REPORT NO. 1432/02

ANGUS COUNCIL

FINANCE AND INFORMATION TECHNOLOGY COMMITTEE – 3rd December, 2002

POLICY AND RESOURCES COMMITTEE – 10th December, 2002

TREASURY MANAGEMENT ANNUAL REPORT – 2001/2

REPORT BY THE DIRECTOR OF FINANCE

ABSTRACT

This report represents the Treasury Management Annual Report for 2001/2 as a requirement of the Treasury Management in the Public Services Code of Practice issued by the Chartered Institute of Public Finance and Accountancy in 2001.

1. RECOMMENDATION

It is recommended that members consider and approve the attached Annual Report on Treasury Management Activities for Angus Council for 2001/2. Members should note the requirements of the Treasury Management Policy Statement and Section 15 of the Council's Financial Regulations pertaining to Treasury Management. Members should also note the availability of the Treasury Management Systems Document and the Treasury Management Practices Document. The Treasury Management Systems Document covers detailed systems and procedures within the Treasury Management Section of the Finance Department and the Treasury Management Practices Document sets out the manner whereby the Treasury Management Policies and Objectives may be achieved, managed and controlled.

2. INTRODUCTION AND BACKGROUND

The need to prepare a Treasury Management Policy Statement and Treasury Management Annual Report is a requirement of the Treasury Management in the Public Services Code of Practice published by the Chartered Institute of Public Finance and Accountancy in 2001. Members are referred to Report Number 786/02 to the Finance and Information Technology Committee dated 18th June, 2002 at which the Code of Practice was adopted for implementation within Angus Council.

3. TREASURY MANAGEMENT ANNUAL REPORT

A copy of the Treasury Management Annual Report is attached at Appendix 1 for consideration and approval by members.

4. TREASURY MANAGEMENT POLICY STATEMENT AND SUPPORTING TREASURY MANAGEMENT PRACTICES DOCUMENT

The Treasury Management Policy Statement and supporting Treasury Management Practices Document were most recently approved by the Finance and Information Technology Committee dated 18th June, 2002. Since that time the Policy Statement and Practices Document have been strictly adhered to and have resulted in the exercise of stringent financial control within the Treasury Management Section of the Finance Department. Notwithstanding the foregoing, the Policy Statement and Practices Document and their operation within the Treasury Management Section of Finance has been the subject of ongoing monitoring to take account of changing circumstances in this area of activity. Such a review has revealed the operational adequacy and effectiveness of the Policy Statement and Practices Document with no requirement for amendment at this time.

A copy of the existing Treasury Management Policy Statement is attached at Appendix 2 and members should note that the Treasury Management Practices Document is available on demand.

5. CONCLUSION

It is concluded that members should consider and approve the attached Annual Report on Treasury Management Activities for financial year 2001/2 as attached at Appendix 1.

6. HUMAN RIGHTS IMPLICATIONS

There are no Human Rights Implications arising as a result of this report.

7. CONSULTATION

The Chief Executive and the Director of Law and Administration have been consulted in the preparation of this report.

DAVID S SAWERS
DIRECTOR OF FINANCE

NOTE

No background papers as defined by Section 50D of the Local Government (Scotland) Act, 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing this report.

Appendix 1

Angus Council - Treasury Management Annual Report

The Annual Report covers:

- the Council's treasury position for 2001/2;
- performance measurement;
- borrowing strategy for 2001/2;
- borrowing outturn for 2001/2;
- investment strategy for 2001/2;
- investment outturn for 2001/2;
- compliance with treasury limits;
- debt rescheduling.

1. Portfolio Position for 2001/2

The Council's total external debt position at the beginning and end of year was as follows:

		31st March 2002 Total Principal		31st March 2001 Total Principal	
Fixed Rate Funding	PWLB	£ 104.940 m		£ 101.476 m	
	Market	£ 1.250 m	£ 106.190 m	£ 1.250 m	£ 102.726 m
Variable Rate Funding	PWLB	£ Nil		£ 2.000 m	
	Market	£ 2.523 m	£ 2.523 m	£ 2.959 m	£ 4.959 m
Total External Debt			**£ 108.713 m**		**£ 107.685 m**
Total Investments - internally managed			£ 10.776 m		£ 12.450 m

The Council's equated external debt position and corresponding equated external interest rate for the year was as follows:

		2001/2 Equated Principal		2001/2 Equated Rate	
Fixed Rate Funding	PWLB	£ 103.158 m		6.21 %	
	Market	£ 1.250 m	£ 104.408 m	6.95 %	6.22 %
Variable Rate Funding	PWLB	£ 1.692 m		4.07 %	
	Market	£ 2.906 m	£ 4.598 m	8.16 %	6.65 %
Equated External Debt			**£ 109.006 m**		**6.24 %**
Equated Investments - internally managed			£ 15.774 m		4.97 %

In addition to the financing of capital debt from external sources, the Council maintains a number of internal funds and current revenue balances which are used in support of capital debt. The interest added to internal funds is based on the previous year's loans fund rate and, therefore, the rate applied for 2001/2 was 7.08 per cent (Reference Report Number 693/97 to the Finance and Information Technology Committee dated 10th June, 1997 and the Policy and Resources Committee dated 17th June, 1997). The interest added to current revenue balances is based on an average short term rate for 2001/2 which was calculated at 4.79 per cent.

