

TREASURY MANAGEMENT REPORT

PURPOSE

The purpose of this report is to advise Cabinet of the Council's Treasury Activities for 2003/2004.

1. MAXIMUM BORROWING LEVELS

- 1.1 Each year the Council makes a determination, as required by Section 45 of the Local Government and Housing Act 1989, relating to the maximum external debt that will be allowed in the following financial year. The determination also sets limits for borrowing of a short-term nature (less than 365 days) and places a maximum limit on debt with variable interest rates.
- 1.2 The limit for external borrowing is calculated in accordance with government regulations and gives a figure higher than the Council's actual external borrowing. This is due to the effect of using capital receipts and revenue fund balances as a substitute for external borrowing and the need to provide flexibility and headroom in managing cashflow. Cabinet will be aware that the limits to external borrowing imposed by Government have now been abolished with the introduction of the Prudential Code for Capital Investment. The Council now sets its own borrowing limits as detailed in the Cabinet report in February this year.
- 1.3 The limits for 2003/2004 approved by the Council were as follows: -

Borrowing Limits	£
Total Debt	105,000,000
Short Term Debt	40,000,000
Proportion of Debt with Variable Interest Rates not to Exceed	25%

The Council's actual figures did not exceed these limits at any stage during the year.

2. BORROWING TRANSACTIONS 2003/2004

- 2.1 The Public Works Loan Board (PWLB) had been the sole source of long-term borrowing for the Council since its inception and was the main source for long-term borrowing for the Council during 2003/2004. However during 2003/2004 the Council also borrowed from the money market in the form of a LOBO. LOBO loans became an attractive source of long term borrowing during 2003/2004 with low interest rates available, therefore it was decided to take advantage of this and it is estimated that interest savings of approximately £500,000 will be generated over the two year fixed period of the LOBO loan. The following summary gives information relating to the Council's external borrowing transactions in 2003/2004.

External Borrowing	£
As at 1st April, 2003	62,540,965
New Borrowing (see paragraph 2.2)	15,483,997
Less: Repayments	(25,170,011)
As at 31st March, 2004	<u>52,854,951</u>

2.2 The following new loans were taken during 2003/2004 as part of debt rescheduling exercises. This rescheduling took place after careful consideration of interest rate forecasts, expected capital spending and repayment profile. The rescheduling resulted in the Council obtaining lower interest rates payable on loans, an improved debt repayment profile and generated approximately £430,000 in interest savings over the term of the replacement loans. Two other factors made debt rescheduling particularly attractive in 2003/2004, ahead of the commencement of the new Prudential Code regime on 1st April 2004:

- the abolition of the Provision for Credit Liabilities (PCL), meant that 2003/2004 was the last opportunity to charge premia incurred in rescheduling debt to the PCL.
- The abolition of Higher Rate quota by the PWLB, meant that 2003/2004 was the last opportunity to convert higher quota PWLB loans using higher quota discount rates (which were higher than lower quota discount rates more commonly used in debt rescheduling). Using higher discount rates, where possible, enabled premia costs to be reduced, or discounts earned to be increased.

Date	Loan Type	Amount £	Period Years	Interest Rate %
09/07/03	Variable – Maturity	4,300,000	1	3 month variable
11/08/03	Variable – Maturity	1,481,142	1	3 month variable
14/01/04	Variable – Maturity	3,702,855	1	3 month variable
04/02/04	LOBO	6,000,000	50	2 years at 2.85%, then 48 years 4.5%
		15,483,997		

Rates of interest available in the year for PWLB Fixed Rate - Maturity (Lower Quota 20 to 25 years) loans ranged from 4.4% to 5.15%.

2.3 The cost of borrowing in 2003/2004 was £191,795 more than the budget of £2,976,909. Interest payments totalled £3,168,704. The average rate for the debt portfolio held at the year end dropped again this year from 5.6% to 4.7%, reflecting the repayment of short-dated high interest loans and new borrowing at lower interest rates as part of the rescheduling exercise (see paragraph 2.2).

2.4 The longer term debt at 31st March 2004 falls due for repayment as follows (NB it is assumed that the LOBO loan will be repaid in February 2006):

Long-term Debt Profile	£	% of total debt
Within		
1 year	11,135,249	21
1 – 5 years	12,817,039	24
5 – 10 years	1,373,427	3
10 – 15 years	1,897,226	4
15 years and over	25,632,010	48
	52,854,951	100

- 2.5 In addition to the external borrowing identified above, the Council has a bank overdraft facility with its bankers, National Westminster Bank plc, of £6,000,000, which was used on a limited basis during the year. This was used in replacement of any short-term borrowing of amounts less than £100,000 where it would not be cost effective to borrow through the money market. The overdraft facility was also used on a few occasions e.g. to process urgent CHAPS payments (approved by the County Treasurer) and the late repayment of a short term investment (for which the Council was subsequently compensated).
- 2.6 The Council's aim is to maintain a nil cleared balance, as far as possible, in low-interest bearing bank accounts. This is hard to achieve because some payments are made directly to the bank. However, such sums are not significant in overall terms. The average daily bank balance for 2003/2004, on which debit and credit interest is calculated, was £4,329 in credit. **Annex A** illustrates the balances for 2003/2004.

