and therefore there will not be a need for an additional net provision within the estimates. The budget book will however in future contain the added line showing the cost of the consultants.

8 LEGAL IMPLICATIONS

None

9 PARISH IMPLICATIONS

None

10 RECOMMENDATION

It is proposed that the Working Group **RECOMMEND**

(i) That Members authorise the appointment of Treasury Management Advisors through the tendering process for a period of 5 years (Notice at 3 years).

(ii) That Members receive a further report on the appointment of the Cash Fund Manager together with the criteria for investments following the initial work of the consultants. (HFS)

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