

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE – 18 APRIL 2002

TREASURY MANAGEMENT – ANNUAL STRATEGY REPORT 2002/2003

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 the Committee of the proposed Treasury Management Strategy for the financial year 2002/03.

2 BACKGROUND INFORMATION

- 2.1 The annual treasury management 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 2002/03 covers: -

- Revised CIPFA Code of Practice – Treasury Management in the Public Sector.
- Interest rate forecasts
- Capital financing & borrowing strategy
- Interest rate risk & sensitivity
- Investment strategy
- Revenue implications
- Debt rescheduling

- 2.2 This Committee is required to consider an annual strategy report on the treasury management function for the succeeding financial year. The submission of this report has been postponed until this meeting to allow for advice to be taken upon the form and content of the changes introduced by the revised CIPFA Code of Practice, which are set out in paragraph 3.

3 REVISED CIPFA CODE OF PRACTICE

- 3.1 In line with best practice, the Council has previously adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) “Code for Treasury Management in Local Authorities”. CIPFA has now issued a revised guidance document – “Treasury Management in the Public Sector – A Code of Practice and Cross-Sectoral Guidance Notes”, which recommends that all public service organisations adopt as part of their standing orders, financial regulations, or other formal policy documents, the following four clauses:

Clause 1: - This Council adopts the key recommendations of CIPFA’s Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 4 of that Code.

Clause 2: - Accordingly, this Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies and objectives of its treasury management policies
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 & 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Any such amendments shall not result in the Council materially deviating from the Code's key recommendations.

Clause 3: - This Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy report and plan in advance of the year, and an annual report after its close, in the form prescribed in its Treasury Management Practices (TMPs).

Clause 4: - This Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Policy & Resources Committee, and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the Council's policy statement and TMPs and, CIPFA's Standard of Professional Practice on Treasury Management.

It is recommended that the four clauses set out above are adopted and incorporated within the standing orders, financial regulations and the Treasury Management Policy Statement as appropriate.

- 3.2** Members should note that all of these practices are currently in place and the adoption of the precise wording of the revised code is proposed simply to ensure full compliance.

