

Treasury Management

Recommendation:

- (i) That the performance of the Fund Managers and the Devon and Cornwall Investment Fund along with the overall functioning of the Treasury Management Strategy be noted

1. Performance of the Fund Managers

- 1.1 On the basis of previous reports on Treasury Management performance the Police Authority decided to disinvest from the poorest performing fund manager on a phased basis. Information was sought from Morley about their holdings and it was clear that funds could be withdrawn promptly without losses. All funds have therefore been withdrawn from Morley and invested in the Devon and Cornwall Investment Fund (details are provided in paragraph 2 below). The table below gives the performance for the two fund managers to the end of September 2007 and also unaudited figures for Investec until the end of October 2007.

Period 1 April 2007 to 30 September 2007 % return on investment after fees			
	Benchmark %	Actual %	Difference %
Investec	2.90	2.76	-0.14
Morley	2.90	2.46	-0.44
Period 1 April 2007 to 31 October 2007 % return on investment after fees (based on unaudited figures)			
Investec	3.39	3.30	-0.09
Morley	N/A	N/A	N/A

These figures make clear that the trend of under-performance by Morley identified in earlier in the year continued in August and September. They also show a slight improvement for Investec.

- 1.2 Investec have recently provided a forecast of their performance for the full financial year 1 April 2007 to 31 March 2008.

Annual Forecast 2007/8	
Investec – “central case”	5.80%
Investec – Forecast for Benchmark	5.65%

This shows that Investec are forecasting that they will exceed the benchmark when the full year is taken into account. This remains to be seen - it is hoped to meet with Investec in December.

- 1.3 The budget has been set on the basis of a return from short-term deposits of 5.4%. The returns received to date and the central case forecast provided by Investec now indicate an average return of 5.5%.

2. Devon and Cornwall Investment Fund

- 2.1 Following the decision to withdraw funds from Morley a Devon and Cornwall Investment Fund has been established. The aim of the fund is to invest in fixed interest deposits. The detailed investment strategy was set out in the paper to Resources Committee on 13 September. The investment decisions for the fund and the current deposits are set out in Annex 1.

- 2.2 The performance of the fund is as follows

Devon and Cornwall Investment Fund	
Average rate of interest as at 31 October 2007	6.10%
Benchmark rate (7 day LIBID) for October 2007	5.83%

The budgeted rate of return is 5.4%. Initial returns are good but the average rate of interest for the year may fall slightly as shorter term deposits reach maturity before the end of the year and the funds are re-invested. The investment strategy is based on a likely decline in interest rates over the next few months. Money has been lent over longer periods (a small portion for two years). At present the strategy appears to be sound.

3. Total Short Term Deposits

- 3.1 The fund valuations as at 31 October 2007 are as follows:

	£000
Investec	27,042
Devon and Cornwall Investment Fund	<u>14,560*</u>
Total	41,502

*including accrued interest

In addition to the above sterling deposits a holding of 2 million euros is deposited with Investec (further details of this holding are given at paragraph 7.2 below).

4. Performance of Cash Managers

- 4.1 The average rate of interest earned by Devon County Council on daily cash balances for the period 1 April 2007 to 31 October 2007 was 5.63%. This compares with a budgeted rate of 5.4%

5.0 Borrowing

- 5.1 The position with regard to borrowing has not changed since the last report. The original capital programme contained proposed borrowing of £8.284m of

which £4.124m was to be borrowed in July 2007. The relatively high level of interest rates over the period and slippage on the capital programme mean that additional borrowing has been deferred to reduce costs. Interest rates and capital spending will continue to be reviewed during the year. Additional borrowing will only take place if planned spending and interest rates suggest that this would be prudent.

