Agenda Item No. 5

TAYSIDE JOINT POLICE BOARD

FINANCE COMMITTEE

21st December, 2001

Report by the Treasurer No. PB 59 /2001

SUBJECT : TREASURY MANAGEMENT ANNUAL REPORT – 2000/1

ABSTRACT

This report apprises Members of the Treasury Management Activities for Angus Council (the Council) for 2000/1 which also incorporates Treasury Management Activities for the Tayside Joint Police Board (the Board).

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 Board.

1. RECOMMENDATION

It is recommended that Members consider and approve the attached Annual Report on Treasury Management Activities for the Board for 2000/1.

2. INTRODUCTION

The Loan Portfolio in support of Tayside Joint Police Board Capital Debt is managed along with the Loan Portfolio in support of Angus Council Capital Debt by the Director of Finance for Angus Council (Treasurer to Tayside Joint Police Board) with support from the Treasury Management Section within the Finance Department of Angus Council. The Loan Portfolios for Tayside Joint Police Board and Angus Council are not managed separately but are taken together as a Total Loan Portfolio in support of Total Capital Debt for both the Board and the Council. The loans which constitute the Total Loan Portfolio cannot, therefore, be identified as loans which specifically relate to the Board or the Council.

3. BACKGROUND

The need to prepare a 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.

The Treasury Management Annual Report for Angus Council, which incorporates Treasury Management Activities of Tayside Joint Police Board, has been prepared and presented by the Director of Finance for Angus Council (Treasurer to Tayside Joint Police Board) for approval and adoption by Members of Angus Council and is attached for approval and adoption by Members of Tayside Joint Police Board.

4. TREASURY MANAGEMENT ANNUAL REPORT

A copy of the Treasury Management Annual Report is attached for consideration and approval by Members of the Board.

Members are referred to the final paragraph of Section 1 of the Treasury Management Annual Report – Current Portfolio Position - which provides details of the capital debt administered by Angus Council on behalf of Tayside Joint Police Board.

The amount of capital debt outstanding at 1st April, 2000 and administered throughout 2000/1 for Tayside Joint Police Board was £11.374 million. This compares with Total External Capital Debt of £108.567 million outstanding at 1st April, 2000 and administered throughout 2000/1 by Angus Council. The Tayside Joint Police Board element of capital debt, therefore, constitutes approximately 10 per cent of Total External Capital Debt administered by Angus Council.

5. CONCLUSION

It is concluded that Members of the Board should consider and approve the attached Annual Report on Treasury Management Activities for financial year 2000/1 as attached.

6. HUMAN RIGHTS IMPLICATIONS

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

7. CONSULTATION

The Chief Constable and the Clerk have been consulted in the preparation of this report.

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<u>NOTE</u>

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).