It should be noted that the Angus Council loans fund rate for 2001/2 was 6.37 per cent which is below the Scottish Local Authority average loans fund rate of 6.95 per cent.

The Council, of course, incurs expenses in administering and managing the loans fund and the rate required to recover such expenses from borrowing accounts in 2001/2 was 0.075 per cent.

It should also be noted that the foregoing includes capital debt which the Council administers for other organisations, for example, Tayside Police, from whom it receives reimbursement of loan charges (i.e. the amount of principal repayments and charges for interest and expenses) incurred on their behalf. The amount of capital debt outstanding at 1st April, 2001 and administered throughout 2001/2 for Tayside Police was £12,449,156.89.

2. Performance Measurement

One of the key changes in the 1996 revision of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities was the introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed, debt performance indicators are more complex and the traditional average debt portfolio rate of interest (as indicated within Section 1 above) remains the main guide for comparison purposes. CIPFA have acknowledged the difficulty in developing debt performance indicators within the Treasury Management Panel Guidance Note of July, 1998 and have suggested that performance should be measured by reference to compliance with the procedural aspects of the Code and the traditional average debt rate. For the purpose of providing comparative debt performance indicators, the traditional average portfolio rate of interest for Angus Council for 2001/2 of 6.37 per cent, quoted within Section 1 above, is lower than the Scottish Local Authority average loans fund rate of 6.95 per cent.

3. Borrowing Strategy for 2001/2

The Council's Treasury Strategy for the financial year was based on a view of the United Kingdom (UK) economy being weighed down at the start of the year by the Foot and Mouth crisis and also by the downturn in world growth caused by a contraction of the United States (US) economy. UK growth was, therefore, expected to be marginally depressed below the trend rate of 2.5 per cent.

Inflationary pressures were weak and RPIX (headline inflation less mortgage interest rates) was expected to track the bottom part of the target band of 1.5 per cent to 3.5 per cent. The labour market was a cause for concern due to the very low level of unemployment although actual wage inflation was moderate. The housing market was showing growing strength while the manufacturing sector started the year in positive territory although the growth rate was minimal. However, consumer demand, confidence and borrowing were all robust. This was, therefore, a very different situation from that in the US and did not require further cuts in base rate in order to stimulate demand.

The effect on interest rates for the UK was, therefore, expected to be, as follows:

Shorter term variable interest rates – The average City view anticipated that the stronger outlook for growth for the UK economy than the US economy would mean that the base rate would probably not need to fall below 5.5 per cent throughout the year although there was some chance that it could fall to 5.25 per cent.

Longer term fixed interest rates – The view on longer term fixed interest rates was broadly neutral with Public Works Loan Board rates remaining around 5 per cent.

The Treasury Strategy adopted by the Council – The Treasury Strategy agreed by Committee based upon the above forecast was, as follows:

The risks intrinsic in the shorter term variable rates are such when compared to historically low longer term funding that the Council would maintain a stable, longer term portfolio by drawing longer term fixed rate funding.

When considered in terms of actual borrowing and investment for 2001/2 this strategy proved successful and beneficial to the Council.

4. Borrowing Outturn for 2001/2

Shorter term variable interest rates - The Monetary Policy Committee (MPC) had to cut the base rate in April to 5.5 per cent and in May to 5.25 per cent as its central forecast for RPIX (headline inflation less mortgage interest rates) in 2 years time showed that it was going to undershoot the target. It was also very concerned about the extent of the downturn in the United States (US) although the downside potential for United Kingdom (UK) rates was minimal (at that time) due to the strength of the domestic economy and the housing market and a programme of expanding Government expenditure. The manufacturing sector was also maintaining a low rate of growth. However, the downturn in the US continued further and the MPC cut the base rate again in August to 5 per cent. The events of September 11th then brought a completely different world economic scenario with central banks around the world cutting rates aggressively in order to stimulate growth. The MPC cut the base rate repeatedly reaching a floor of 4 per cent in November. It was not expected that the US economy would recover quickly so the surge in growth in the Spring of 2002 came as a welcome surprise. The money market then grossly over reacted and by the end of March 2002 was indicating that the base rate would reach 5.6 per cent by the end of 2002 in order to cool down the economy. The Federal Reserve and the MPC adopted, therefore, a cautious approach and left rates unchanged in the first quarter of 2002 and it was predicted that they were likely to continue this approach for some months further.

