Report No 1251/04

ANGUS COUNCIL

RESOURCES AND CENTRAL SERVICES COMMITTEE 21 OCTOBER 2004
STRATEGIC POLICY COMMITTEE 26 OCTOBER 2004

SUBJECT: TREASURY MANAGEMENT ANNUAL REPORT 2003/04

REPORT BY DIRECTOR OF FINANCE

Abstract: This report apprises Members of the Treasury Management Activities for Angus Council for 2003/4. The production of a Treasury Management Annual Report is a requirement of the Treasury Management in the Public Services Code of Practice issued by the Chartered Institute of Public Finance and Accountancy in 2001.

1 RECOMMENDATION

1.1 It is recommended that Members consider and approve the attached Annual Report on Treasury Management Activities for Angus Council for 2003/4. 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 and the Treasury Management Practices Document. The Treasury Management Systems Document covers detailed systems and procedures within the Treasury Management Section of the Finance Department and the Treasury Management Practices Document sets out the manner whereby the Treasury Management Policies and Objectives may be achieved, managed and controlled.

2 INTRODUCTION

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

3 TREASURY MANAGEMENT ANNUAL REPORT

3.1 The Treasury Management Annual Report details the Treasury Management Activities for Angus Council for 2003/4 and is attached at Appendix 1 for consideration and approval by Members.

4 TREASURY MANAGEMENT POLICY STATEMENT

4.1 The Treasury Management Policy Statement was most recently approved by the Resources and Central Services Committee dated 6 May 2004. 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.

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

5 HUMAN RIGHTS IMPLICATIONS

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

6 CONSULTATION

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

7 CONCLUSION

7.1 It is concluded that Members should consider and approve the attached Annual Report on Treasury Management Activities for financial year 2003/4 as attached at Appendix 1.

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 the above Report.

DSS/SMS/PH
11/10/04

E:\Admin\Reports\Year2004\October\1251-04.rtf

David S. Sawers
Director of Finance

Appendix 1

ANGUS COUNCIL - TREASURY MANAGEMENT ANNUAL REPORT

The Annual Report covers:

- the Council's portfolio position for 2003/4;
- performance measurement;
- borrowing strategy for 2003/4;
- borrowing outturn for 2003/4;
- investment strategy for 2003/4;
- investment outturn for 2003/4;
- compliance with treasury limits;
- debt rescheduling.

1. Portfolio Position for 2003/4

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

		Total Principal 31 March 2004		Total Principal 31 March 2003	
Fixed Rate Funding	PWLB	£ 96.369 m		£ 103.940 m	
	Market	£ 12.000 m	£ 108.369 m	£ 1.250 m	£ 105.190 m
Variable Rate Funding	PWLB	£ Nil		£ Nil	
	Market	£ 2.004 m	£ 2.004 m	£ 2.087 m	£ 2.087 m
Total External Debt			**£ 110.373 m**		**£ 107.277 m**
Total Investments - internally managed			£ 8.943 m		£ 9.000 m

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

		Equated Principal – 2003/4		Equated Rate – 2003/4	
Fixed Rate Funding	PWLB	£ 98.893 m		6.23 %	
	Market	£ 1.000 m	£ 99.893 m	3.60 %	6.20 %
Variable Rate Funding	PWLB	£ Nil		Nil %	
	Market	£ 2.993 m	£ 2.993 m	6.67 %	6.67 %
Equated External Debt			**£ 102.886 m**		**6.21 %**
Equated Investments - internally managed			£ 8.025 m		3.63 %

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 2003/4 was 6.08 per cent (Reference Report Number 693/97 to the Finance and Information Technology Committee dated 10th June, 1997 and the Policy and Resources Committee dated 17th June, 1997). The interest added to current revenue balances is based on an average short term rate for 2003/4 which was calculated at 3.67 per cent.

It should be noted that the Angus Council loans fund rate for 2003/4 was 5.84 per cent.

The Council, of course, incurs expenses in administering and managing the loans fund and the rate required to recover such expenses from borrowing accounts in 2003/4 was 0.09 per cent.

