

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE – 20 SEPTEMBER 2005

TREASURY MANAGEMENT ANNUAL REPORT FOR 2004/2005 AND REVIEW OF ACTIVITY FOR 2005/06

Report by Executive Head of Finance

1 PURPOSE OF REPORT

- 1.1** To inform Members of the Committee of the out-turn performance of the Treasury Management function for the financial year ended 31 March 2005, including the actual prudential indicators for 2004/05 in line with the requirement of the Prudential Code for Capital Finance in Local Authorities, and review current year performance.

2 BACKGROUND INFORMATION

- 2.1** The Council's treasury management activities are regulated by a variety of professional codes, statutes and best practice guidance, which include: -
- (a)** 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;
 - (b)** The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities to restrict the amount of borrowing undertaken – no such action was taken during 2004/05.
 - (c)** 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.

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector, "the Code", and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

2.2 The Code requires as a minimum the regular reporting of treasury management activities to: -

- (a) Forecast the likely activity for the forthcoming year – the annual strategy report was approved by this committee at its meeting on 8 February 2005.
- (b) Review actual activity for the proceeding year and comment on interim performance in the current financial year – the purpose of this report.

3 PERFORMANCE SUMMARY 2004/05

3.1 External Debt Outstanding at 31 March 2005

The movement in the external debt portfolio of the Council during 2004/05 is shown in the following table. External debt is used to finance both the capital investment strategy of the Council, together with short term cash flow requirements. Surplus cash balances are invested throughout the year typically by making term deposits with banks, building societies and other local authorities.

Category	O/S at 1 April 2004 - £M	Net movement in Debt Level	O/S at 31 March 2005 - £M
Public Works Loan Board	145.180	(21.517)	123.663
Market Loans	45.600	21.501	67.101
Temporary Borrowings	0.000	-	0.000
European Investment Bank	0.540	(0.254)	0.286
Other Loans	0.001	-	0.001
Trusts & Bequests etc.	0.770	0.003	0.773
TOTAL BORROWING	192.091	(0.267)	191.824
Short Term Investments	(22.650)	(17.150)	(39.800)
NET EXTERNAL DEBT	169.441	(17.417)	152.024

During the year £21.500M of PWLB loans were repaid early and replaced with market debt as part of a rescheduling exercise which resulted in annual savings for the Council of approximately £0.300M. A further £0.017M was repaid to the PWLB in respect of annual loan repayments. Glasgow City Council administers on behalf of the 12 successor authorities the outstanding European Investment Bank debt which was inherited from Strathclyde Regional Council. During the year £0.254M was repaid in relation to these loans. The net balances held on behalf of the Common Good funds and charitable trusts increased slightly during the year by £0.003M.

The increase in the level of short term investment balances reflects the increase in the general and specific reserves held by the Council at 31 March 2005, together with the maturity profile of external debt - the majority of which is not due to be repaid until financial year 2030 or beyond.

In order to limit the risk from interest rate movements, operational limits are in place that restricts the ratio of fixed to variable rate debt to 60:40. The analysis of the external debt between fixed and variable rates of interest is summarised below.

Category	As at 31 March 2004			As at 31 March 2005		
	Principal	% of Total	Average Interest Rate	Principal	% of Total	Average Interest Rate
Fixed Interest Rate Debt	154.680	80.5%	6.30%	154.664	80.6%	6.10%
Variable Interest Rate Debt	37.411	19.5%	3.60%	37.160	19.4%	3.60%
Total External Debt	192.091	100.0%	5.80%	191.824	100.0%	5.60%
Fixed Interest Investments	(21.000)	92.70%	4.00%	(35.500)	89.2%	4.90%
Variable Rate Interest	(1.650)	7.30%	3.90%	(4.300)	10.8%	4.60%
Total External Investments	(22.650)	100%	4.00%	(39.800)	100.0%	4.90%
NET EXTERNAL DEBT	169.441			152.024		

3.2 Loans Fund Borrowing Requirement

During 2004/05 the total capital investment undertaken by the Council was £28.202M. This was financed through a mix of capital receipts arising from the sale of assets; direct revenue contributions (CFCR), along with specific capital grants for schemes such as flood prevention and public transport initiatives.

