COMMITTEE:	**CABINET**
DATE:	**5th SEPTEMBER 2002**
SUBJECT:	**TREASURY MANAGEMENT – ANNUAL REPORT FOR 2001-2002 AND INTERIM REVIEW OF 2002-2003**
REPORT OF:	**DIRECTOR OF FINANCE AND CORPORATE SERVICES**
Ward(s):	All
Purpose:	To review the Treasury Management work carried out in 2001-2002 and in 2002-2003 to date.
Contact:	Sue McHugh, Director of Finance and Corporate Services Telephone 01323 415104 or internally on extension 5104.
Recommendations:	Cabinet is recommended to note the activities undertaken during 2001-2002 and 2002-2003 to date.

1.0	**<u>Introduction</u>**
1.1	This report provides Members with information on the range and performance of the Council's Treasury Management activities in 2001-2002. It is a requirement of the CIPFA Code of Practice on Treasury Management and covers two main areas – · Debt, borrowing and restructuring · Investment and cashflow management
1.2	It also provides an update on developments in 2002-2003.

1.3	**All Treasury Management activities for 2001-2002 were undertaken in accordance with the Treasury Policy Statement approved by Cabinet on 7th June 2001.**		
1.4	**For 2002-2003, the Council has adopted the new Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in the Public Services to apply with effect from 1st April 2002. This was recommended by Cabinet at its meeting on 6th February 2002 and formally adopted by Council on 27th February 2002**		
2.0	**Debt, Borrowing and Restructuring 2000-2001**		
2.1	Outstanding debt decreased by £1.2 million during the year (see table 1). This consisted of a reduction in temporary loans of £1 million as a result of improved cashflow, and a reduction of £200,000 from normal half yearly repayments of annuity and equal instalment loans.		

2.2 We were unable to carry out any restructuring exercises in the year on PWLB loans. This is because we found ourselves in the unenviable position of having a portfolio of long term high rate fixed interest loans whilst being in a low interest environment. Where we sought to carry out restructuring or premature repayment exercises, we were prevented by the very high premia that would be payable to our lenders.

The charging of premia is normal commercial practice in the loans market, whereby a lender will effectively be seeking compensation for the loss of interest in giving up a loan running at higher than current interest rates.

We have paid premia in the past as part of beneficial restructuring exercises, but the gap between our loan portfolio rates and current market rates gave rise to excessive and uneconomic levels of premia.

We had also to be aware of the impact of any large scale transfer (LSVT) of the Council's housing stock. The Housing Revenue Account (HRA) takes by far the largest share of the Council's loan debt and as a consequence takes the largest share of any premia. However, premia is written off to the HRA over a maximum of 10 years. If LSVT were to go ahead, in say two years time, there would be no longer be an HRA to write off the residual premia. By default this would fall as an additional cost to the General Fund.

Because we were unable to undertake any restructuring during the year, our levels of debt remained high in 2001-2002. At the same time the allocation of debt between HRA and General Fund was shifting - HRA going down as a consequence of amounts set aside being greater than new credit approvals, with the reverse being true for the General Fund. The result of this shift was to levy a lower interest charge to the HRA and a higher charge to General Fund. These factors were significant in the respective revenue outturn figures for 2001-2002 which were reported to Cabinet on 1st July 2002. They continue to be significant for the current financial year.

2.3 The impact on our debt portfolio can be seen in table 1 below. This summarises the movements during the year and shows the effects on PWLB fixed and variable rate loans of the two restructuring exercises.

Table 1 – Movements in Outstanding Debt

	1st April 2001 £m.	New Borrowing £m.	Repayments £m.	31 March 2002 £m.
PWLB – Fixed	31.6	-	0.2	31.4
Stock – Fixed	7.5	-	-	7.5
Temporary - Fixed	1.0	2.5	3.5	0.0

		40.1	2.5	3.7	38.9

2.4 Section 45 of the Local Government and Housing Act 1989 requires the Council to set limits for its external borrowing prior to each financial year. For 2001-2002 the limits were approved by the Cabinet on 7th February 2001.

Table 2 shows the approved limits along with the maximum actual borrowing at any point during the year. It demonstrates that none of our limits were breached.

Table 2 – Borrowing Limits

	2000-2001 Limit (£m)	2000-2001 Maximum Actual £(m)	2001-2002 Limit (£m)	2001-2002 Maximum Actual (£m)
Total Borrowing	54	41.3	43	39.1
Temporary Borrowing	15	1.0	4	1.5
Variable Rate Borrowing	27	4	10.75	0

2.5 Table 3 shows that the average interest rate of PWLB fixed rate debt remained static at 8.10% between 31st March 2001 and 31st March 2002.

2.6 Overall the average interest rate payable on the debt portfolio at 31st March 2002 was 8.23% which shows a slight increase year on year because of the repayment of temporary loans.

Table 3 – Average Interest Rates

		31.03.99	31.03.00	31.03.01	31.03.02
		%	%	%	%
	PWLB – Fixed	8.29	8.65	8.10	8.10
	PWLB – Variable	5.36	5.90	-	-
	Market Loans – Fixed	7.83	-	-	-
	Stock - Fixed	8.78	8.78	8.78	8.78
	Temporary – Fixed	-	5.87	5.89	-
	Average	7.88	8.36	8.15	8.23

2.7 Finally, external interest payments in 2001-2002 amounted to £3.22 million. This compares with £3.25m in 2000-2001. It has stayed broadly the same because the level of our fixed rate debt portfolio has remained constant.

2.8 For Members information a histogram is attached as Appendix 1 to this report which shows our debt maturity profile at 31st March 2002. This shows very little change from the position at 31st March 2001 because of the limited scale of transactions entered into during 2001-2002.

