REPORT NO. 1249/05

ANGUS COUNCIL

RESOURCES AND CENTRAL SERVICES COMMITTEE – 20th October 2005

STRATEGIC POLICY COMMITTEE – 25th October 2005

TREASURY MANAGEMENT ANNUAL REPORT - 2004/05

REPORT BY THE ACTING DIRECTOR OF FINANCE

ABSTRACT

This report apprises Members of the Treasury Management Activities for Angus Council for 2004/5. 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

It is recommended that the Committee:-

(i) considers and approves the attached Annual Report on Treasury Management Activities for Angus Council for 2004/5;

(ii) notes the requirements of the Treasury Management Policy Statement and Section 15 of the Council's Financial Regulations pertaining to Treasury Management; and

(iii) notes the availability of the Treasury Management Practices Document which sets out the manner whereby the Treasury Management Policies and Objectives may be achieved, managed and controlled.

2. INTRODUCTION

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

The Treasury Management Annual Report details the Treasury Management Activities for Angus Council for 2004/5 and 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 Resources and Central Services Committee dated 17 March 2005. 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.

The Policy Statement and its operation within the Treasury Management Section of Finance has been, and is, the subject of ongoing monitoring to take account of changing circumstances in this area of activity. This 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 and Members should note that the Treasury Management Practices Document is available on demand.

5. HUMAN RIGHTS IMPLICATIONS

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

6. CONSULTATION

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

7. CONCLUSION

It is concluded that Members should consider and approve the attached Annual Report on Treasury Management Activities for Angus Council for 2004/5 as attached at Appendix 1.

COLIN McMAHON
ACTING 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.

Appendix 1

Angus Council - Treasury Management Annual Report

The Annual Report covers:

- the Council's portfolio position for 2004/5;
- performance measurement;
- borrowing strategy for 2004/5;
- borrowing outturn for 2004/5;
- investment strategy for 2004/5;
- investment outturn for 2004/5;
- compliance with treasury limits;
- debt rescheduling.

1. Portfolio Position for 2004/5

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

		Total Principal 31 March 2005		Total Principal 31 March 2004	
Fixed Rate Funding	PWLB	£ 96.369 m		£ 96.369 m	
	Market	£ 16.000 m	£ 112.369 m	£ 12.000 m	£ 108.369 m
Variable Rate Funding	PWLB	£ Nil		£ Nil	
	Market	£ Nil	£ Nil	£ 2.004 m	£ 2.004 m
Total External Debt			**£ 112.369 m**		**£ 110.373 m**
Total Investments - internally managed			£ 13.944 m		£ 8.943 m

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

		Equated Principal – 2004/5		Equated Rate – 2004/5	
Fixed Rate Funding	PWLB	£ 96.369 m		6.26 %	
	Market	£ 14.333 m	£ 110.702 m	3.53 %	5.90 %
Variable Rate Funding	PWLB	£ Nil		0.00 %	
	Market	£ Nil	£ Nil	0.00 %	0.00 %
Equated External Debt			**£ 110.702 m**		**5.90 %**
Equated Investments - internally managed			£ 13.780 m		4.66 %

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 2004/5 was 5.84 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 2004/5 which was calculated at 4.57 per cent.

The overall Angus Council loans fund rate for 2004/5 was 5.75 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 2004/5 was 0.07 per cent.

It should 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 2004 and administered throughout 2004/5 for Tayside Police was £17,410,105.02.

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 2004/5 was 5.75 per cent - as quoted within Section 1 above. This compares favourably against the average loans fund rate of 6.25 per cent for Scottish Local Authorities (excluding Orkney and Shetland). The lowest loans fund rate was 4.91 per cent (Dumfries and Galloway) and the highest loans fund rate was 7.49 per cent (North Lanarkshire).

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 2004/5

Background

The Council's Treasury Strategy for the financial year was based on a view of the United Kingdom (UK), United States (US) and world economic growth rates continuing to strengthen as the recovery from the down turn caused by the Iraq war in the first half of 2003 gathered momentum. In the UK, base rate had risen from a low of 3.5 per cent to 4 per cent by February 2004; this was still a low rate by historic standards which was acting to stimulate the economy. The Monetary Policy Committee (MPC) was therefore expected to eliminate that stimulus by gradually raising base rate back to more normal levels (near to 5 per cent) during the year.

Similarly the US Fed was expected to raise rates from the exceptionally low rate of 1 per cent to reduce the major stimulus to the economy but by way of a phased series of gentle increases as there were still concerns about the recovery being a jobless recovery.

The Eurozone growth rate was expected to improve but not substantially as the dollar was expected to weaken against the Euro and so negatively impact Eurozone exports. The

European Central Bank (ECB) was therefore expected to leave rates unchanged at 2 per cent so as to continue to provide some stimulus for the economy in the absence of major inflationary concerns.

Inflation in all 3 areas was expected to be well contained.

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 strengthening growth rate in the UK, US and world economies would lead to gentle increases in the UK base rate from 4 per cent to reach about 5 per cent by the end of 2004 and then remain there for most of 2005.

Longer term fixed interest rates – The view was that longer term Public Works Loan Board rates would be fairly stable around the 5 per cent level for most of the financial year (equivalent to a longer term gilt yield of approximately 4.85 per cent).

The Treasury Strategy adopted by the Council

The Council Officers, in conjunction with the Treasury Advisers, continually monitored 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 was to be re-appraised with the likely action that fixed rate funding would be drawn whilst interest rates were relatively cheap.

