HEREFORDSHIRE COUNCIL

TREASURY MANAGEMENT ACTIVITIES 2004/2005

PROGRAMME AREA REPONSIBILITY: CORPORATE STRATEGY AND FINANCE

CABINET **15TH SEPTEMBER, 2005**

Wards Affected

Countywide.

Purpose

To receive a report on the Council's Treasury activities for the period 1st April 2004 to 31st March 2005 and the outturn of Prudential Indicators for the year 2004/05.

Key Decision

This is not a key decision.

Recommendation

THAT the report detailed in Appendix 1 be noted.

Reasons

The reporting of the past financial year's performance is a requirement of the Council's Treasury Management Policy.

Considerations

1. A detailed report is attached at Appendix 1 with the following key points specifically drawn to the attention of Cabinet:

   - With regard to the transactions for the financial year 2004/05, the cost of borrowing was below the budget and the investment income was above the budget (Section 2 and 3 of the report refers).

   - The return on internally managed investments exceeded the index benchmark for 2004/05 (Section 3 of the report refers).

   - The net return on externally managed funds was in line with the index benchmark for 2004/05 (Section 3 of the report refers).

   - The treasury limits and prudential indicators were complied with during 2004/05 (Section 6 of the report refers).

Further information on the subject of this report is available from
Samantha Pitt on 01432 261860

Risk Management

Risk is managed in accordance with the Treasury Management Policy Statement approved by Cabinet in February 2002.

Consultees

None identified.

Background Papers

None identified.

APPENDIX 1

TREASURY MANAGEMENT REPORT 2004/05

PURPOSE

The purpose of this report is to advise Cabinet of the Council's Treasury Activities for 2004/05.

1. INTRODUCTION AND BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by this Council in February 2002 and this Council fully complies with its requirements. The primary requirements of the Code are the:-

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the Cabinet of an annual strategy report for the year ahead and an annual review report of the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local 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. "

1.3 An Internal Audit Review in February 2005 noted that the treasury management system has a satisfactory system of control.

1.4 This annual treasury report covers:

- the Council's Borrowing Transactions 2004/05;
- the Council's Investment Transactions 2004/05;
- the strategy for 2004/05;
- the economy in 2004/05;
- borrowing and investment rates in 2004/05;
- compliance with treasury limits and Prudential Indicators;

2. THE COUNCIL'S BORROWING TRANSACTIONS 2004/05

2.1 The following summary gives information relating to the Council's long-term borrowing transactions in 2004/05.

Long-term Borrowing	£
As at 1st April 2004	52,854,951
New Borrowing (see paragraph 2.3)	26,000,000
Less: Repayments	(11,135,249)
As at 31st March 2005	**67,719,702**

2.2 The Public Works Loan Board (PWLB) remains the main source of long-term borrowing for the Council. In addition to PWLB loans the Council have also borrowed from the money market in the form of LOBO loans. LOBO loans have recently become an attractive source of long-term borrowing and therefore it was decided to take advantage of this in order to generate interest savings.

2.3 After careful consideration of interest rate forecasts, expected capital spending, repayment profile and having regard to the existing debt, loans were taken during 2004/05 as follows:

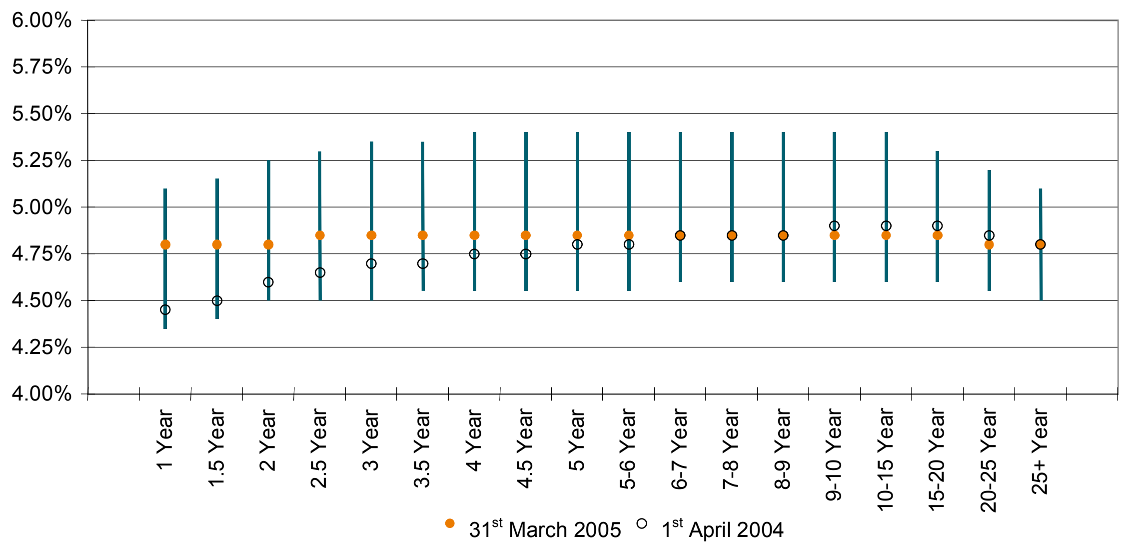
Date	Loan Type	Lender	Amount £	Period Years	Interest Rate %
12/08/04	Fixed Maturity	PWLB	5,000,000	26	4.80
30/09/04	Fixed Maturity	PWLB	7,000,000	27	4.75
26/10/04	Fixed Maturity	PWLB	3,000,000	1	4.50
24/11/04	LOBO	Danske Bank	6,000,000	50	2 years at 1.60%, then 48 years at 4.50%
15/02/05	Fixed Maturity	PWLB	5,000,000	28	4.50
			26,000,000		

