

## **EAST AYRSHIRE COUNCIL**

### **COUNCIL MEETING – 21 JUNE 2007**

#### **TREASURY MANAGEMENT ANNUAL REPORT FOR 2006/2007 AND UPDATE ON 2007/08 STRATEGY**

##### **Report by Executive Head of Finance**

## **1 PURPOSE OF REPORT**

- 1.1** To inform Members of the Council of the treasury activity for the financial year ended 31 March 2007. The report also covers the actual Prudential Indicators for 2006/07 in accordance with the requirements of the Prudential Code, and provides an update on the 2007-08 strategy.

## **2 BACKGROUND INFORMATION**

- 2.1** The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken. No restrictions were made in 2006/07;
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- 2.2** The Council undertakes capital expenditure to create, improve or enhance the life of its assets. These activities can be funded from related income such as capital receipts, capital grants with any residue which cannot be immediately paid for giving rise to a borrowing need. This borrowing need will be charged to revenue over a number of years. This area of capital expenditure activity is regulated by the CIPFA Prudential Code, which requires actual outturn to be reported in the following areas:

- Capital expenditure;
- Capital Financing Requirement;
- Debt;
- Ratio of financing costs to net revenue stream.

Additional indicators are included to ensure comprehensive annual reporting.

- 2.3** Part of the Council's treasury activities is to address any borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance in accordance with the CIPFA Code of Practice on Treasury Management.
- 2.4** The Code requires as a minimum the regular reporting of treasury management activities to: -
- (a)** Forecast the likely activity for the forthcoming year in this respect the annual strategy report was approved by the Policy & Resources committee at its meeting on 27 March 2007.
  - (b)** Review actual activity for the proceeding year and comment on interim performance in the current financial year which is the purpose of this report.

### **3 PERFORMANCE SUMMARY 2006/07**

#### **3.1 Capital Expenditure and Financing 2006/07**

During 2006/07 the total capital investment undertaken by the Council was £32.925M. This forms one of the required prudential indicators (a list of all mandatory indicators is at Appendix 1), and the table below shows how this was financed with the resultant need to borrow of £12.840M.

	<b>General Fund</b>	<b>HRA</b>	<b>Total</b>
	<b>£'M</b>	<b>£'M</b>	<b>£'M</b>
Total capital expenditure	21.479	11.446	32.925
Resourced from:-			
Capital receipts	-	(9.556)	(9.556)
Capital grants	(8.767)	-	(8.767)
Revenue	(0.225)	(1.537)	(1.762)
<b>Un-financed capital expenditure (additional need to borrow)</b>	<b>12.487</b>	<b>0.353</b>	<b>12.840</b>

### 3.2 The Council's Overall Borrowing Need

3.2.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's external debt position and represents all 2006/07 plus all historic net capital expenditure which has not yet been charged to revenue. The following table summarises the movement in the Council's Capital Financing Requirement (CFR) during 2006-07.

	General Fund £'M	Housing £'M	Total £'M
Opening balance 1 April 2006	127.723	54.691	182.414
Add : Un-financed capital expenditure 2006/07 (3.1 above)	12.487	0.353	12.840
Less : CLF repayments in 2006/07 on historic debt	(5.667)	(2.019)	(7.686)
Less : Capital Receipts used to reduce historic debt	(0.026)	-	(0.026)
<b>Closing balance 31 March 2007</b>	<b>134.517</b>	<b>53.025</b>	<b>187.542</b>

### 3.3 Treasury Position at 31 March 2007

3.3.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Executive Head of Finance and Asset Management can manage the Council's actual borrowing position by either borrowing to finance the CFR, choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing), or borrowing for future increases in the CFR (borrowing in advance of need).

3.3.2 The external debt portfolio position of the council of the Council at 31 March 2007 compared to the previous year is shown in the following table.

	O/S @ 1 April 2006 £'M	Net movement in Debt Level £'M	O/S @ 31 March 2007 £'M
Public Works Loan Board	123.361	(0.019)	123.342
Market Loans	67.100	-	67.100
Temporary Borrowings	-	-	-
European Investment Bank	0.195	(0.055)	0.140
Trusts & Bequests etc.	0.775	0.005	0.780
<b>TOTAL BORROWING</b>	<b>191.431</b>	<b>(0.069)</b>	<b>191.362</b>
Short Term Investments	(48.750)	(5.250)	(54.000)
<b>NET EXTERNAL DEBT</b>	<b>142.681</b>	<b>(5.319)</b>	<b>137.362</b>

3.3.3 There was no underlying need to borrow at 31 March 2007 as the CFR at 31 March 2007 is £187.542M (3.2 above) and the total external borrowing shown in the table above is £191.362M. During the year external borrowing was held effectively static with the net movement in the above table representing the council's existing obligations to meet external loan repayments during 2006/07.

