ITEM No. 12

REPORT NO. 1385/01

ANGUS COUNCIL

FINANCE AND INFORMATION TECHNOLOGY COMMITTEE – 27th November, 2001

POLICY AND RESOURCES COMMITTEE – 4th December, 2001

TREASURY MANAGEMENT ANNUAL REPORT – 2000/1

REPORT BY THE DIRECTOR OF FINANCE

ABSTRACT

This report apprises members of the Treasury Management Activities for Angus Council for 2000/1. The production of a Treasury Management Annual Report 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 Treasury Management Annual Report is 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 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 which covers detailed systems and procedures within the Treasury Management Section of the Finance Department.

1. RECOMMENDATION

It is recommended that members consider and approve the attached Annual Report on Treasury Management Activities for Angus Council for 2000/1. Further, 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 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 Annual Report 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 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

The Treasury Management Policy Statement was most recently approved by the Finance and Information Technology Committee dated 13th March, 2001 and the Policy and Resources Committee dated 20th March, 2001. 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 financial year 2000/1 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.

Angus Council - Treasury Management Annual Report

The Annual Report covers:

- the Council's current treasury position;
- performance measurement;
- borrowing strategy for 2000/1;
- borrowing outturn for 2000/1;
- investment strategy for 2000/1;
- investment outturn for 2000/1;
- 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 2001 Total Principal		31st March 2000 Total Principal	
Fixed Rate Funding	PWLB	£101.476 m		£ 96.144 m	
	Market	£ 1.250 m	£102.726 m	£ 1.869 m	£ 98.013 m
Variable Rate Funding	PWLB	£ 2.000 m		£ 2.741 m	
	Market	£ 2.959 m	£ 4.959 m	£ 7.813 m	£ 10.554 m
Total External Debt			**£107.685 m**		**£108.567 m**
Total Investments - internally managed			£ 12.450 m		£ 12.825 m

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

		2000/1 Equated Principal		2000/1 Equated Rate	
Fixed Rate Funding	PWLB	£101.504 m		7.09 %	
	Market	£ 1.805 m	£103.309 m	6.85 %	7.08 %
Variable Rate Funding	PWLB	£ 2.399 m		6.02 %	
	Market	£ 4.204 m	£ 6.603 m	7.72 %	7.10 %
Equated External Debt			**£109.912 m**		**7.08 %**
Equated Investments - internally managed			£ 16.674 m		5.91 %

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 2000/1 was 7.69 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 2000/1 which was calculated at 5.84 per cent.

It should be noted that the Angus Council loans fund rate for 2000/1 was 7.08 per cent which is within the Scottish Local Authority average loans fund rate of 7.40 per cent. It should also be noted that at the close of the 2000 calendar year an opportunity was taken to restructure an element of the Council's external debt (Reference Section 8 – Debt Rescheduling) which will result in the Angus Council loans fund rate falling to approximately 6.75 per cent for 2001/2.

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 2000/1 was 0.11 per cent.

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, 2000 and administered throughout 2000/1 for Angus Further Education College and Tayside Police was £118,736.50 and £11,374,090.92 respectively.

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 (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 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 an adaptation of 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 2000/1 of 7.08 per cent, quoted within Section 1 above, is within the Scottish Local Authority average loans fund rate of 7.40 per cent.

3. Borrowing Strategy for 2000/1

The Council's Treasury Strategy for the financial year was based on the market view that world economic growth was gaining momentum after the downturn in 1998 caused by financial crises in Russia, Japan and the Far East. This led to an expectation that interest rates around the world would be on a modest rising trend in order to contain growing inflationary pressures while longer term borrowing fixed interest rates continued to run at historically low levels.

The United Kingdom (UK) recovered quickly from the near recession of the latter half of 1999 and produced a remarkable combination of unemployment falling to very low levels, above trend Gross Domestic Product growth and inflation running comfortably below the Monetary Policy Committee target of 2.5 per cent. Whilst some quarters expected the UK to be increasingly affected by European Economic and Monetary Union (EMU) leading to further convergence of UK interest rates with Euro rates (i.e. a fall in shorter term rates and a rise in longer term rates), the level of political opposition to UK entry into the Euro meant such pressures were minimal.

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 robust outlook for growth in 2000 would mean that the base rate would have to rise from 6.00 per cent to 6.25 per cent or possibly 6.50 per cent. Base rate actually remained at 6.00 per cent all year with the first cut to 5.75 per cent in February, 2001.

