ITEM No. 9

REPORT NO. 1091/98

ANGUS COUNCIL

FINANCE AND INFORMATION TECHNOLOGY COMMITTEE - 20th October, 1998

POLICY AND RESOURCES COMMITTEE - 27th October, 1998

TREASURY MANAGEMENT - ANNUAL REPORT - 1997/8

REPORT BY THE DIRECTOR OF FINANCE

ABSTRACT

This report details Treasury Management Activities for Angus Council for financial year 1997/8.

1. RECOMMENDATION

It is recommended that members consider and approve the attached Annual Report on Treasury Management Activities for Angus Council for 1997/8.

2. INTRODUCTION AND BACKGROUND

Treasury Management in Local Government is regulated by the 1996 revision of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management in Local Authorities (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and approval of a Treasury Management Policy Statement which sets out Council, Committee and Chief Financial Officer responsibilities and delegation / reporting arrangements (this was most recently approved by the Finance and Information Technology Committee dated 17th March, 1998 and the Policy and Resources Committee dated 24th March, 1998).

A requirement of the Council's Treasury Management Policy Statement is the reporting to the Finance and Information Technology Committee of both the expected treasury activity for the forthcoming financial year (the Treasury Management Strategy Statement) and subsequently the results of the Council's Treasury Management Activities in that year (this Treasury Management Annual Report). Treasury Management in this context is defined as:

> "The management of the Local Authority's cash flows, its borrowings and its investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks."

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

As indicated at 2 above the Treasury Management Policy Statement was most recently approved by the Finance and Information Technology Committee dated 17th March, 1998 and the Policy and Resources Committee dated 24th March, 1998. Since that time the Policy Statement has been strictly adhered to and has resulted in the exercise of stringent financial control within the Treasury Management Section of the Finance Department. Notwithstanding the foregoing, the Policy Statement and its 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 with no requirement for amendment at this time.

A copy of the existing Treasury Management Policy Statement is attached at Appendix 2 for the information of members.

5. CONCLUSION

It is concluded that members should consider and approve the attached Annual Report on Treasury Management Activities for 1997/8.

6. 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.

SMS
09/10/98

Angus Council - Treasury Management Annual Report

This Annual Report covers:

- the Council's current treasury position;
- performance measurement;
- debt strategy for 1997/8;
- debt outturn for 1997/8;
- investments strategy for 1997/8;
- investments outturn for 1997/8;
- compliance with treasury limits;
- debt rescheduling;

1. Current Portfolio Position

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

		31st March 1998 Total Principal		31st March 1997 Total Principal	
Fixed Rate Funding	PWLB	£89.144 m		£79.471m	
	Market	£ 2. 295 m	£91.439m	£ 3.301m	£82.772m
Variable Rate Funding	PWLB	£ 4. 965 m		£ 5.261m	
	Market	£ 5. 016 m	£ 9. 981m	£ 6.970m	£12.231m
Total External Debt		**£ 101.420m**		**£95.003m**	
Total Investments - internally managed		£ 12.206m		£ 8.130m	

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

		1997/8 Equated Principal		1997/8 Equated Rate	
Fixed Rate Funding	PWLB	£88.748 m		8.66 %	
	Market	£ 2.454 m	£91.202 m	6.83 %	8.61 %
Variable Rate Funding	PWLB	£ 5.137 m		7.01 %	
	Market	£ 5.162 m	£ 10.299 m	8.47 %	7.74 %
Equated External Debt			**£ 101.501 m**		**8.52 %**
Equated Investments - internally managed		£ 15.757 m		7. 17 %	

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 1997/8 was 7.69% (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 1997/8 which was calculated at 6.86%.

The inclusion of internal funds and current revenue balances in the funding of capital debt has the effect of reducing the loans fund rate for 1997/8 to 7.92% which is favourable when compared with the Scottish Local Authority average loans fund rate of 8.39%.

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 1997/8 was 0.11%.

It should also be noted that the foregoing includes capital debt which the Council administers for other organisations, namely Angus Further Education College and 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, 1997 and administered throughout 1997/8 for Angus Further Education College and Tayside Police was £150,350 and £7,476,067 respectively.

2. Performance Measurement

One of the key changes in the 1996 revision of the CIPFA Code of Practice on Treasury Management in Local Authorities (the Code) 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 in the process of being developed by CIPFA and are not available for use this year (it is anticipated that they will be available for the 1998/9 annual report). These indicators are more complex than the investment indicators and CIPFA received a significant number of comments to an early proposal which has delayed initial implementation. For the purposes of providing comparative debt performance indicators the traditional average portfolio rate of interest of 7.92% quoted within section 1 above is favourable when compared with the Scottish Local Authority average loans fund rate of 8.39%.