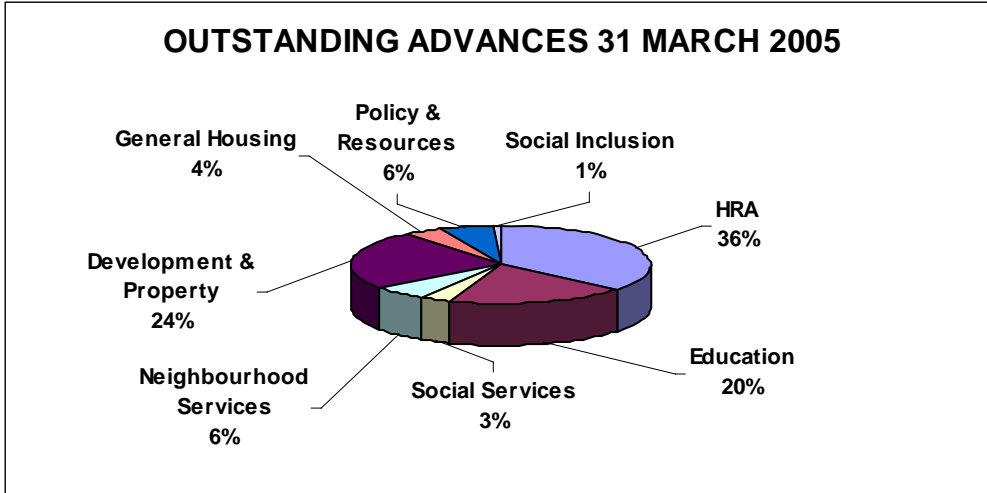
The Consolidated Loan Fund (CLF) acts as the internal bank of the Council making capital advances to borrowing departments during the year to support their investment programmes, these advances are repaid to the CLF over the useful life of the asset, together with interest and expenses – similar to a mortgage. In 2004/05 Service Departments repaid principal to the CLF of £7.465M in scheduled redemption.

The overall activity in 2004/05 resulted in net repayments to the loans fund from Services of £2.699M. The total movement in respect of capital activities during the year is summarised in the following table.

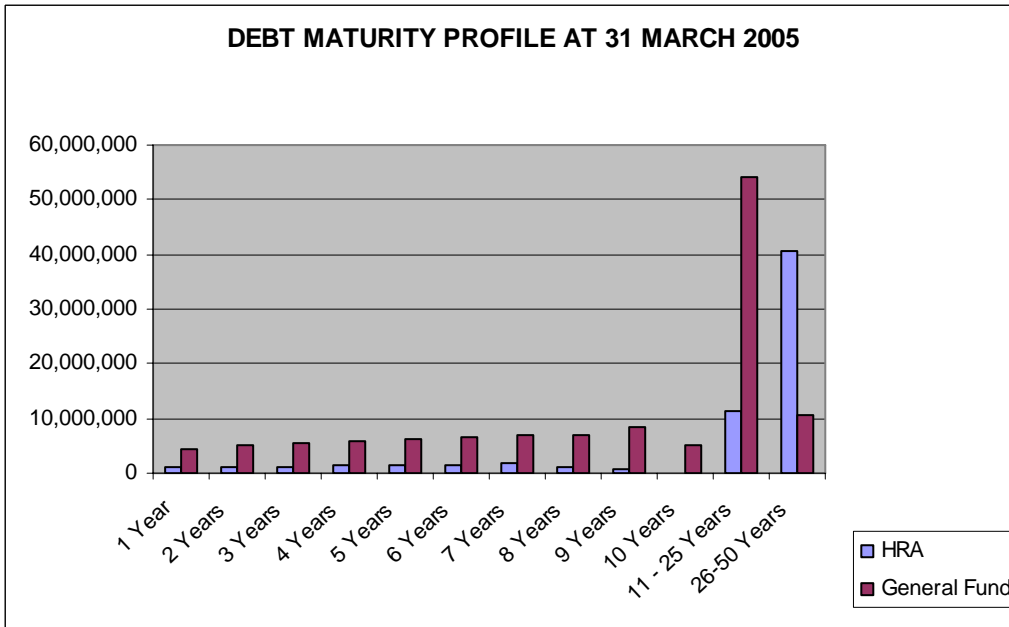
	HRA	General Fund	Total
	£'M	£'M	£'M
Capital Expenditure	11.793	16.409	28.202
Financed By:			
Capital Grants	-	(7.523)	(7.523)
Useable Capital Receipts	(7.629)	(0.027)	(7.656)
C.F.C.R.	(4.164)	-	(4.164)
Total Funding	(11.793)	(7.550)	(19.343)
Net Expenditure to Finance	-	8.859	8.859
Principal Repaid in Year			
From Revenue	(1.483)	(5.982)	(7.465)
From Capital	(4.063)	-	(4.063)
Total Redemption	(5.546)	(5.982)	(11.528)
Advances (Repayments)	(5.546)	2.877	(2.669)
Outstanding Advances at 1 April 2004	68.746	122.822	191.568
Outstanding Advances at 31 March 2005	63.200	125.699	188.899