3. INVESTMENTS 2003/2004

- 3.1 The 1990 Regulations – Local Authority (Capital Finance) Approved Investments generally preclude long term investments, i.e. for a period exceeding one year. However limited access to the gilt market (Government Bonds) is available through schemes offered by fund managers.
- 3.2 The following provides a short Market Overview of short-term and long-term interest rates in 2003/2004

Short-term interest rates – Base rate was unexpectedly cut from 4.0% to 3.75% in February 2003 as Iraq war fears dampened growth prospects. A further cut to 3.5% in July was the bottom of this interest rate cycle. Rapidly improving growth prospects in the 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%, to be followed by a further increase in February 2004 to 4.0%.

Long-term interest rates – The PWLB lower quota 25-30 year rate started the year at 4.80% but fell to a bottom of 4.40% 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 4.9 – 5.05% until late December, after which it eased back to 4.75% by the end of March 2004.

- 3.3 In order to minimise risk when investing Council funds, the Treasury Management Policy Statement sets out certain criteria and limits for the selection and monitoring of the list of Approved Investment Counterparties. This list is reviewed and revised, as appropriate, each month to take account of changes in credit ratings of individual counterparties. During the year the limits were marginally breached on a few occasions (these were approved by the County Treasurer) due to a lack of interest from potential counterparties (e.g. Building Societies not prepared to accept short term deposits).
- 3.4 **Internally Managed Investments** - During the year interest rates earned on internally managed funds have varied between 4.63% and 2.81% and the average daily investment managed internally was £33,157,425. The actual daily investments ranged from £43,640,000 to £12,570,000 during the year, which illustrates how much the temporary cashflow fluctuates throughout the year. The temporary short-term investment transactions for 2003/2004 are summarised as follows:

Internally Managed Funds	£	£
Balance at 1st April 2003		32,540,000
Investments made during year (285 transactions)	783,382,865	
Investments recalled during year	<u>(802,112,714)</u>	(18,729,849)
Balance at 31st March 2004		<u>13,810,151</u>

- 3.5 The level of funds that were available for investment decreased as expected during the year, following the payment of PWLB loan repayments due and meeting expenditure as the capital programme progressed.
- 3.6 The average interest rate achieved on internally managed funds was 3.65%, which compares favourably with the generally accepted yardstick of the average 7-Day (LIBID) rate (uncompounded) of 3.52%. The average return over the last six years has been 0.26% above the benchmark. The Council's returns on the temporary investments largely mirrored the prevailing base rate. **Annex B** compares the average interest rate earned on internally managed funds, the 7-day (LIBID) rate, the borrowing rate offered by PWLB (for lower quota 20-25 year maturity loans) and the Bank of England Base Rate.
- 3.7 **Externally Managed Investments** - Council funds of £6,822,721 (as at 31st March 2004) continued to be managed externally by Investec Asset Management Ltd (Investec). The average net return for the year was 2.69% and the net income earned is added to the fund. This did not compare well to the benchmark of the average 7-Day (LIBID) rate (compounded) of 3.59%. However, the average return over the last six years has been 0.40% above the benchmark.
- 3.8 Investec performed poorly compared to other fund managers in 2003/2004 due to the untimely disposals of gilts. However, they have assured the Council that they have taken steps to amend their investment process and that their long term strategy will improve from 2004/2005. The Council continues to monitor Investec's performance on a monthly basis and initial indications are that performance will improve in 2004/2005.
- 3.9 The Council achieved well above its investment income budget of £650,000 in 2003/2004 (as summarised in below). This was primarily due to slippage on the Capital Programme and cashflow advantages on delays in spending to budget, together with increased interest rates.

Summary of Investment Income	2003/2004 Actual £
Internally Managed Funds	1,227,628
Externally Managed Funds (net)	<u>183,212</u>
	1,410,840
Less: transfers to Schools	(115,824)
Interest payments to trusts etc.	<u>(58,948)</u>
	<u>(174,772)</u>
Interest Received 2003/2004	<u>1,236,068</u>
Budget 2003/2004	650,000
Variance	+90%