3. Debt Strategy for 1997/8

Interest Rates - The interest rate views incorporated within the Council's Treasury Strategy Statement were based upon Officers views with assistance from the Council's appointed Treasury Advisers (Sector Treasury Services Limited) supported by a selection of City forecasts. The consensus view on the United Kingdom (U.K.) Economy for the year suggested that the U.K. Economy would experience accelerating domestic demand and increasing inflationary pressures. These measures were expected to cause the base rate to rise during the year and longer term fixed rates to increase. Market uncertainty on the outcome of the General Election on 1st May, 1997 was also thought to push longer term fixed interest rates higher in the shorter term. The rise in all interest rates was expected to subside late in the year as Economic and Monetary Union (E.M.U.) considerations began to influence the wider European Communities.

Treasury Strategy for 1997/8 - The Council had historically adopted a long term approach to treasury issues. Whilst short term interest rates were expected to remain the cheapest option during the period, the uncertainty surrounding the effect of the General Election prompted the strategy to focus on drawing longer term fixed rate funding to reduce but not eliminate the Council's exposure to short term interest rates.

4. Debt Outturn for 1997/8

Interest Rates - The financial year began with long term rates relatively low against market forecasts and the main domestic focus being the forthcoming General Election. The City took the large Labour majority in its stride with little immediate reaction to the change of political control and interest rates remained attractive against historical perspectives.

The first unexpected event of the year for the financial system proved to be Chancellor Brown's early decision to initiate independent control over the move in base rates to the Bank of England. This proved to be very popular with the interest rate market primarily because of the loss of political interference and the consequent transparency in the interest rate setting mechanism. The Bank of England's Monetary Policy Committee was set the clear objective of maintaining underlying inflation within a 1 per cent and 2.5 per cent range through monetary policy.

Once released from political constraints the Bank of England acted swiftly to address rising inflationary problems by increasing the base rate 1.25 per cent in five successive 0.25 per cent moves to a peak of 7.25 per cent. One of the key economic concerns during this period was the impact of windfall gains from building society flotations.

The direct and clear anti inflationary stance of the Bank of England prompted a strong fall in longer term fixed interest rates against market forecasts. A side effect of the base rate rise was an influx of international money in anticipation of rising sterling returns causing sterling to appreciate reducing the competitiveness of U.K. exporters.

Longer term fixed interest rates continued to fall on speculation of an early entry by the U.K into E.M.U. and were pushed lower still because of the gathering financial crisis in Asia. The Asian crisis saw both a fall in global growth expectations and an investment flight to quality from the Far East into the United States (U.S.) and the U.K.

The trend in U.K. interest rates has essentially mirrored expectations in respect of base rate movements with longer term fixed rates moving contrary to expectations.

Treasury Borrowing

Type of Loan	Balance as at 01.04.97 £'000	Borrowing during year £'000	Repaid during year £'000	Balance as at 31.03.98 £'000
PWLB	84,732	20,367	10,990	94,109
Other Mortgages / Bonds	3,301		1,006	2,295
Temporary Loans	2,230	24,135	25,615	750
Covenant - Ex ADC	867		121	746
Covenant - Ex TRC	3,873		353	3,520
Total	**95,003**	**44,502**	**38,085**	**101,420**

Debt Performance - The Director of Finance drew longer term fixed debt to reduce volatility and risk in the portfolio in advance of the General Election and to reduce costs as fixed rates fell below short term 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 long term fixed borrowing which has resulted in an actual loans fund rate for 1997/8 of 7.92% compared with the budgeted rate for 1997/8 of 8.50%.

5. Investments Strategy for 1997/8

The Council manages its investments in-house and invests with the institutions listed in the Council's standard lending list. The Council invests for a range of periods from overnight to 364 days dependent on the Council's cash flows and the interest rates on offer.

Investment Strategy - The expectation for shorter term interest rates (shown in section 3 above) in conjunction with cash flow requirements suggested a short term investment strategy for in-house investments whereby investments would be kept relatively short in duration.

6. Investments Outturn for 1997/8

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

Treasury Lending

Type of Investment	Balance as at 01.04.97 £'000	Lending during year £'000	Repaid during year £'000	Balance as at 31.03.98 £'000
Bank of Scotland	1,930	159,272	158,996	2,206
Money Market	6,200	201,292	197,492	10,000
Total	**8,130**	**360,564**	**356,488**	**12,206**

The Council's cautious and controlled approach to Treasury Lending resulted in an equated investment and rate of return for 1997/8, as follows:

	Equated Investment £m	Rate of Return %	Benchmark Return * %
Internally Managed	**15.757**	**7.17**	**6.98**

* - The Benchmark is taken to be the Local Authority 7 Day Return Index as sourced from Datastream

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 Policy Statement and Treasury Strategy Statement.