3.3 Loans Fund Debt & Maturity

The distribution of the departmental debt which remained outstanding to the consolidated loans fund from Services at 31 March 2005 of £188.899M is illustrated in the following table.



Of the total debt owed by Services to the CLF of £188.896M approximately 35.26% is due to be repaid within the next 10 years with the remainder due between 11 and 50 years. The maturity profile is shown in the following graph.



3.4 Performance Indicators

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 is shown below.

Year	Opening Advances £'M	Closing Advances £'M	Average Advances £'M	Interest & Expenses £'M	Pool Rate %
2002/03	189.653	189.395	189.524	12.106	6.39%
2003/04	189.395	191.568	190.482	11.422	6.00%
2004/05	191.568	188.899	190.233	10.422	5.49%

The reduction in the annual average rate has been achieved through the active management of the loans fund and incorporates savings recognised through debt rescheduling to take advantage of lower interest rates, together with investment income received during the year. Any further reduction in this average rate will be partly dependant upon the level of return available on investments during subsequent financial years.

3.5 Prudential Indicators and Compliance Issues

The Prudential Code requires that the actual prudential indicators for the financial year 2004/05 are reported to Committee, 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 shown below:

3.5.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is a gauge for the Council's debt position shown above. In order to ensure that over the medium term borrowing - net of investments is only undertaken for a capital purpose, net borrowing should not, except in the short term, exceed the CFR for the current financial year plus the expected changes to the CFR in the subsequent 2 financial years. The table below confirms that the Council has complied with this requirement.

	31 March 2005	
	Limit	Actual
Net borrowing position	185.305	152.024
Capital Financing Requirement (CFR)	204.596	188.899

The actual level of net borrowing and CFR were less than estimated due to the lower overall level of capital expenditure during the year combined with the higher than expected level of investment balances.

3.5.2 Authorised Limit & Operational Boundary

The Authorised Limit is the estimated amount of borrowing that can be allocated to capital expenditure as required by s35 of the Local Government in Scotland Act 2003. 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. During 2004/05 the maximum level of borrowing of £192.091M did not exceed either limit.

3.5.3 Maturity Structure of Fixed Borrowing

The amount of fixed rate debt due to mature in 10 years or more is 98.7% compared to the target level of 95%. This is due in the main to previous rescheduling which took advantage of fixed longer term interest rates. This position will continue to be reviewed as part of the overall portfolio management process.

