ITEM No. 5

REPORT NO. 310/98

ANGUS COUNCIL

FINANCE AND INFORMATION TECHNOLOGY COMMITTEE - 17th March, 1998

POLICY AND RESOURCES COMMITTEE - 24th March, 1998

TREASURY MANAGEMENT

REPORT BY THE DIRECTOR OF FINANCE

ABSTRACT

This report brings before Members a revised Treasury Management Policy Statement for Angus Council and apprises Members of the proposed Treasury Management Strategy for Angus Council in 1998/9. The revision of the Treasury Policy Statement is recommended to allow lending to Local Authorities on the same basis as U.K. Clearing Banks and Building Societies with the requisite credit ratings. The production of a Treasury Management Strategy Statement for the forthcoming year is a requirement of the revised Code of Practice on Treasury Management in Local Authorities issued by the Chartered Institute of Public Finance and Accountancy in May, 1996. The revised Treasury Policy Statement and the Treasury Strategy Statement are submitted for consideration by members with a view to obtaining approval for adoption by the Council. In addition to the foregoing, members should note the requirements of Section 13 of the Council's Financial Regulations pertaining to Treasury Management and the availability of the Treasury Management Systems Document which covers detailed systems and procedures within the Treasury Management Section of the Finance Department.

1. RECOMMENDATION

It is recommended that the Committee agrees the adoption of the attached Treasury Management Policy Statement and Treasury Management Strategy Statement for implementation within Angus Council. Further, members should note the requirements of Section 13 of the Council's Financial Regulations pertaining to Treasury Management and the availability of the Treasury Management Systems Document which covers detailed systems and procedures within the Treasury Management Section of the Finance Department.

2. INTRODUCTION AND BACKGROUND

The need to prepare a Treasury Management Policy Statement and Treasury Management Strategy Statement is a requirement of the Code of Practice on Treasury Management in Local Authorities published by the Chartered Institute of Public Finance and Accountancy 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.

3. TREASURY MANAGEMENT POLICY STATEMENT

The Treasury Management Policy Statement was most recently approved by the Finance and Information Technology Committee on 21st October, 1997. 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. Further, 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 need to recommend certain changes to the Policy Statement specifically with regard to the placing of surplus funds with approved organisations for investment. Although no change is required to the criteria pertaining to approved organisations for investment it is suggested that total permitted lending to Local Authorities be brought in line with existing lending arrangements to approved Banks and Building Societies i.e. the total permitted lending to any one Local Authority be increased from £1 million to £5 million. The foregoing amendment to the Policy Statement would allow the Treasury Management Section additional flexibility in the placing of investments at no increased risk with the possibility of higher rates of return.

A copy of the revised Treasury Management Policy Statement is attached at Appendix 1 for consideration and approval by Members.

4. TREASURY MANAGEMENT STRATEGY STATEMENT

The Treasury Management Strategy Statement sets out the expected treasury activities for the forthcoming financial year and is attached at Appendix 2 for consideration and approval by Members.

5. FINANCIAL IMPLICATIONS

There are no immediate financial implications arising from the content of this report.

6. CONCLUSION

It is concluded that the Treasury Management Policy Statement requires revision and Members are requested to consider and approve the revised Policy Statement as attached at Appendix 1. It is further concluded that Members should consider and approve the Treasury Management Strategy Statement for financial year 1998/9 as attached at Appendix 2.

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.

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 (C.I.P.F.A.) 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 1A, 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, reporting 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 are:

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 1B. 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 Authority's policy is not to appoint External Investment Fund Managers as core / surplus funds do not normally exceed £7.5 million which is considered the minimum required for external management in terms of providing the Fund Manager with adequate resources for diversification and to justify the fee.

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 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; or
- to other non-capped Local Authorities. The total lent to any one Authority not to exceed £5 million at any time

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

Appendix 2

Angus Council - Treasury Management Strategy Statement

Introduction

The Treasury Management Strategy details the expected activities of the Treasury function in the financial year 1998/9. Its production and submission to the Finance and Information Technology Committee is a requirement of the Council's approved Treasury Management Policy most recently approved at the Finance and Information Technology Committee dated 21st October, 1997 and further submitted for approval to this meeting of the Finance and Information Technology Committee dated 17th March, 1998. The strategy covers:

- the current treasury position;
- prospects for interest rates;
- treasury limits in force which will limit the activity of the Council;
- capital borrowings required and the portfolio strategy;
- investments strategy;
- the application of set aside capital receipts;
- debt rescheduling opportunities.