It should also be noted that the foregoing includes capital debt which the Council administers for other organisations, for example, Tayside Police, from whom it receives reimbursement of loan charges (i.e. the amount of principal repayments and charges for interest and expenses) incurred on their behalf. The amount of capital debt outstanding at 1 April 2003 and administered throughout 2003/4 for Tayside Police was £15,479,210.79.

2. Performance Measurement

One of the key changes in the 1996 revision of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities was the introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed, debt performance indicators are more complex and the traditional average debt portfolio rate of interest (as indicated within Section 1 above) remains the main guide for comparison purposes. CIPFA have acknowledged the difficulty in developing debt performance indicators within the Treasury Management Panel Guidance Note of July 1998 and have suggested that performance should be measured by reference to compliance with the procedural aspects of the Code and the traditional average debt rate. For the purpose of providing comparative debt performance indicators, the traditional average portfolio rate of interest for Angus Council for 2003/4 was 5.84 per cent - as quoted within Section 1 above. This compares favourably against other mainland Local Authorities with Angus Council having the third lowest loans fund rate. The lowest loans fund rate was 5.16 per cent (Dumfries and Galloway) and the highest loans fund rate was 7.73 per cent (Aberdeenshire).

It should be noted that the Treasury Management Section of Angus Council Finance Department are assisted with shorter term borrowing and lending by Brokers who are well placed to secure market counterparties in accordance with the Treasury Management Practices Document (and approved creditworthy counterparty list with specific counterparty limits). The Brokers who currently act on behalf of the Council (and who are the subject of ongoing monitoring) are Prebon Marshall Yamane (UK) Ltd and Tradition (UK) Ltd. Such a review has revealed the operational adequacy and effectiveness of the Brokers, as indicated, with no requirement for amendment at this time.

3. Borrowing Strategy for 2003/4

Background

The Council's Treasury Strategy for the financial year was based on a view of the United Kingdom (UK) economy being weighed down at the start of the year by continuing weak growth in the United States (US) and by world fears of war in Iraq which together produced an expectation of overall weak world economic growth. These war fears helped to dampen consumer confidence, demand, manufacturing production and capital investment and to depress share prices which had already been hit by the accounting scandals in the US in the first half of 2002. Base rate was therefore forecast to stay at 4 per cent during 2003, although there were concerns that if growth prospects weakened further then it could be cut.

Inflationary pressures were expected to remain weak and RPIX (headline inflation less mortgage interest rates) was expected to be near or below the target rate of 2.5 per cent. On the other hand, the level of increase in consumer and corporate borrowing was a cause for concern as this could make borrowers highly sensitive to any increase in base rate. Unemployment was expected to continue to run at historically remarkably low levels but wage inflation was benign. House prices were increasing at an alarmingly high rate. The manufacturing sector was continuing to contract. Looking forward, however, expectations of robust consumer demand, confidence and borrowing together with strong growth in planned public expenditure were expected to provide solid underpinning to the growth rate in the UK economy. This was, therefore, a different situation from that in the US and did not require further cuts in base rate in order to maintain a reasonably healthy and consistent rate of growth in 2003.

The Expected Effect on Interest Rates for the UK

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 weak outlook for growth for the UK and US economies would prompt the Monetary

Policy Committee (MPC) to leave the base rate at 4 per cent. The risk remained that growth was not as feeble as forecast and a quick recovery in the US would remove pressures to keep rates low. If this was the case, then UK base rates could rise by the end of 2003.

Longer term fixed interest rates – The view was that longer term Public Works Loan Board rates would fall slightly to 4.40 per cent (equivalent to long term gilt yield of approximately 4.25 per cent) and remain around that level for the year.

The Treasury Strategy adopted by the Council

The Council Officers, in conjunction with the Treasury Advisers, to continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- *In the event of an acceleration in growth and an expected rise in longer and shorter term 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.

- *In the event of a slowdown in growth and an expected fall in longer and shorter term interest rates* - fixed rate borrowings will be postponed (waiting for borrowings to get cheaper) and any rescheduling from fixed rate funding into variable or shorter rate funding will be exercised.