3.6 Operational Limits

The Council seeks to comply with best practice in all areas of treasury management. During 2004/05 the following limits were set and adhered to: -

LIMIT	PURPOSE	ACHIEVED
The ratio of fixed rate loans to variable rate should not exceed 60:40	Limits the exposure to increases in interest rates and provides budget certainty	YES
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	YES
No broker should handle more than 75% of annual treasury transactions	To prevent over reliance on one broker and ensure competition within market is utilized	YES

3.7 Investment Activity

The Council does not have the authority to actively use a wide range of investment products, investments are therefore placed with institutions such as banks, building societies and other local authorities. During the year the Council maintained an average investment balance of £31.225m and received an average return of 4.90%. The comparable performance indicator is the average 7 day LIBID rate, which was 4.50%.

4 INTERIM PERFORMANCE DURING 2005/06

The following provides an interim analysis of the Council's treasury management activities during the period April to August 2005.

4.1 Interest Rates

In approving the treasury strategy for 2005/06 Committee noted that longer term interest rates were expected to rise and that the base rate was expected to remain relatively flat. In practice longer term rates have moved downwards, reflecting market expectations of future economic conditions and adjusting interest rates accordingly. Shorter term rates have remained constant in line with the previous forecast, an initial cut in the base rate of 0.25% in August 2005 has taken place and it is anticipated that further rate cuts may occur place over the second half of the financial year.

4.2 Borrowing & Investment Strategy

To date during 2005/06 there has been no requirement to borrow long term to finance capital expenditure, due to the overall spend profile. Interest rates will continue to be closely monitored and if longer term rates remain comparatively cheap then it is anticipated that any required borrowing will take advantage of these to lock into the low rates available.

The investment portfolio has continued to be managed to ensure that there is both liquidity overall, together with taking advantage of the maximum periods of investment and rates available. The average investment rate is currently 4.853%, which compares favourably to the market comparator.

4.3 Performance Indicators

It is expected that the Council's pooled interest rate will outturn in line with or slightly under the 2004/05 figure of 5.49%. This will depend in part on the overall level of investment income received during the year which will be influenced by the interest rates available, this position will continue to be closely monitored during the year.

4.4 Treasury Operational Limits

The limits set for the treasury function for the first half of 2005/06 have been complied with.

4.5 Revised Counter Party Investment List

The counterparty list sets out those institutions that the Council will transact investment business with. The list is reviewed on a regular basis to ensure that a sufficiently diversified market is maintained into which surplus funds can be placed. This process is carried out in conjunction with Butlers the appointed Treasury Management advisors. The revised list is attached as Appendix 2 to this report for information.

4.6 Banking Arrangements

4.6.1 The Council resolved at its meeting on 29 April 2004 that the authorised signatories to the Council bank accounts would be:

One signatory from either:

- Executive Head of Finance; Financial Controller

Any two signatories from:

- Finance Manager – Financial Accounting & Control;
- Finance Manager – Strategic & Operational Accounting; Strategic & Operational Accountant.

4.6.2 Following the recent Best Value Service Review of Finance Services, members are asked to recommend to Council that the authorised signatory list is amended, and that the Bank is advised accordingly, to reflect the revised posts within the Service, and that the authorised signatories are: -

One signatory from either:

- Executive Head of Finance; Financial Controller

Any two signatories from:

- Exchequer Manager; Risk Manager; Payments Manager; Corporate Accounting Manager; Chief Accountant

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 the Committee agrees to recommend that the Council: -

- 7.1** resolves that the authorised bank signatories are amended as per paragraph 4.6 above; and
- 7.2** otherwise note the content of the report.

Alex McPhee
Executive Head of Finance

RB/DMW
29 August 2005

LIST OF BACKGROUND PAPERS NIL

Members wishing further information should contact Robin Baker, Financial Controller, Telephone (01563) 576331.

