

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE - 28 MARCH 2000

TREASURY MANAGEMENT – ANNUAL STRATEGY REPORT 2000/2001

Report by Director of Finance

1 PURPOSE OF REPORT

- 1.1 To present to Members for consideration a Treasury Management Strategy for the financial year 2000/01.

2 BACKGROUND INFORMATION

- 2.1 The Council's Treasury Strategy details the expected activities of the Treasury Management function for the coming year. The production of the annual strategy report by the Director of Finance is a requirement of the Treasury Policy Statement. The Strategy is intended to cover:

- The projected treasury position of the Council – 2000/2001.
- Interest rate forecasts.
- Effective treasury policy limits.
- Estimated capital borrowing requirements
- Borrowing strategy and debt rescheduling opportunities.

3 PROJECTED TREASURY POSITION 2000/01

3.1 Outstanding Departmental Advances

Capital expenditure by service departments is financed by advances from the Consolidated Loans Fund (CLF), which operates as the internal bank of the Council. Advances to departments are repaid over the expected life of the capital asset acquired based upon a calculated annuity basis. The projected movement in the CLF during 2000/01 is illustrated in table 3.1.

	CLF Advances at 31 March 2000 £'000	Estimated Advances During the Year	Estimated Principal Repaid During the Year	Estimated Advances O/S at 31 March 2001 £'000
Housing Revenue Account	80.632	(0.551)	(0.208)	79.873
General Fund Services				
Housing	8.327	0.400	(0.286)	8.441
Development Services	42.782	1.540	(1.304)	43.018
Community Services	10.672	0.500	(0.485)	10.687
Social Work	7.716	0.330	(0.210)	7.836
Education	30.672	1.450	(0.371)	31.751
Policy and Resources	6.137	1.650	(0.572)	7.215
Urban Aid	2.110	0.000	(0.051)	2.059
	108.416	5.870	(3.279)	111.007
Business Units	0.446	0.000	(0.061)	0.385
TOTAL	189.494	5.319	(3.548)	191.265

Table 3.1

The Council is required to “set aside” 75% of HRA capital receipts from council house sales to repay outstanding debt. It is estimated that this will equate to approximately £4.050M in 2000/01. There is no requirement to set aside General Services capital receipts for debt redemption. Overall net advances to fund departmental capital works are anticipated to be £5.319M whilst repayment of outstanding principal totalling £3.548M is projected. The anticipated performance of the Loans Fund for the current financial year is summarised as follows:

	1999/00 £M	2000/01 £M
Estimated Opening Loans Fund Advances	187.952	189.494
Estimated Closing Loans Fund Advances	189.494	191.265
Average Loans Fund Advances Outstanding	188.723	190.380
Projected Loans Fund Interest	14.140	14.154
Projected Loans Fund Expenses	0.250	0.250
Projected CLF Interest Rate %	7.49%	7.43%
Projected CLF Expenses Rate %	0.132%	0.131%

The projected consolidated loan fund interest rate of 7.43% for 2000/01 compares favourably to the pool interest rate assumed by the Scottish Executive in calculating the AEF support for loan charges of 7.7%. The pool interest rate is calculated by using a weighted average of all Scottish authorities.

3.2 Outstanding Loan Portfolio

In order to fund capital advances the CLF raises loans from a number of different approved sources. Short-term cash flow requirements are typically funded by borrowing “temporary” loans from other local authorities and public bodies, which are included on the approved list. The anticipated movement in the loan portfolio for 2000/01 is shown below.

Category	Projected Balance O/S at 1 April 2000	Estimated Net Borrowing Requirement for Year	Estimated Balance O/S at 31 March 2001	% of Out'ding Debt
Public Works Loan Board	169.598	6.200	175.798	81.959%
Market Loans	15.250	2.00	17.250	8.043%
Temporary	18.592	0.078	18.670	8.704%
European Investment Bank	1.687	(0.350)	1.337	0.623%
Other Loans	0.008	(0.008)	0.000	0.00%
Covenant Loan	0.750	(0.150)	0.600	0.280%
Common Good & Trusts	0.814	0.025	0.839	0.391%
TOTAL	206.699	7.795	214.494	100.00%

4. INTEREST RATE FORECASTS

4.1 Short Term Interest Rates

The Bank of England's Monetary Policy Committee (MPC) raised the base rate of lending by a total of 0.5% in two separate increases in September and November 1999, to 5.5%, and again by 0.5% and 0.25% in January and February 2000 respectively. This was done as a reaction to concern at the medium term outlook for inflation levels within the economy. At present the members of the MPC are divided over the level of economic growth that can occur before the emergence of inflation. This uncertainty is likely to give rise to a further increase in short-term rates during 2000/01. Any increase will impact on the cost of temporary borrowing undertaken by the Council to fund the daily cash flow requirements.