3.3.4 In order to mitigate the risk from interest rate movements, limits are in place which restrict the ratio of fixed to variable rate debt to 60:40. The table below analyses the external debt between fixed and variable rates of interest at 31 March 2007. The average interest rates shown are as at 31 March 2007.

Category	Principal	% of Total	Average Interest
	£'M		Rate %
Fixed Interest Rate Debt	172.182	89.98%	5.887%
Variable Interest Rate Debt	19.180	10.02%	5.051%
<b>Total External Debt</b>	<b>191.362</b>	<b>100.00%</b>	<b>5.760%</b>
<b>Investments</b>	<b>(54.000)</b>		<b>5.408%</b>
<b>NET EXTERNAL DEBT</b>	<b>137.362</b>		

3.3.5 The Treasury Strategies for 2006/07 and 2007/08 identified a combined underlying total borrowing requirement in excess of £30M for these two years. Although there was some slippage in the 2006/07 capital programme, compared to the original plan, these projects will still be undertaken and the overall position remains unchanged. As reported in the 2007/08 Treasury Strategy our Treasury advisors have been monitoring interest rates to identify the optimum time to borrow £18M of these funds since December 2006. Taking into consideration subsequent recent increases in interest rates and the level of short term investments currently held by the council which can be utilised to meet any short term funding needs it is unlikely that these funds will be borrowed in the immediate future.

3.3.6 The short term investments held of £54M represent the general and specific reserves of the council combined with its working capital requirements as well as any difference between the councils need to borrow and its actual levels of external borrowing at any point in time. The level of these investments increased by £5.250M during 2006-07 as a result of the increase in the General Fund balance in 2006-07 and a reduction in working capital requirements being offset by the increased Capital Financing Requirement with no corresponding increase in external borrowing.

3.3.7 These investments are all short term investments, less than 364 days, placed with institutions such as banks, building societies and other local authorities. The investments are managed on a daily basis and over the year the average investment balance held was £54.090M with an average return of 4.85%.

### 3.4 Performance Indicators

- 3.4.1 The headline performance indicator for treasury management is the average cost of servicing loans as reflected in the consolidated loans fund interest and expenses rate – the pool rate. The performance over the last 3 financial years calculated in accordance with LASAAC guidance is shown below.

Year	Opening Advances £'M	Closing Advances £'M	Average Advances £'M	Interest & Expenses £'M	Pool Rate %
2004/05	191.568	188.896	190.232	11.154	5.86%
2005/06	188.896	182.414	185.655	11.161	6.01%
2006/07	182.414	187.541	188.425	11.405	6.05%

- 3.4.2 The rate is effectively static between 2005/06 and 2006/07 as there has been no significant change in external debt held and the external investments rates have been relatively static for much of the two year period in line with the interest base rate.

### 3.5 Prudential Indicators and Compliance Issues

- 3.5.1 The Prudential Code requires that the actual prudential indicators for the financial year 2006/07 are reported to members, these are included for information in Appendix 1. A number of these indicators provide either an overview or a limit on treasury activity, and these are explained below:

### 3.6 Capital Financing Requirement

- 3.6.1 In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, exceed the CFR for 2006/07 plus the expected changes to the CFR over 2007/08 and 2009/10. The table below confirms that the Council has complied with this at 31 March 2007.

	Original £'M	Actual £'M	ACHIEVED
Net borrowing position	195.090	137.362	<b>YES</b>
Capital Financing Requirement (CFR)	215.674	187.542	<b>YES</b>

- 3.6.2 The actual levels of net borrowing and CFR are less than the original indicator value set in February 2006 as the actual levels of capital expenditure since then have been lower than anticipated. The net borrowing position has also been reduced by the higher level of investment balances.

### 3.7 Authorised Limit & Operational Boundary

- 3.7.1 The Authorised Limit is the "Affordable Borrowing Limit" required by Section 35 of the Local Government in Scotland Act 2003. This is the Council's maximum borrowing level and was originally set at £239.068M for 2006/07.

3.7.2 The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached. This was originally set at £234.272M for 2006/07.

3.7.3 During 2006/07 the maximum level of actual borrowing was £191.431M and did not exceed either limit.

### **3.8 Maturity Structure of Fixed Borrowing**

3.8.1 The amount of fixed rate debt due to mature in 10 years or more is 98.01% which was within the maximum limit set for this indicator in 2006-07 of 100%. The remaining balance of 1.99% is due for periods less than 10 years and is well within the maximum levels set for those periods.

### **3.9 Investments Held by the Council**

3.9.1 Councils in Scotland are legally restricted in the range of investment products which they can use and investments are therefore placed with institutions such as banks, building societies and other local authorities. The average interest rate achieved for investments placed within the year was 4.921% which is comparable to the 7 day average LIBOR rate offered by the market of 4.942%.