8. Debt Rescheduling

The anticipation for rescheduling exercises during the year was that opportunities may occur during the period of the General Election. Since the actual trend in interest rates was significantly below consensus expectations, indeed interest rates have been historically low, the opportunities for rescheduling have as a result been minimal.

Angus Council - Treasury Management Policy Statement

Introduction and Background

The need to prepare a Treasury Management Policy Statement is a requirement of the Code of Practice on Treasury Management in Local Authorities (the Code) published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in May, 1992 and revised in May, 1996. Members are referred to Report Number 254/96 to the Finance and Information Technology Committee dated 30th April, 1996 at which the original Code of Practice was adopted for implementation within Angus Council and Report Number 320/97 to the Finance and Information Technology Committee dated 11th March, 1997 at which the revised Code of Practice was adopted for implementation within Angus Council. As a complementary issue the Council's Financial Regulations, as shown at Appendix 2A, have been amended to reflect the requirements of the new Code.

I. Approved Activities of the Treasury Management Operation

1. The approved activities of the Treasury Management Operation cover:

   - borrowing;
   - lending;
   - debt repayment and rescheduling;
   - financial instruments new to the Authority;
   - risk exposure;
   - cash flow;
   - the use of External Fund Managers (other than relating to the Pension Fund).

2. It is the Council's responsibility to approve a Treasury Management Policy Statement (this document), on a periodic basis (i.e. in the event of a major change in policy or, say, every four years). The Council delegates responsibility for review of the policy and monitoring of the Treasury Management Function, in accordance with the Policy, to the Finance and Information Technology Committee (hereafter referred to as the Committee).

3. As a minimum requirement the Committee will receive and consider:

   - an annual Treasury Management Strategy at the commencement of the new financial year (which sets out the likely operations for the forthcoming year);
   - mid way through the financial year an annual report on treasury management activity for the preceding financial year

4. The Director of Finance will:

   - implement and monitor the Treasury Management Policy, revising and resubmitting the Policy for consideration to the Committee and the Council periodically, if material changes are required;
   - draft and submit a Treasury Management Strategy to the Committee at the commencement of each financial year;
   - mid way through the financial year draft and submit to the Committee an annual report on treasury management activity for the preceding financial year;
   - implement and monitor the Strategy and report to Committee any material divergence or necessary revisions as and when required.

II. Formulation of Treasury Management Strategy

1. Whilst this Policy document outlines the procedures and considerations for the Treasury Function as a whole, requiring revision occasionally, the Treasury Management Strategy sets out the expected treasury activities for the forthcoming financial year. This Strategy will be submitted to Committee for approval at the commencement of each financial year.
2. The Treasury Management Strategy is concerned with the following elements:
   - the prospects for interest rates;
   - the limits placed by Council on treasury activities (per this Policy):
   - the expected borrowing strategy;
   - the temporary investment strategy;
   - the expectations for debt rescheduling.
3. The Treasury Management Strategy will establish the expected move in interest rates against alternatives (using published forecasts, where applicable) and highlight sensitivities to different scenarios.

III. Approved Methods and Sources of Raising Capital Finance

1. Finance will only be raised in accordance with legislation, and within this limit the Council has a number of approved methods and sources of raising capital finance. These include:

On Balance Sheet	**Fixed**	**Variable**
Public Works Loan Board	●	●
Market long term	●	●
Market temporary	●	●
Local temporary	●	●
Local Bonds	●	
Overdraft		●
Internal (capital receipts and revenue balances)	●	●
Off Balance Sheet		
Leasing (not operating leases)	●	●
Covenants	●	●
Other Methods of Financing		
Government and European Community Capital Grants		
Lottery monies		
Private Finance Initiatives		

2. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The Director of Finance has delegated powers through this Policy and the Strategy to take the most appropriate form of borrowing from the approved sources.

IV. Approved Instruments and Organisations for Investments

1. Investment Regulations in Scotland are primarily governed by Section 3 of the Local Government (Scotland) Act, 1973 which allows investment in:

    - Scottish Councils;
    - Committees, Joint Committees or Joint Boards; and
    - Scottish Water Authorities

2. These Regulations are overly restrictive for the current Scottish Local Authority Function and the Accounts Commission has acknowledged this in their Guidance Note 96/5 (LA) - Borrowing in Advance of Need. This document suggests there is sufficient tolerance within Section 69 of the 1973 Act to expand the allowable organisations for investments to suitable U.K. based Financial Institutions included in CIPFA FIS news article issued in 1986. Whilst CIPFA have now withdrawn this Guide, the scope of the advice appears to remain valid under the Accounts Commission Guide. As a consequence the Guidance allows investment counterparties from the following financial sectors:

    - Clearing Banks and their subsidiaries
    - Nationalised Industries and Building Societies

    The Guidance does provide some latitude to invest over and above these types of Institutions.