2.4 Rates of interest available during the year for PWLB Fixed Rate – Maturity (25 to 30 Years) loans ranged from 4.50% to 5.10%. As further comparative performance indicators, average PWLB maturity loan interest rates for 2004/05 were: -

- 1 year 4.72%
- 9-10 year 4.99%
- 25-30 year 4.82%

The graph below shows the range (high and low points) in rates for each maturity period during the year, and individual rates at the start and end of the financial year.

PWLB rates 2004/05



2.5 The cost of borrowing in 2004/05 was £1,122,596 less than the budget, mainly due to slippage on the Capital Programme and new borrowing at low interest rates. Interest payments totalled £2,663,710. The average rate of interest paid on borrowings during the year was 4.62% compared to 5.40% in 2003/04, reflecting the repayment of short-dated high interest loans and new borrowing at low interest rates.

2.6 The longer term debt at 31st March 2005 falls due for repayment as follows (NB it is assumed that the LOBO loans will be repaid after the initial 2-year period of each loan).

Long-term Debt Profile **Within**	**£**	**% of total debt**
1 year	9,423,523	14
1 – 5 years	12,648,877	19
5 – 10 years	1,423,894	2
10 – 15 years	3,979,271	6
15 years and over	40,244,137	59
	67,719,702	**100**

2.7 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.

2.8 The Council's aim is to maintain a nil cleared balance, as far as possible, in low-interest bearing accounts. This is hard to achieve in practice because some payments are made directly in to the bank. However, such sums are not significant in overall terms. The average daily bank balance for 2004/05, on which debit and credit interest is calculated was £30,503 in credit. **Annex A** illustrates the balances for 2004/05.

3. THE COUNCIL'S INVESTMENT TRANSACTIONS 2004/05

3.1 **Internally Managed Investments** – The Council manages its in-house investments with the institutions listed in the Council's approved lending list. The Council placed investments for a range of periods from overnight to 364 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

3.2 During the year the interest rate earned on internally managed funds have varied between 3.45% and 5.00% and the average daily investment managed internally was £29,114,791. The actual daily investments ranged from £11,860,000 to £45,732,248, which illustrates how much the temporary cash flow fluctuates throughout the year. The temporary short-term investment transactions for 2004/05 are summarised as follows:

Internally Managed Investments	£	£
As at 1st April 2004		13,810,151
Investments made during year (254 transactions)	1,022,446,981	
Investments recalled during year	(1,010,267,132)	12,179,849
As at 31st March 2005		**25,990,000**

3.3 The level of funds of funds that were available for investment increased during the year, due to budget underspends and slippage on the Capital Programme.

3.4 The average interest rate achieved on internally managed funds was 4.64%, which compares favourably with the generally accepted yardstick of the average 7-Day LIBID rate (uncompounded) of 4.50%. The Council's return on 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 the PWLB (for 25-30 year maturity loans) and the Bank of England Base Rate.

3.5 **Externally Managed Investments** – Council funds of £7,143,049 (as at 31st March 2005) continued to be managed externally by Investec Asset Management Ltd (Investec). The fund management agreement between the Council and Investec defines the limits for maximum duration of investments for the fund and the Counterparty criteria and exposure limits.