6 Budget Position for 2007/8

6.1 The budget position is included in the Financial Monitoring report. This is a net benefit of £444,000 after the virement of savings of £230,000 earlier in the year. This arises from:

- a reduction in the cost of interest payments for long term borrowing (borrowing in 2006/7 was less than originally planned and additional borrowing for early 2007/8 has been deferred).
- the latest forecast for average interest receipts to be achieved by the external fund managers is slightly above the budget forecast
- the interest rate for the Devon and Cornwall Investment Fund is substantially above the budgeted rate for short term deposits
- an increase in the average balance available for investment by the Cash Managers (daily balances) as compared with the budget model. This is caused by; additional capital receipts (for example the sale of masts), increased capital grants, the profile of pensions top grant which was not known at the time the budget was set, and deferred payment of pay awards etc.

6.2 There may be scope for further savings dependent on the profile of cash spending in the remaining months of the year and the interest rates achieved on investments.

7.0 Foreign Exchange Transactions

7.1 The price of the new Force Helicopter (to be delivered in 2010) is fixed in euros and the deposit was due in October . The national framework agreement for the purchase of Helicopter allows the exchange rate for the deposit to be fixed at the point that the order is placed. The exchange rate for euros was monitored in August and early September and this showed that the euro was strengthening against the pound. The order was therefore finalised and sent as quickly as was possible (the order date was the 17 September). The euro then continued to rise against the pound confirming that this was the correct decision. If the actual cost in sterling as fixed on the order date is compared to the potential sterling cost on the invoice date a saving of £13,500 was achieved by placing the order quickly.

7.2 Following approval by the Police Authority to make specific arrangements to protect against exchange rate movements in relation to the cost of purchasing the new Force Helicopter 2 million euros were purchased in October 2007 and deposited in with Investec in a euro liquidity fund. This transaction will protect against increases in the cost of euros relative to the pound.

8.0 Conclusion

The Treasury Management Strategy is producing useful budget savings that offset spending pressures elsewhere in the budget. However the complexity of world financial markets mean that interest rates have been very volatile over the last 4 months. In addition whilst economic forecasts can be used to predict trends in “fundamentals” other factors are less easy to predict and can have a significant impact on both market rates and the timing of changes in market rates. The investment strategy for the new Devon and Cornwall Investment Fund is based on an interpretation of the economic indicators that suggests a slow down in growth in the domestic and world economies and a fall in interest rates. Close monitoring of market rates and underlying economic data will take place with the aim of maximising the returns over both the short and medium term horizons.

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Annex 1

Devon and Cornwall Police Authority Investment Fund - Investment Decisions

Date	Decision
3 October 2007	Fund opened with £12.0m disinvested from Morley and invested immediately for a range of periods (see table below)
22 October 2007	Temporary cashflow surplus plus a forecast decline in interest rates over next 3 – 12 months led to a decision to temporarily increase the fund by £2.5m and to increase the average length of deposits. An extra £2.5m was invested for 2 years. This will protect against reduced rates later in 2008/9 should interest rates fall as predicted.
5 November 2007	Concern over rates available when Newcastle Building Society deposit matures in January 2008 led to a decision to reduce shorter term holdings and increase longer term holdings whilst higher rates are available. DEPFA bank (1-month) monies replaced by 12-month deposit with Skipton Building Society.

Devon and Cornwall Investment Fund Holdings

	Start Date	Maturity Date	Length	Rate (%)	3-Oct-07 £000	22-Oct-07 £000	05-Nov-07 £000
DEPFA	03/10/2007	05/11/2007	1 mth	6.05%	2000	2000	0
Newcastle BS	03/10/2007	04/01/2008	3 mths	6.24%	2000	2000	2000
Alliance & Leicester	03/10/2007	03/10/2008	1 year	6.06%	3000	3000	3000
Yorkshire BS	03/10/2007	03/10/2008	1 year	6.08%	3000	3000	3000
Bradford & Bingley	03/10/2007	03/10/2008	1 year	6.05%	2000	2000	2000
Coventry BS	22/10/2007	01/10/2009	2 years	6.12%		2500	2500
Skipton BS	05/11/2007	03/11/2008	1 year	6.12%			2000
Total					12,000	14,500	14,500
			Average rate		6.0917%	6.0966%	6.1062%