EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE - 22 FEBRUARY 2001

TREASURY MANAGEMENT – ANNUAL STRATEGY REPORT 2001/2002

Report by Director of Finance

1 PURPOSE OF REPORT

1.1 In line with the requirements of the Treasury Policy Statement to seek the approval of Members of the proposed Treasury Management Strategy for the financial year 2001/02.

2 BACKGROUND INFORMATION

2.1 The Council's annual treasury strategy should take account of the key economic and policy components that will influence the projected treasury position for the forthcoming financial year. The strategy for 2001/02 covers:-

- The role of the Consolidated Loans Fund
- Interest rate forecasts
- The anticipated capital programme
- Loans fund performance indicators
- Borrowing requirement & strategy
- Interest rate risk
- Interest rate sensitivity
- Investment strategy
- Revenue implications
- Debt rescheduling

3 PROJECTED TREASURY POSITION 2001/02

3.1 The role of the Consolidated Loans Fund

All income and expenditure of the Council is aggregated for the purposes of cash flow and administered through the Consolidated Loans Fund (CLF). This brings together all of the bank accounts of the Council.

The purpose of this aggregation is to bring all transactions together to allow the "group" treasury position to be determined on a daily basis, as well as minimising bank charges and expenses through the active management of the bank balance. The treasury function is centralised to ensure appropriate risk management, economies of scale, the harnessing of available expertise, clear lines of communication, and coherence of treasury activity.

3.2 Interest Rate Forecasts

The Monetary Policy Committee of the Bank of England has maintained the base rate at 6% since February 1999. Some economic forecasters have indicated that they feel that base rates have reached their peak level and, whilst they will remain at this level well into 2001, the slower economic activity could lead to a relaxation of monetary policy and a downward movement in rates. Longer-term rates will already have factored in these potential movements and are not expected therefore to vary significantly, from their current levels.

The following table reflects the forecast of interest rates for the period December 2000 to March 2002 used in calculations for 2001/02.

Projected Interest Rates – 2001/02							
Date	**Base Rate**	**3 Month**	**6 Month**	**1 Year**	**5 Year**	**10 Year**	**15+ Years**
2000							
Dec	6.00%	6.1%	6.1%	6.1%	5.5%	5.3%	5.1%
2001							
March	6.00%	6.0%	5.8%	5.6%	5.3%	5.3%	5.2%
June	5.75-6.00%	6.0%	5.7%	5.5%	5.3%	5.3%	5.2%
Sept	5.75%	5.8%	5.5%	5.4%	5.2%	5.3%	5.1%
Dec	5.5%	5.6%	5.5%	5.3%	5.2%	5.2%	5.1%
2002							
March	5.5%	5.5%	5.4%	5.2%	5.1%	5.2%	5.2%

3.3 The Anticipated Capital Programme 2001/02

Each year departments undertake capital expenditure in line with the overall allocations agreed by this Committee, together with the Housing Committee for the HRA capital programme. The monies required to finance these schemes are advanced from the Consolidated Loans Fund capital account, and repaid over a period of years in line with the expected life of the asset created.

The CLF borrows monies to finance these advances and makes an annual charge to departments to recover interest and expenses. The Scottish Executive announced in December an increase in the level of borrowing consent for Councils. This will increase the available General Services consent from £6.301M in 2001/02 to £7.053M in 2003/04.

The Housing Capital Account is still required to “set aside” 75% of receipts from house sales and 50% of other receipts for the repayment of debt. This will result in a net repayment to the CLF of approximately £0.571M. The following table summarises the expected movement in the Capital Account for 2001/02.

Service	CLF Advances at 31 March 2001 £'000	Estimated Advances During the Year £'000	Estimated Principal Repaid During the Year £'000	Estimated Advances O/S at 31 March 2002 £'000
Housing Revenue Account	78.729	(0.571)	(0.288)	77.870
General Fund	112.770	6.838	(2.737)	116.871
Business Units	0.393	0.000	(0.054)	0.339
TOTAL	**191.892**	**6.267**	**(3.079)**	**195.080**

3.4 Loans Fund Performance Indicators 2001/02

A key performance measure in respect of Treasury Management is the annual "Pool Rate". This expresses the annual cost of borrowing as a percentage of the overall capital debt. The three-year performance of the CLF is summarised in the following table.