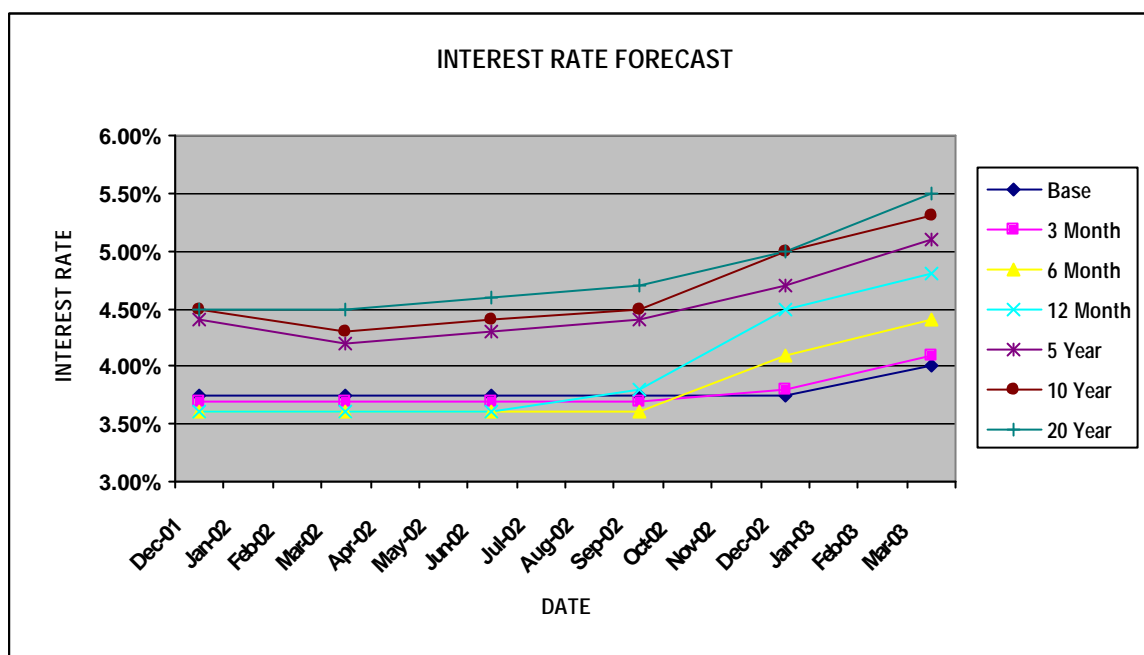
4 INTEREST RATE FORECAST

4.1 Interest Rate Projections 2002/2003

The United Kingdom economy has remained comparatively robust, whilst economic growth is expected to fall below the target rate of between 2.25% and 2.5% per annum, it is projected to recover late in 2002. Inflationary pressure remains low, with raw material prices weakening in an environment of downbeat economic activity. With the deceleration of UK earnings growth the Monetary Policy Committee of the Bank of England has acknowledged these through interest rate reductions.

The relaxation of monetary policy however in 2001 combined with the large-scale fiscal expansion associated with the Comprehensive Spending Review should boost activity in the second half of the year. This is likely to be accompanied by a corresponding tightening of monetary policy and an upward movement in interest rates in the third and fourth quarter of the year.

The following graph reflects the forecast of interest rates for the period December 2001 to March 2003 used in preparing the projected debt charges.



5 CAPITAL FINANCING & BORROWING STRATEGY 2002/2003

5.1 The estimated capital expenditure that will be undertaken during 2002/2003 is £17.852M. This is summarised in the following table together with the expected source of funding.

	HRA £'M	General Fund £'M	Total £'M
Est' Capital Exp'	9.399	8.453	17.852
Financed By:			
<i>General Consents</i>	3.489	6.397	9.886
<i>Specific Consents</i>	0.000	0.911	0.911
Useable Receipts	1.593	1.145	2.738
CFCR	4.317	0.000	4.317
Total Funding	9.399	8.453	17.852

5.2 The overall projected borrowing requirement takes into account the approved Section 94 consent, together with the requirement to refinance maturing debt, less the annual redemption payment made of existing advances by borrowing departments, together with the continued requirement to "set aside" 75% of Right to Buy receipts for debt redemption within the HRA. This can be summarised in the following table: -

£M	
New Borrowing Section 94	9.886
Replace Maturing Loans	0.004
Annual Debt Redemption	(3.695)
Debt Redemption – HRA Set aside	(4.598)
Estimated Borrowing Requirement	1.597

Movements in working capital and cash flow balances will continue to be financed through short term borrowing/lending, typically to/from other local authorities and government bodies, in accordance with the Treasury Management Policy and Practices.

- 5.3** The forecast interest rates indicate that in assessing longer term borrowing consideration should be taken to acting early in the new financial year, to lock into lower long term rates as a hedge against projected rises in interest rates. This however requires to be balanced against the view that short-term variable rates will remain at rates below their longer-term counterparts offering savings within the current year. The borrowing strategy adopted will therefore balance the shorter-term gains available with the overall need to secure fixed longer-term rates ensuring future stability in the budget process.
- 5.4** The loan fund acts as the internal bank for Service Departments. Advances are made to borrowing departments to finance approved capital expenditure, which are repaid over the assumed useful life of the asset created. The following table summarises the expected movement in the level of Service “loan” accounts in the financial year 2002/2003.

	HRA £'M	General Fund £'M	Trading Services £'M	Total £'M
Est.' Advances O/S at 1.4.2002	76.858	107.555	0.393	184.806
Estimated Capital Advances	3.489	7.308	0.000	10.797
Principal Repaid	(0.170)	(3.470)	(0.055)	(3.695)
Debt Repaid from Receipts	(4.598)	0.000	0.000	(4.598)
Est.' Advances O/S at 31.3. 2003	75.579	111.393	0.338	187.310

6 INTEREST RATE RISK & SENSITIVITY

- 6.1** The interest rate forecast set out in paragraph 4.1 indicates that whilst a modest rise in rates is anticipated it is not projected that these will be subject to a high level of fluctuation. It is however considered prudent to limit the exposure to sudden and unexpected changes in interest rates by setting limits on the percentage of the overall portfolio that can be at variable rates, and the level of debt maturing in any one financial year.
- 6.2** The current limits provide that the maximum ratio of fixed rate loans to variable rate loans is 75:25, whilst the maximum level of annual maturity is 20% of the total portfolio. It is recommended that these be continued for 2002/2003.