4. Borrowing Outturn for 2003/4

Shorter term variable interest rates – Base rate was unexpectedly cut from 4 per cent to 3.75 per cent in February 2003 as Iraq war fears dampened growth prospects. A further cut to 3.50 per cent in July was the bottom of this interest rate cycle. Rapidly improving growth prospects in the United States (US) from late July provoked a turn around in market expectations to increases in base rate, the first of which duly came in November to 3.75 per cent, to be followed by a further increase in February, 2004 to 4 per cent.

Longer term fixed interest rates – The Public Works Loan Board lower quota 25–30 year rate started the year at 4.80 per cent but fell to a bottom of 4.40 per cent in mid June 2003. However, the rapid increase in growth prospects in the US in July pushed this rate back up to a range of 4.90 to 5.05 per cent until late December, after which it eased back to 4.75 per cent by the end of March 2004.

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

Actual Borrowing

Type of Loan	Balance as at 01.04.2003 £'000	Borrowing during year £'000	Repaid during year £'000	Balance as at 31.03.2004 £'000
PWLB	103,940	-	7,571	96,369
Other Mortgages / Bonds	1,250	-	1,250	-
Temporary Loans	-	33,110	33,110	-
Covenant - Ex ADC	332	-	83	249
Covenant - Ex TRC	1,755	-	-	1,755
Total	**107,277**	**33,110**	**42,014**	**98,373**

Debt Performance – In accordance with the Treasury Strategy outlined at Section 3 above, it was determined that there would be an acceleration in growth with rises in shorter term and longer term interest rates. The Director of Finance, therefore, decided to run down existing investment levels to finance capital expenditure in favour of drawing longer term fixed debt in view of the poor returns on offer from investments and interest savings to be achieved through debt reduction.

As a result of this action the actual loans fund rate for 2003/4 was 5.84 per cent compared with the budgeted rate for 2003/4 of 6.36 per cent.

5. Investment Strategy for 2003/4

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 2003/4

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

Actual Lending

Type of Investment	Balance as at 01.04.03 £'000	Lending during year £'000	Repaid during year £'000	Balance as at 31.03.04 £'000
Bank of Scotland	-	216,660	207,717	8,943
Money Market	9,000	364,428	373,428	-
Total	**9,000**	**581,088**	**581,145**	**8,943**

The Council's cautious and controlled approach to Treasury Lending resulted in an equated investment and rate of return for 2003/4, as follows:

	Equated Investment £'000	Rate of Return %	Benchmark Return * %
Internally Managed	8,025	3.63	**3.52**

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

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

7. Compliance with Treasury Limits

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

8. Debt Rescheduling

During the early part of financial year 2003/4 the Council were holding significant cash balances. In reviewing the cash flow projection at the end of July, 2004 it appeared that part of the cash would be surplus to current year requirements. With overall debt being serviced at 6.2 per cent and with investment returns averaging 3.6 per cent it was decided to redeem a proportion of the outstanding Public Works Loan Board (PWLB) external debt.

Acting on advice from the Council's Treasury Management Advisers – Sector Treasury Services Ltd – a package of loans was selected amounting to £7.571 million with an average rate of 5.139 per cent and an average duration of 20 years.

After taking account of all costs associated with the repayment (including breakage costs for loans which were repaid) the current year cost to the Council was approximately £90,000. However, annual recurring savings of £48,000 were achieved resulting in a total of approximately £500,000 in discounted cash flow terms over the 20 year period.

The Council subsequently borrowed long term market loans (LOBOS – Lenders Option / Borrowers Option) of £8 million in March 2004 at an average rate of 3.62 per cent for an initial period of 4 years. These loans then step up to an average rate of 4.7 per cent for the remaining period of 46 years unless the lender decides to ask for an increase in the rate (which is based on market pricing). The Council then has an option to accept the increase or repay the loans. The Council borrowed a further £4 million LOBO at the end of March 2004 at a rate of 3.55 per cent for 4 years which reverts to a rate of 4.75 per cent. These deals were done to secure funding at low rates for the medium term recognising savings against PWLB rates which were considerably higher. The foregoing has the favourable effect of reducing the average rate of external debt from 6.21 per cent to 5.96 per cent.

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

Appendix 2

Angus Council - Treasury Management Policy Statement

Introduction and Background

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

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

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

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

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