Longer term fixed interest rates – The longer term fixed interest rates were at their lowest during 1999/2000 and, therefore, a modest rise was expected during 2000/1. Longer term fixed interest rates were expected to remain lower than shorter dated and variable interest rates although the margin was expected to close by the year end. This forecast was fulfilled throughout 2000/1.

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 2000/1 this strategy proved successful and beneficial to the Council.

4. Borrowing Outturn for 2000/1

At the start of the year, Monetary Policy Committee thinking was dominated by concerns as to whether the base rate should be raised in order to cool down the economy from an unsustainably high rate of growth. However, as the year progressed growth declined and in January concern switched to cutting interest rates due to a sharp slowdown in the United States (US) economy which precipitated an emergency 0.50 per cent cut in the US short term interest rate (the Fed rate) on 3rd January. This was followed by two further cuts of 0.50 per cent in January and March with a view to avoiding hardship for the US economy. However, the UK economy was in a much stronger position than the US economy as the manufacturing sector was still in low growth (not recession) and consumer confidence was at record levels (as reflected in robust consumer borrowing and spending). In addition the Government had a planned programme of increasing expenditure over the next few years which would generate a £16 billion deficit in 2003/4. The downside potential for base rates in the UK was, therefore, very limited compared to that for the Fed rate.

Demand for long gilts was driven by the Minimum Funding Requirement (MFR) and Equitable Life needing to switch £2.5 billion from equities into gilts on becoming a closed fund in the first quarter of 2001. However, the preliminary Myners Report in November, and the final report in March, eased pressure on buying long gilts by recommending abolition of the MFR. The Chancellor confirmed acceptance of this recommendation in the March Budget Statement. The record surplus on the Government Budget plus the bonanza from mobile licence sales in June caused a reduction in the issue of gilts. However, in May the Treasury issued new 2032 gilts to relieve pressure on long gilt yields and added to it further during the year. Long gilt yields did not, therefore, go as low as in 1999/2000 and the Public Works Loan Board (PWLB) Lower Quota 20-25 year interest rate bottomed at 4.625 per cent.

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

Actual Borrowing

Type of Loan	Balance as at 01.04.2000 £'000	Borrowing during year £'000	Repaid during year £'000	Balance as at 31.03.2001 £'000
PWLB	98,885	29,529	24,938	103.476
Other Mortgages / Bonds	1,288	-	38	1,250
Temporary Loans	5,000	4,900	9,900	-
Covenant - Ex ADC	581	-	83	498
Covenant - Ex TRC	2,813	-	352	2,461
Total	**108,567**	**34,429**	**35,311**	**107,685**

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 2000/1 of 7.08 per cent compared with the budgeted rate for 2000/1 of 7.78 per cent.

5. Investment Strategy for 2000/1

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 2000/1

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

Actual Lending

Type of Investment	Balance as at 01.04.00 £'000	Lending during year £'000	Repaid during year £'000	Balance as at 31.03.01 £'000
Bank of Scotland	825	261,126	259,501	2,450
Money Market	12,000	64,600	66,600	10,000
Total	**12,825**	**325,726**	**326,101**	**12,450**

The Council's cautious and controlled approach to Treasury Lending resulted in an equated investment and rate of return for 2000/1, as follows:

	Equated Investment £m	Rate of Return %	Benchmark Return * %
Internally Managed	16,674	5.91	**5.67**

* - 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 Policy Statement and Treasury Strategy Statement.

8. Debt Rescheduling

At the close of the 2000 calendar year there was an opportunity to restructure an element of the Council's external debt into more flexible lower interest rate loans. On 14th December, 2000 (acting on advice from the Council's Treasury Management Advisers - Sector Treasury Services Ltd) a £20 million package of 5 year to 12 year Public Works Loan Board (PWLB) loans at an average interest rate of 7.30 per cent were repaid and financed by a £20 million new borrowing package of 20-25 year PWLB loans at 4.625 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 ranges from £255,000 to £300,000 for the first eight 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.

It should be noted that the loan interest savings, as indicated within the previous paragraph, 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 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. say every four years or in the event of a major change in Policy). 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 or if material changes are required;
   - draft and submit an Annual 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 the 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 Money		
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 Investment Purposes

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 approved organisations for investment purposes to suitable UK 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 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

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 Purposes

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 (HOBS);
- the Bank of Scotland Term Deposit Centre (TDC);
- any of the UK 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 normally to exceed £5 million at any time (excluding accumulation of interest);
- other non-capped Local Authorities. The total lent to any one Authority not normally to exceed £5 million at any time (excluding accumulation of interest)

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