	1999/2000 Actual	2000/01 Projected Actual	2001/02 Estimate
Opening Loans Fund Advances	187.952	188.286	191.892
Closing Loans Fund Advances	188.286	191.892	195.080
Average Loans Fund Advances	188.119	190.089	193.486
Loans Fund Interest	14.148	13.571	13.949
Loans Fund Expenses	0.295	0.295	0.285
Loans Fund Interest Rate	7.5%	7.1%	7.2%
Loans Fund Expenses Rate	0.16%	0.16%	0.15%

In determining the loan and lease charge support within the Aggregate External Finance (AEF) for 2001/02 the Scottish Executive has used an estimated interest rate of 7.2%. The projected average cost of borrowing for the Authority is therefore in line with the national estimate.

3.5 Borrowing Requirement & Strategy

Each year assumptions require to be made about the level of new borrowing. This includes the requirements of the capital programme, long term loans due to be redeemed, and the anticipated level of debt redemption. The net estimated borrowing requirement for 2001/02 is therefore £3.188M and is analysed as follows.

	£M
New Borrowing (Capital allocations)	10.017
Replacement Loans	0.000
Debt Redeemed – Annual	(3.079)
Debt Redeemed – HRA Set Aside	(3.750)
Total Estimated Borrowing Requirement	**3.188**

3.6 Interest Rate Risk

In order to limit the potential exposure to sudden or unexpected interest rate movements the Treasury Policy Statement provides that the maximum ratio of fixed rate loans to variable rate loans is 75:25, and that no more than 20% of the long-term debt should mature in any one-year. It is proposed that these limits be retained as the operational parameters for 2001/02.

The principal of fully utilising the Public Works Loan Board quota for 2001/02 will be complied with, as this will provide the opportunity to lock into low fixed rate interest rates.

3.7 Interest Rate Sensitivity

Whilst over 90% of external debt comprises fixed rate loans the portfolio is still influenced by movements in the interest rate. Any new borrowing carried out during the year will be concluded at the prevailing market rates. Based upon the current estimates a quarter percent upward movement in PWLB rates would result in additional interest of approximately £0.016M. A similar movement in short term rates (temporary loans) would cost £0.032M.

3.8 Investment Strategy

Any investments made during the year will typically arise from short-term cash-flow surpluses. Investments will be made in accordance with the Treasury Policy Statement and will in the first instance be placed on straight overnight deposit with the Council's bankers.

3.9 Revenue Implications

The following table sets out the assumptions made in setting the annual debt charges estimates for 2001/02, together with how these are allocated between the Council Services.

	£'M
Interest Charged:	
Public Works Loan Board	12.145
Market Loans	0.468
European Investment Bank	0.111
Temporary Borrowing	0.746
Covenant Loans	0.042
SDA Loans	0.003
Interest on Internal Balances	0.125
Premiums Written Off	0.314
Total Interest Charges	**13.949**
Direct Loan Charges	1.948
Loan Fund Expenses	0.285
Principal Redemption	3.533
Total Loan Fund Charges	**19.715**
Service Allocation	
General Fund Services	13.622
Housing Revenue Account	6.020
Business Units	0.073
Total	**19.715**

These estimates will provide a base position against which the performance of the loan fund will be monitored and reported on during the financial year.

Any additional borrowing consent that is granted during 2001/02 would have a revenue consequence through additional interest charges. It is estimated that an extra £1.000M of consent would increase interest charges by approximately £0.025M.

3.10 Debt Rescheduling

The debt portfolio will continue to be reviewed during the financial year and the advice of the Council's appointed Treasury Management advisors considered in order to identify any rescheduling opportunities available. Any rescheduling will require to satisfy the following criteria.

- The ability to demonstrate cash savings without increasing the overall risk profile.
- Continued operation within the parameters set for the financial year.

Any rescheduling carried out during the year will be reported to the next meeting of this Committee following the conclusion of the process.

4 RECOMMENDATIONS

It is recommended that Members: -

4.1 approve the Treasury Management Strategy for 2001/02; and

4.2 otherwise note the contents of this report.

Alex McPhee
Director of Finance

RB
6 February 2001

LIST OF BACKGROUND PAPERS
NIL

Any person who wishes any further information on this report should contact Robin Baker, Treasury Services Manager, Tel 01563 576331.

AGENDA