1. Current Portfolio Position

The Council's total external debt position at the commencement of financial year 1997/8 was, as follows:

		1 April 1997 Principal	
Fixed Rate Funding	PWLB	£79.471m	
	Market	£ 3.301m	£82.772m
Variable Rate Funding	PWLB	£ 5.261m	
	Market	£ 6.970m	£12.231m
Total External Debt		**£95.003m**	
External Investments - internally managed		£ 8.13m	

The Council's equated external debt position and corresponding equated external interest rate for the financial year 1996/7 was, as follows:

		1996/7 Equated Principal		1996/7 Equated Rate	
Fixed Rate Funding	PWLB	£68.907m		9.22%	
	Market	£ 3.123m	£72.030m	7.03%	9.12%
Variable Rate Funding	PWLB	£ 6.055m		6.01%	
	Market	£17.111m	£23.166m	6.54%	6.40%
Equated External Debt		**£95.196m**		**8.46%**	
External Investments - internally managed		£ 0.625m		5.83%	

2. Treasury Limits for 1998/9

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 set by Angus Council as part of its treasury policy 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

3. Prospects for Interest Rates

The market view on the prospects for interest rates are becoming increasingly dominated by the prospect of European Monetary Union (E.M.U.) within Europe whether or not the United Kingdom (U.K.) joins. With the German Economy being the main economy within Europe, the key influences will be:

- the convergence of European interest rates (including the U.K.) to German interest rate levels

- the state of the German Economy and the likely move in German interest rates

Whilst there remains considerable risk over timing and impact of E.M.U., the effect on interest rate prospects in the U.K. is, as follows:

Short term interest rates - The "average" City view anticipates that accelerating inflationary pressures will see the base rate rising to approximately 7.50 per cent by the end of financial year 1997/8. As E.M.U. considerations grow during 1998/9 and the U.K. Economy shows signs of economic slow down, it is anticipated that there will be some easing in the base rate through the latter part of the financial year into following years.

Longer term interest rates - The longer term fixed interest rates are widely expected to rise modestly through financial year 1998/9 and peak between 7.00 per cent and 7.25 per cent. Longer term fixed interest rates are widely expected to start falling into 1999/2000.

4. Capital Borrowings Required and the Portfolio Strategy

Based upon the prospects for interest rates outlined above, there are a number of strategy options available. The anticipation is that short term rates will be more expensive than longer term fixed borrowing until mid 1998, at which time rising longer term rates and falling base rates will see the yield curve return to normality. This expectation provides a variety of options:

- the expectation for falling base rates in the future is so strong that the drawing of cheaper, longer term funding in the near term will entail longer term costs and, therefore, maintaining a short term position will lead to a cheaper, low risk longer term portfolio;

- the risks intrinsic in the short term variable rates are such, when compared to historically low long term funding, that a stable, longer term portfolio will be maintained by drawing longer term fixed rate funding

Against the background of E.M.U. and the risks involved with its success, caution will be adopted with our 1998/9 treasury operations. The Director of Finance will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

Sensitivity of the forecast - The main sensitivities of the forecast are likely to be two scenarios: a breakdown of E.M.U. or rise in general European fixed interest rates (which may see higher than anticipated U.K. fixed interest rates); and a smooth transition of E.M.U. with lower interest rates and a quicker than anticipated fall. The Council Officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- *an unexpected sharp rise in long and short term rates* - In the event of a sharp rise in interest rates the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are relatively cheap.

- *an unexpected sharp fall in long and short term rates* - In the event of falling interest rates the borrowings will be postponed (waiting for borrowings to get cheaper), and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.

5. Temporary Investments Strategy

It is anticipated that there will be no long term investments during the course of the year. Temporary investments will be made depending on their duration and the structure of interest rates at the time. Investments will be made in accordance with the Approved Investment Regulations (1990) and with the institutions identified in the Council's investment list approved as part of the Treasury Policy Statement.

6. Set Aside Capital Receipts

With effect from 1 April 1996 Scottish Authorities were required to set aside a proportion of any new capital receipt for either:

- the redemption of external debt; or
- to use the monies to finance new capital, as an alternative to new borrowing (this is not an addition to the capital allocation).

Consideration will be given to utilise either of these methods depending on the benefit to be gained for the Authority.

7. Debt Rescheduling

Any debt rescheduling is likely to take place in the second half of the financial year as fixed interest rates are anticipated to be at their highest. although the situation will be continually monitored in order to take advantage of any perceived abnormalities in the yield curve.

Any positions taken via rescheduling will be in accordance with the strategy position outlined in Section 4 above. The reasons for any rescheduling to take place will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the strategy outlined in Section 4 above; and
- in order to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).