- 6.3 The sensitivity of interest costs to the Council of movements in interest rates is limited through the parameters set in paragraph 6.2. It is estimated that an increase of 1% in longer-term rates above those built into the estimates would increase costs by £0.070M, whilst a similar increase on short-term rates would result in an estimated increase of £0.120M.

7 INVESTMENT STRATEGY

- 7.1 The opportunity to invest surplus funds during the year typically arises from short-term cash flow gains. Investments will therefore be made in the first instance with the Council's bankers and with reference to, the limits set out in the Treasury Management Practices. Longer-term investment decisions will be made after assessing the anticipated cash flow profile of the Council.

8 REVENUE IMPLICATIONS IN 2002/03

- 8.1 The following table sets out the assumptions made about interest and expense in setting the annual debt charges estimates for 2002/03, together with the expected charges to the relevant Service accounts.

Interest Charged:	£'M
Public Works Loan Board	12.380
Market Loans	0.380
European Investment Bank	0.100
Temporary Borrowing	0.500
Covenant Loans	0.036
Interest on Internal Balances	0.057
Premiums Written Off	0.314
Total Interest Charges	13.767
Loan Fund Expenses	0.285
Principal Redemption	3.695
Total Loan Fund Charges	17.747
Service Allocation	£'M
General Fund Services	11.867
Housing Revenue Account	5.800
Business Units	0.080
Total	17.747

- 8.2 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.
- 8.3 Any additional borrowing consent that is issued by the Scottish Executive during 2002/03 would have a revenue consequence through additional interest charges. It is estimated that an extra £1.000M of consent would increase loan fund charges by approximately £0.026M in 2002/03 and £0.052M in subsequent financial years. Under present distribution arrangements, additional grant support would offset this however.

9 DEBT RESCHEDULING

- 9.1** The advice of the Council's appointed Treasury Advisors will continue to be considered in respect of specific opportunities to identify savings and efficiencies through rescheduling.
- 9.2** If sufficient financial benefit can be demonstrated then consideration will be given to the following options: -
- Conversion of long term fixed rate loans at par, or with discount into one-year variable rate loans, to take advantage of lower short-term rates.
 - The replacement of PWLB rate loans with long-term market loans at lower interest rates.
 - The recent PWLB circular no. 125 provided that a fixed rate loan can be replaced with another without the need for additional quota, allowing a degree of flexibility in balancing the portfolio to take advantage of interest rate changes.
- 9.3** Rescheduling will continue to be carried out with reference to demonstrating savings without increasing the overall risk exposure, as well as ensuring compliance with the operational limits set for the year. Any such rescheduling will be reported to the Policy & Resources Committee, once completed.

10 FINANCIAL IMPLICATIONS

- 10.1** The revenue implications shown in paragraph 8.1 have been included within the approved estimates for the General Fund, Housing Revenue Account and Business Units for 2002/2003.

11 POLICY/LEGAL IMPLICATIONS

- 11.1** The Treasury Policy Statement will require to be updated to incorporate the recommended clauses set out in paragraph 3.1.

12 RECOMMENDATIONS

It is recommended that the Committee: -

- 12.1** recommend to the Council that the clauses detailed in paragraph 3.1 are adopted and that the Financial Regulations are amended accordingly;
- 12.2** recommend to the Council that the operational limits detailed in paragraph 6.2 are adopted for the current year; and
- 12.3** otherwise, note the content of the report.

Alex McPhee
Director of Finance

RB
9 April 2002

LIST OF BACKGROUND PAPERS

1. Treasury Management in the Public Sector – CIPFA Code of Practice and Cross-Sectoral Guidance Notes.
2. Treasury Management Policy Statement 2001/02 – Report by Director of Finance to Policy & Resources Committee 4 October 2001

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

AGENDA