4.2 Longer Term Interest Rates

The rate of interest charged by the Public Works Loan Board is calculated using a formula linked to the yield available from government issued "gilt edged" securities. In December 1999 the PWLB added a half percentage point margin to the cost of long-term loans to compensate for prevailing market conditions, which had reduced yields below the real cost of government borrowing. The cost of longer-term gilts is however expected to remain within a very narrow interest rate range during 2000/01, although this is subject to market conditions remaining relatively static. If these conditions prevail it will remain the best option to the Council to continue to borrow long term monies, taking the opportunity to "lock into" these historically low rates for the immediate future.

4.3 Projected Interest Rates – 2000/01

The following table summarises the current forecast of interest rates for the period December 1999 to March 2001.

Date	Base Rate	3 Month	6 Month	1 Year	5 Year	10 Year	15+ Years
1999							
Dec	5.50%	6.10%	6.30%	6.70%	6.10%	5.50%	5.00%
2000							
March	5.75%	6.00%	6.20%	6.50%	5.70%	5.30%	4.80%
June	6.00%	6.10%	6.30%	6.60%	5.70%	5.10%	4.70%
Sept	6.0-6.25%	6.20%	6.40%	6.60%	5.80%	5.10%	4.80%
Dec	6.0-6.25%	6.30%	6.40%	6.50%	5.90%	5.20%	4.90%
2001							
March	6.0-6.25%	6.30%	6.30%	6.30%	5.70%	5.10%	4.80%

5 EFFECTIVE TREASURY POLICY LIMITS

5.1 The Treasury Policy Statement previously approved by the Council set out the maximum limits in respect of fixed to variable rate loans, together with annual debt maturity. These are

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- The maximum level of variable debt should not exceed 25% of the overall portfolio.
- The maximum level of debt maturing in any one year shall not exceed 20%.

It is proposed that these limits be continued as the operational parameters for the financial year 2000/01.

6. ESTIMATED CAPITAL BORROWING REQUIREMENT

- 6.1 The estimated borrowing requirement takes account of the anticipated capital programme for 2000/01, together with the level of debt redemption by departments to the Consolidated Loans Fund. Whilst the actual level of borrowing consent has still to be confirmed by the Scottish Executive indicative figures have been issued. It is also necessary to consider the need to replace any long-term loans that will mature within the financial year when making this calculation.

Estimated Borrowing Requirement 2000/01	£'000
Estimated New Borrowing (Capital Consents)	9.593
Replacement Loans (PWLB & Market Loans)	5.800
Debt Redemption: Principal Repaid	(3.548)
Debt Redemption: Capital Receipts HRA	(4.050)
TOTAL	7.795

7. BORROWING STRATEGY & DEBT RESCHEDULING

- 7.1 The loan portfolio will continue to be managed within the operational parameters set out in 5.1 above. The current forecast for interest rate movements suggest that a continued policy of borrowing long term funds (>20 years) at relatively low fixed rates of interest will best meets the objective of minimising the annual debt servicing costs.

- 7.2 The prevailing market conditions will continue to be monitored during the course of the year and should these change then consideration of further rescheduling the portfolio will be made based upon:

- The ability to derive cash savings without increasing the overall risk profile.
- The achievement of the overall Treasury Strategy outlined above.
- The continued proactive management of the maturity pattern and interest rate exposure.

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

8. TREASURY MANAGEMENT CONSULTANTS

8.1 As previously reported to this Committee the firm of Butlers, a division of Garban Securities Limited, were appointed to act as Treasury Management Advisors, for an initial period of 3 years, at an annual cost of £11,500 per annum. Their role includes:

- Treasury Strategy and Procedures review.
- Compliance with CIPFA Code of Practice for Treasury Management
- Debt Portfolio Management, including provision of advice on debt rescheduling, availability and timing of new borrowing and interest rate forecasting.
- Ongoing training for Treasury Management staff.

8.2 A review of the current Treasury procedures and level of compliance with the CIPFA code has been carried out, and a final report is expected from Butlers in the near future.

8.3 During 1999/200, following a review of the debt portfolio, which took into account the prevailing market conditions, Butlers recommended a programme of rescheduling that effectively reduced the overall cost of borrowing by approximately £1.200M in the current financial year. Given the level of savings achieved it is considered that the cost of the service provided to the Council represents value for money. Butlers will continue to provide guidance on further rescheduling opportunities as and when they arise.

9 RECOMMENDATIONS

9.1 It is recommended that Members approve the Treasury Management Strategy for 2000/01 and otherwise note the contents in this report.

Alex McPhee
Director of Finance

RB/JP
29 February 2000

LIST OF BACKGROUND PAPERS NIL

AGENDA