Longer term fixed interest rates - The 20 to 25 year lower quota Public Works Loan Board (PWLB) fixed interest rate varied within quite a narrow band until September 11th ; remaining generally between 5 per cent and 5.25 per cent for most of the time (higher quota 5.25 per cent to 5.50 per cent). The subsequent dire economic news from the US during the autumn depressed equity markets and led to a flight to quality from equities to bonds. Longer term fixed interest rates (these are gilt yields which are determined by market forces) fell, therefore, to remarkably low levels in early November and both lower and higher quota 20 year to 25 year PWLB rates hit 4.5 per cent. After November economic news improved and the US equity market staged a partial recovery leading to a reversal of the flight to quality thus causing longer term fixed interest rates to rise. The 20 year to 25 year lower quota PWLB rate rose back into the 5 per cent to 5.25 per cent band again (higher quota 5.125 per cent to 5.5 per cent) for most of the first quarter of 2002.

Detailed below are the results of the borrowing strategy undertaken by the Council.

Actual Borrowing

Type of Loan	Balance as at 01.04.2001 £'000	Borrowing during year £'000	Repaid during year £'000	Balance as at 31.03.2002 £'000
PWLB	103,476	11,126	9,662	104,940
Other Mortgages / Bonds	1,250	-	-	1,250
Temporary Loans	-	18,000	18,000	-
Covenant - Ex ADC	498	-	83	415
Covenant - Ex TRC	2,461	-	353	2,108
Total	**107,685**	**29,126**	**28,098**	**108,713**

Debt Performance - The Director of Finance drew longer term fixed debt to take advantage of low longer term interest rates and to reduce exposure to much higher shorter term interest rates. Recognising the need to reduce volatility and risk, and having to take appropriate action in this respect, the Director has managed to achieve savings through longer term fixed borrowing which has resulted in an actual loans fund rate for 2001/2 of 6.37 per cent compared with the budgeted rate for 2001/2 of 6.75 per cent.

5. Investment Strategy for 2001/2

The Council's investment strategy requires management of investments in-house and placement of investments with the institutions listed in the Council's standard lending list. The Council's investment strategy also requires placement of investments for a range of periods from overnight to 364 days dependent on the Council's cash flows and the interest rates on offer.

6. Investment Outturn for 2001/2

Detailed below are the results of the investment strategy undertaken by the Council.

Actual Lending

Type of Investment	Balance as at 01.04.01 £'000	Lending during year £'000	Repaid during year £'000	Balance as at 31.03.02 £'000
Bank of Scotland	2,450	302,553	300,227	4,776
Money Market	10,000	404,235	408,235	6,000
Total	**12,450**	**706,788**	**708,462**	**10,776**

The Council's cautious and controlled approach to Treasury Lending resulted in an equated investment and rate of return for 2001/2, as follows:

	Equated Investment £'000	Rate of Return %	Benchmark Return * %
Internally Managed	15,774	4.97	**4.38**

* - The benchmark is the average 7 day LIBID rate (uncompounded) sourced from the Financial Times.

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

7. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits set out in the Council's Treasury Management Practices Document.

8. Debt Rescheduling

During February, 2002 the Council had an opportunity to take advantage of continuing low longer term interest rates. Acting on advice from the Council's Treasury Management Advisers - Sector Treasury Services Ltd - a package of £1.13 million of fixed rate loans at 9 per cent with an average duration of 6 years was restructured into a 20 year loan at 4.875 per cent. After taking account of all costs associated with the rescheduling exercise (including breakage costs for loans which were repaid) the annual revenue benefit to the Council amounts to £30,000 for the first six years of the new loan period. Further, it is anticipated that additional benefits will accrue should Sector's long term view of future interest rate movements prove correct.

At the same time £2 million of variable rate debt was converted to 20 year fixed interest rates at 4.875 per cent to maintain the stability of the debt portfolio.

It should be noted that the loan interest savings, as indicated above, will accrue to the General Fund and the Housing Revenue Account (of Angus Council) and Tayside Police resulting in reduced loan charges (in accordance with their respective shares of loan debt).

Angus Council - Treasury Management Policy Statement

Introduction and Background

The need to prepare a Treasury Management Policy Statement is a requirement of the Treasury Management in the Public Services Code of Practice published by the Chartered Institute of Public Finance and Accountancy in 2001. Members are referred to Report Number 786/02 to the Finance and Information Technology Committee dated 18th June, 2002 at which the Code of Practice was adopted for implementation within Angus Council.

The Treasury Management Policy Statement for the Council is, as follows:

- The Council defines its treasury management activities as the management of the authority’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

- The Council regards the successful identification, monitoring and control of risk to be prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is, therefore, committed to the principles of achieving best value in treasury management and to employing suitable performance measurement techniques within the context of effective risk management.