ACTUAL PRUDENTIAL INDICATORS 2004/05

	2004/05 Estimate £'M	2004/05 Actual £'M
1. Capital Expenditure		
General Fund	30.722	16.409
Housing	11.702	11.793
Total	42.171	28.202
2. Capital Financing Requirement (CFR)		
General Fund	133.879	125.699
Housing	70.717	63.200
Total	204.596	188.899
3. Total External Borrowing		
Borrowing	205.305	191.824
Other Long Term Liabilities	-	-
Total Debt	205.305	191.824
Investments	(20.000)	(39.800)
Net Borrowing	185.305	152.024
4. Authorised Limit	233.000	192.091
5. Operational Boundary	227.000	192.091
6. Ration of Financing Costs to Net Revenue Stream		
General Fund	6.430%	6.039%
Housing	17.600%	16.637%
7. Incremental Impact of Capital Investment on Council Tax	£0.68	£0.24
8. Incremental Impact of Capital Investment on Housing Rents	£0.15	£0.00
9. Upper Limits on Fixed Interest rates	90%	80.5%
10. Upper Limits on Variable interest rates	40%	19.5%
11. Maturity Structure of Fixed rate Borrowing (against maximum position in year)	Limit	Actual
Under 12 Months	25%	0.00%
12 Months – 2 Years	25%	0.01%
2 Years – 5 Years	50%	0.05%
5 Years – 10 Years	75%	0.01%
10 Years and above	95%	98.7%
12. Maximum principal funds invested	100% < 1 Year	100% < 1 Year
13. Adoption of CIPFA Code of Practice-	Yes	Yes

INVESTMENT COUNTERPARTY LIST

Counterparty	Investment Limit	Time Limit
BANKS		
Barclays Bank	£5,000,000	> 365 Days
Bank of Scotland (Ireland)	£5,000,000	> 365 Days
Adam & Co.	£5,000,000	> 365 Days
Ulster Bank Ireland Limited	£5,000,000	> 365 Days
Ulster Bank Ltd	£5,000,000	> 365 Days
Bradford & Bingley	£5,000,000	> 365 Days
Co-operative Bank Plc	£5,000,000	> 365 Days
Northern Rock Plc	£5,000,000	> 365 Days
Abbey National Plc	£5,000,000	> 365 Days
Alliance & Leicester	£5,000,000	> 365 Days
Schroders Plc	£5,000,000	> 365 Days
KBC Bank	£5,000,000	> 365 Days
Deutsche Bank AG	£5,000,000	> 365 Days
HSH Nordbank AG	£5,000,000	> 365 Days
Landesbank Baden-Wurttemberg Guaranteed	£5,000,000	> 365 Days
Allied Irish Banks Plc	£5,000,000	> 365 Days
Anglo Irish Bank Corporation	£5,000,000	> 365 Days
Bank of Ireland	£5,000,000	> 365 Days
Irish Permanent Plc	£5,000,000	> 365 Days
DePfa Bank Plc	£5,000,000	> 365 Days
IIB Bank Limited	£5,000,000	> 365 Days
Dexia Banque Internationale a Luxembourg	£5,000,000	> 365 Days
Banco Espirito Santo	£5,000,000	> 365 Days
BUILDING SOCIETIES		
Nationwide	£4,000,000	> 365 Days
Britannia	£3,000,000	> 365 Days
Yorkshire	£3,000,000	> 365 Days
Portman	£3,000,000	> 365 Days
Coventry	£3,000,000	> 365 Days
Chelsea	£3,000,000	> 365 Days
Skipton	£3,000,000	> 365 Days
Leeds & Holbeck	£3,000,000	> 365 Days
West Bromwich	£3,000,000	> 365 Days
Cheshire	£3,000,000	> 365 Days
Derbyshire	£3,000,000	> 365 Days
Principality	£3,000,000	> 365 Days
Newcastle	£3,000,000	> 365 Days
Norwich & Peterborough	£3,000,000	> 365 Days
Dunfermline	£3,000,000	> 365 Days
EBS	£3,000,000	> 365 Days
Stroud & Swindon	£3,000,000	> 365 Days
Nottingham	£3,000,000	> 365 Days
Scarborough	£3,000,000	> 365 Days
Progressive	£3,000,000	> 365 Days
OTHER		
Local Authorities; Police & Fire Authorities Etc	£5,000,000	> 365 Days