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

For information the above strategy has been pursued into the current financial year.

4. Borrowing Outturn for 2004/5

Shorter term variable interest rates – The Monetary Policy Committee (MPC) raised base rate from 4 per cent in 0.25 per cent steps in May, June and August to reach 4.75 per cent where the rate then stayed for the rest of the financial year. The surge in base rate in the first half of 2004 was prompted by major concerns at the pace of increase in house prices which were running at about 20 per cent by mid summer. Associated with this was the strong economic growth (Gross Domestic Product was up from 2.2 per cent in 2003 to 3.1 per cent in 2004 – in line with the Chancellor’s forecast) stoked by increases in government and consumer expenditure both partly financed by robust increases in borrowing. There were major concerns that these rates of increase were unsustainable and that the MPC had to act quickly to cool the economy. During the autumn it became clear that the increases in base rate had had the desired effect and that the Housing Market had turned; increases in house prices were then on a falling trend reaching around 10 per cent per annum by February 2005. Base rate was then on a knife edge during quarter 4 of 2004 and quarter 1 of 2005 as to whether or not a further increase to 5 per cent was needed to rein in the economy and keep inflation on target. However, the steep increases in oil prices, particularly towards the end of 2004 and in quarter 1 of 2005, reduced consumer spending power and negatively impacted consumer sentiment and expenditure. That debate and tension around raising base rate continued into the start of 2005/6. Inflation has been well below the 2 per cent MPC target for the Consumer Prices Index (averaging 1.3 per cent in 2004), but the sharp increase in oil prices and the consequent anticipated quick feed through into the price of goods and services caused an increase in inflation expectations around the beginning of 2005. Wage inflation has not been a cause for concern during 2004/5 despite unemployment remaining at historically low levels.

In the United States (US) the Fed raised rates in 0.25 per cent increments from 1 per cent starting in June and reaching 2.75 per cent in February 2005 on the back of strong Gross Domestic Product growth of 4.4 per cent in 2004 and low inflation. There was a temporary soft patch of growth in the autumn of 2004.

In the Eurozone the European Central Bank (ECB) left its rate unchanged at 2 per cent all year. Gross Domestic Product growth improved from 0.5 per cent in 2003 to 1.8 per cent in 2004 but faltered in the second half; unemployment was stable at just under 9 per cent all year.

Longer term fixed interest rates – The Public Works Loan Board 25–30 year rate started the year at 4.80 per cent and then hovered around 5 per cent to 5.1 per cent in May and June before falling back and falling sharply in November / December to reach 4.5 per cent by the end of 2004. During February and March 2005 the rate rose again to a peak of 4.9 per cent as high oil prices renewed inflation concerns.

Actual Borrowing

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

Type of Loan	**Balance as at 01.04.2004 £'000**	**Borrowing during year £'000**	**Repaid during year £'000**	**Balance as at 31.03.2005 £'000**
PWLB	96,369	0	0	96,369
Lenders Option / Borrowers Option (LOBO)	12,000	4,000	0	16,000
Other Mortgages / Bonds	0	0	0	0
Temporary Loans	0	0	0	0
Covenant - Ex ADC	249	0	249	0
Covenant - Ex TRC	1,755	0	1,755	0
Total	**110,373**	**4,000**	**2,004**	**112,369**

The borrowing includes a further market loan undertaken on the basis of a Lenders Option / Borrowers Option (LOBO) in September 2004 when rates fell as forecast. This secured a low rate of 3.2 per cent for 2 years (when Public Works Loan Board rates were around 4.9 per cent) with a step up rate of 4.5 per cent for potentially the remaining 48 years unless, of course, the lender decides to request an increase in the rate (which is based on market pricing). The Council then has an option to accept the increase or repay the loan.

Debt Performance – As a result of the Treasury Strategy adopted at Section 3 above the actual loans fund rate for 2004/5 was 5.75 per cent compared with the budgeted rate for 2004/5 of 6.2 per cent.

5. Investment Strategy for 2004/5

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 2004/5

Actual Lending

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

Type of Investment	**Balance as at 01.04.04 £'000**	**Lending during year £'000**	**Repaid during year £'000**	**Balance as at 31.03.05 £'000**
Bank of Scotland	8,943	1,268,870	1,263,869	13,944
Money Market	0	146,210	146,210	0
Total	**8,943**	**1,415,080**	**1,410,079**	**13,944**

The Council's cautious and controlled approach to Treasury Lending resulted in an equated investment and rate of return for 2004/5, as follows:

	Equated Investment £'000	**Rate of Return %**	**Benchmark Return * %**
Internally Managed	13,780	4.66	**4.5**

* - 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

It was expected that debt rescheduling opportunities would arise in the first few months of 2004/5 as the monetary-tightening embarked on by the Monetary Policy Committee within 2003/4 continued. This expectation was realised as Public Works Loan Board rates rose in the early part of the year reaching a peak of 5.15 per cent for the 30 year term in May 2004 and 5.4 per cent for the 10 year term in June 2004. Rates over 5 per cent were generally available for debt rescheduling purposes for a time throughout the early summer before dropping back in the late summer to levels that made debt rescheduling opportunities unattractive.

The Council decided that there was no urgency to undertake debt rescheduling within 2004/5 as the most appropriate loans for rescheduling (i.e. the loans which would further smooth out the maturity profile following the debt rescheduling exercise of 2003/4) would provide debt rescheduling opportunities into 2005/6. Such debt rescheduling opportunities are kept under constant review.

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.