3. The Director of Finance will formulate a suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list with specific counterparty limits. This criteria forms part of the Policy and is attached at Appendix 2B. Any revisions to the criteria will be submitted to the Committee for approval.

4. All forms of investment will be considered dependent on the prevailing economic climate, regulations and local considerations. The Director of Finance has delegated powers through this Policy and the Strategy to place the most appropriate form of investment with the approved sources.

V. Policy on Interest Rate Exposure

Section 45 of the Local Government and Housing Act, 1989 requires English and Welsh Councils to approve at the commencement of each financial year certain treasury limits. Although this Act only applies to English and Welsh Authorities it is also recommended as good practice for Scotland. Whilst the Director of Finance is empowered to borrow as circumstances require, the limits for this Council are, as follows:

- temporary borrowing should not normally exceed 20 per cent of total external borrowing or 25 per cent at the discretion of the Director of Finance or £20 million or £25 million respectively, whichever is less

- long term variable interest rate loans should not normally exceed 25 per cent of long term external borrowing or 30 per cent at the discretion of the Director of Finance

- temporary borrowing and long term variable interest rate loans when taken together should not normally exceed 45 per cent of total external borrowing or 55 per cent at the discretion of the Director of Finance

VI. Policy on External Fund Managers (other than relating to Pension Funds)

The Council's policy is not to appoint External Investment Fund Managers as core / surplus funds are not sustained at a level and for a period sufficient to justify such an appointment.

VII. Policy on Delegation and Review Requirements and Reporting Arrangements

The Director of Finance shall have powers to delegate specific functions of Treasury Management to finance staff ensuring that as far as possible a proper system of internal check and division of duties is in place. He will also issue a clear statement of the responsibilities attaching to each post and a clear determination of the limits which apply to each postholder involved in Treasury Management. Details of delegation are recorded in the Treasury Management Systems Document.

Further, the Director of Finance shall ensure provisions exist with regard to absence cover and that staff involved in Treasury Management are given adequate training.

Financial Regulations

TREASURY MANAGEMENT

1 ADOPTION OF CIPFA'S CODE OF PRACTICE

The Director of Finance and his staff shall observe the guidance laid down in the CIPFA Code of Practice for Treasury Management in Local Authorities.

2 TREASURY MANAGEMENT POLICY STATEMENT

The Director of Finance shall prepare a Treasury Management Policy Statement which shall be adopted by the Council and thereafter shall be implemented and monitored by the Finance and Information Technology Committee.

3 TREASURY MANAGEMENT REPORTS

At the commencement of the financial year the Director of Finance shall report to the Finance and Information Technology Committee on Treasury Management Strategy for the forthcoming financial year.

Mid way through the financial year the Director of Finance shall report to the Finance and Information Technology Committee on Treasury Management Activities for the preceding financial year.

4 THE CHIEF FINANCE OFFICER

All money in the hands of the Council shall be under the control of the officer designated for the purposes of Section 95 of the Local Government (Scotland) Act 1973 referred to in CIPFA's Code of Practice as the Chief Finance Officer. The Chief Finance Officer for this Council is the Director of Finance.

5 DELEGATED TREASURY MANAGEMENT POWERS

All executive decisions on borrowing, investment or financing shall be delegated to the Director of Finance who shall act in accordance with the Code.

6 DEPARTURE FROM THE CODE

Should the Director of Finance wish to depart in any material respect from the main principles of the Code, the reasons should be disclosed in a report to the Finance and Information Technology Committee.

Approved Organisations for Investment

Surplus funds, where practicable and reasonable, shall be applied in the first instance to repay temporary borrowing. Where this is not appropriate, surplus funds shall be invested, as follows:

- the Bank of Scotland Home and Office Banking System (H.O.B.S.) or Term Deposit Centre through the Bank; or
- any of the U.K. Clearing Banks and Building Societies with an F1 short term credit rating and preferably an AA long term credit rating. The total lent to any one bank or building society not to exceed £5 million at any time (excluding accumulation of interest); or
- to other non-capped Local Authorities. The total lent to any one Authority not to exceed £5 million at any time (excluding accumulation of interest)

The order of preference should be subject to the interest rates on offer.