### **3.10 Operational Limits**

3.10.1 The Council seeks to comply with best practice in all areas of treasury management. During 2006/07 the following limits were set and adhered to: -

<b>LIMIT</b>	<b>PURPOSE</b>	<b>ACHIEVED</b>
The maximum amount of debt maturing in 1 Year not to exceed 25%	To limit any exposure to high interest rates when renewing maturing debt	<b>YES</b>
No broker should handle more than 75% of annual treasury transactions	To prevent over reliance on one broker and ensure competition within market is utilised	<b>YES</b>
No more than 20% of total investments at any time should be placed with one counterparty.	To limit exposure with any one counterparty	<b>YES</b>

## **4 UPDATE ON 2007/08 STRATEGY**

The following provides an update on the Council's Treasury Management Strategy for 2007-08.

### **4.1 Interest Rates**

4.1.1 In approving the treasury strategy for 2007/08 on 27 March members noted that external advice suggested that interest rates were likely to peak at 5.5% in early 2007. Interest rates have currently reached 5.75% and further increases have not been ruled out throughout the remainder of the year.

## **4.2 Borrowing Strategy**

- 4.2.1 As referred to in paragraph 3.3 above the Treasury Strategies for 2006/07 and 2007/08 identified a combined underlying total borrowing requirement in excess of £30M , taking into account recent increases in interest rates and the level of short term investments currently held by the council it is unlikely that these funds will be borrowed in the immediate future.
- 4.2.2 The situation will continue to be monitored to identify the optimum time to borrow these required funds plus any for future years as appropriate.

## **4.3 Investment Strategy**

- 4.3.1 It is likely that the council will continue to hold significant levels of investment funds throughout the financial year. The investment portfolio will continue to be managed to ensure both liquidity and optimum rates of interest utilising the instant access call accounts as approved as part of the 2006-07 strategy in addition to placing short term deposits through brokers. All investments will be subject to investment limits and counterparty criteria as approved.

## **5 FINANCIAL/ LEGAL/ AUTHORITY IMPLICATIONS**

Nil

## **6 POLICY IMPLICATIONS**

The treasury management policies and practices have been complied with during the year.

## **7 RECOMMENDATIONS**

It is recommended that members note the contents of the report.

Alex McPhee  
**Executive Head of Finance and Asset Management**

LS/JB  
11 June 2007

## **LIST OF BACKGROUND PAPERS NIL**

Members wishing further information should contact Lorna Service, Exchequer Manager, Telephone (01563) 576405.

## ACTUAL PRUDENTIAL INDICATORS 2006/07

	2006/07 Original £'M	2006/07 Actual £'M
<b>1. Capital Expenditure</b>		
General Fund	29.692	21.479
Housing	13.660	11.446
<b>Total</b>	<b>43.352</b>	<b>32.925</b>
<b>2. Capital Financing Requirement (CFR)</b>		
General Fund	153.511	134.517
Housing	62.163	53.025
<b>Total</b>	<b>215.674</b>	<b>187.542</b>
<b>3. Total External Borrowing</b>		
Borrowing	215.09	191.362
Other Long Term Liabilities		-
<b>Total Debt</b>	215.090	191.362
Investments	(20.000)	(54.000)
<b>Net Borrowing</b>	<b>195.090</b>	<b>137.362</b>
<b>4. Authorised Limit</b>	<b>239.068</b>	<b>191.431</b>
<b>5. Operational Boundary</b>	<b>234.272</b>	<b>191.431</b>
<b>6. Ratio of Financing Costs to Net Revenue Stream</b>		
General Fund	6.03%	6.04%
Housing	16.30%	16.74%
<b>7. Incremental Impact of Capital Investment on Council Tax</b>	<b>£1.31</b>	<b>£1.31</b>
<b>8. Incremental Impact of Capital Investment on Housing Rents</b>	<b>£0.00</b>	<b>£0.00</b>
<b>9. Upper Limits on Fixed Interest rates</b>	<b>100%</b>	<b>89.98%</b>
<b>10. Upper Limits on Variable interest rates</b>	<b>50%</b>	<b>10.02%</b>
<b>11. Maturity Structure of Fixed rate Borrowing</b>		
Under 12 Months	10%	0.30%
12 Months – 2 Years	10%	0.04%
2 Years – 5 Years	10%	0.06%
5 Years – 10 Years	25%	1.59%
10 Years and above	100%	98.01%
<b>12. Maximum principal funds invested</b>	<b>100% &lt; 1 Year</b>	<b>100% &lt; 1 Year</b>
<b>13. Adoption of CIPFA Code of Practice-</b>	<b>Yes</b>	<b>Yes</b>