3.6 The average net return for the year was 4.59% and the net income earned is added to the fund. Investec's return was in line with the benchmark of the average 7-day LIBID rate (compounded) of 4.60%.

3.7 Investec performed well compared to other fund managers in 2004/05. The Council continues to monitor Investec's performance on a monthly basis.

3.8 The Council achieved well above its investment income budget of £670,000 in 2004/05 (as summarised below). This was primarily due to slippage on the Capital Programme and cash flow advantages on delays in spending to budget, together with increased interest rates.

Summary of Investment Income	£	£
Internally Managed Funds		1,351,857
Externally Managed Funds (net)		322,337
		1,674,194
Less: transfers to Schools	(200,234)	
Interest payments to trusts etc.	(88,526)	
		(288,760)
Interest Received 2004/05		**1,385,434**

4. THE STRATEGY FOR 2004/05

4.1 The treasury strategy for 2004/05 was based on a view of the UK, 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% to 4.0% by February 2004; this was still a low rate by historic standards which was acting as a stimulus to the economy. The Monetary Policy Committee was therefore expected to eliminate that stimulus by gradually raising base rate back to more normal levels (near to 5%) during the year.

4.2 Similarly, the US Fed was expected to raise rates from the exceptionally low rate of 1.0% 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 was therefore expected to leave rates unchanged at 2.0% so as to continue to provide some stimulus for the economy in the absence of major inflationary concerns. Inflation in all three areas was expected to be well contained.

4.3 The effect on interest rates for the UK was therefore expected to be as follows:

Shorter-term 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 UK base rate.
Longer-term interest rates - The view on longer-term fixed interest rates was that long-term PWLB rates would be fairly stable around the 5.0% level for most of the financial year.

4.4 The strategy agreed by Cabinet, based upon the above forecast, was:

- That the expectation that short-term rates would be good value for some of the 2004/05 borrowing requirement and would assist in lowering debt servicing costs. The risk was that leaving longer-term borrowing to later years could eventually entail higher longer-term interest costs.
- That the risks intrinsic to shorter-term variable interest rates are such, when compared to historically low long term funding costs, that the Council will maintain a stable, longer term portfolio by drawing longer-term fixed rate funding.
- The Council operated both borrowing and investment portfolios and as a consequence was at lower risk from being impacted by a sharp, unexpected rise in short-term variable interest rates.

5. THE ECONOMY IN 2004/05

5.1 **Shorter-term interest rates** – Base rate rose in 0.25% steps from 4.0% in February 2004 to reach 4.75% in August where it stayed for the rest of the financial year. House prices grew strongly during 2004 and consumer confidence was high which fed through into strong increases in personal borrowing. Early in 2005, the housing market slowed sharply and consumer confidence fell as high oil prices reduced spending power and negatively impacted sentiment. This eased pressure for a further increase to 5.0%.

5.2 **Longer-term interest rates** – The PWLB 25-30 year rate started the year at 4.80% and then hovered around 5.0–5.10% in May/June before falling back, and falling sharply in November/December to reach 4.5% towards the end of December 2004. During February/March 2005 the rate rose again to a peak of 4.90% as high oil prices renewed inflation concerns.

6. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

6.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in **Annex C**. The Prudential Indicators set out are recommended by the CIPFA Prudential Code for Capital Finance.

6.2 The outturn of the Capital Programme was provided for Cabinet as part of the Integrated Annual Outturn Report 2004/05. The capital programme outturn for 2004/05 totalled £33,198,152 compared to an original budget of £34,937,786, which represents a decrease of £1,739,634 or 5%. Changes in original capital budgets represent a combination of total increases of £7,597,000 and total decreases of £9,337,000. This is due to new schemes and new sources of funding being identified, slippages and deferment of schemes into future years, and budget virements where necessary.

6.3 The original Prudential Borrowing indication was £5,000,000 however Cabinet subsequently allocated a reduced sum of £4,740,907 to various capital schemes in July 2004. Additional Supported Capital Expenditure (Revenue) (SCE(R)) funded £127,000 of this requirement. The outturn for the use of Prudential Borrowing for 2004/05 was £2,602,502 with the slippage from the original allocation of £2,011,405 now being required in 2005/06. This level of Prudential Borrowing would have required only £1.77 of a Band D Council Tax instead of the original £3.75. Although Prudential Borrowing was less than forecast during the year additional SCE(R) was used and therefore the net Capital Financing Requirement actually increased compared to the original forecast.