3.0 Investments and Cash Flow Management 2001-2002

3.1 Temporary Investments

Table 4 sets out an analysis of temporary investments made during the year.

Table 4 – Temporary Investments Analysis

	2000-2001	2001-2002
Total invested (£m)	**56**	**88**
Number of investments	**61**	**95**
Average investment (£m)	**0.9**	**0.9**
Average Period (Days)	**30**	**34**
Maximum Total Investment (£m)	10.3	13.0
Minimum Total Investment (£m)	NIL	4

The year on year changes stem from an increase in cash available for investment principally from higher value asset sales which we have been unable to use to repay debt.

3.2 Analysis by Counterparty

Table 5 provides an analysis of temporary investments and shows that increasingly the largest share is still made with Building Societies.

Table 5 – Temporary Investments – Analysis by Counterparty

	2000-2001		2001-2002	
	£M	%	£M	%

Clearing Banks	2	4	2	2
Bank Subsidiaries	8	14	4	5
Building Societies	24	43	58.5	66
Other Institutions	4	7	0	0
Local Authorities	7	12	1	1
Foreign Banks	11	20	22.5	26
	56	100	88	100

3.3 Use of Brokers

Investments were primarily arranged through two brokers. No deals were placed direct in 2001-2002. Table 6 below shows the investments made through each broker.

Table 6 – Analysis by Broker

	2000-2001		2001-2002	
	No.	%	No.	%
Garban-Intercapital	26	43	38	40
Tullett and Tokyo	2	3	0	0
R.P. Martin	2	3	1	1
Tradition	26	43	56	59

Direct	5	8	0	0	
	61	100	95	100	

Ideally our business would be spread evenly across all brokers. In practice however the nature of the market means that this is not possible. No fees are payable to brokers for arranging investments.

3.4 Overnight Investments

Overnight Investments are used to maximise interest from day to day cash flow movements when it is not possible or beneficial to arrange a fixed term deposit. All overnight deposits were made with the Council's own bankers and are summarised in table 7.

Table 7 – Overnight Investments

	2000-2001		2001-2002	
£'000	No.	%	No.	%
250 – 499	103	56	78	40
500 – 999	71	38	98	50
1000 – 1999	11	6	20	10
2000 – 2999	-	-	-	-
	185	100	196	100

Total invested (£M)	99		119
Average Investment (£M)	0.534		0.607

Our increased use of this facility was necessary because of the increase in available funds, and because of the constraints of a low interest market. We look to place funds through Temporary Investments (see table 5) wherever possible.

3.5 Management of Bank Balance

Ideally our bank balance at the end of each working day would be zero as surpluses should be placed in either temporary or overnight investments. In practice it is not possible to achieve this as cashflow movements cannot be so precisely forecast. Table 8 on the next page provides an analysis of our bank balances for 2000-2001 and 2001-2002.

Table 8 – Analysis of Bank Balances

	Range £'000	2000-2001 (%)	2001-2002 (%)
Overdrawn	100 +	4	3
	50 – 100	1	4
	0 - 50	28	18
In Hand	0-50	62	71
	50 - 100	4	2

	100 +	1	2	
		100	100	

Table 8 shows that 89% of our balances were within £50,000 of zero compared with 90% in 2000-2001.

3.6 Average Investment Rate

In 2001-2002 the in-house team earned £425,000 in interest on temporary and overnight investments which equated to an average rate of 4.48%. This compares to a figure of £400,000 (6.12%) for 2000-2001.

The standard benchmark for investment performance is the local authority 7 day rate which for 2001-2002 was 4.54%. We therefore under performed the benchmark by 0.06%.

4.0 Developments in 2002-2003

4.1 Debt, Borrowing and Restructuring

The Treasury Management Strategy for 2002-2003 was approved by Cabinet on 6th March 2002. In accordance with the Policy Statement no new loans have been taken in the current year.

We continue to explore options for debt repayment and rescheduling with our treasury advisors – Butlers – who monitor the market on our behalf and advise us as opportunities arise. Most recently we met with Butlers on 14th August to further examine and discuss options to reduce the Council's borrowing costs. We will only implement such options that are consistent with the Council's treasury management strategy, and which give rise to beneficial and sustainable gains.

4.2 Investments

Market investment rates have been fairly constant this year in line with bank base rate which has remained at 4%. We have seen improved overnight deposit rates with our new banker - the Co-op - compared with those offerred last year by our former banker. And because we are currently unable to use our set aside receipts to repay debt, we are running a higher level of temporary investments compared with last year.

Although our performance to the end of July outstrips the benchmark by 0.25%, we are only earning an average of 3.96% on our investments. This has already been brought to Members attention through the first budget monitoring report which was presented to Cabinet on 1st August 2002. This shortfall is particularly painful as it falls entirely to the General Fund – the Housing Revenue Account being protected through its statutory ring-fence status.

A relaxation by Government of some of the stringent controls which govern investments by local authorities has allowed access to new higher interest earning deposits from 1st April 2002. Conscious that the security of the Council's money is the primary cornerstone of the approved Treasury Management Policy Statement, we have yet to trade in these instruments. These new markets for local authority funds are being tested by a number of Council's and it may be that they become an option for us in future in order to improve our investment returns. We remain cautious for the moment however, conscious that our primary objective is to use set aside receipts for the repayment of debt, and that the security of the Council's money is paramount.

5.0 <u>Consultations, Human Resource and Environment Implications</u>

5.1	None.
6.0	**<u>FinanciaI Implications</u>**
6.1	As set out within the body of this report.
7.0	**<u>Summary</u>**
7.1	There were no major developments in Treasury Management during 2000-2001. Debt levels and interest paid remained constant compared with the previous year. Investment returns were lower than expected, principally because of interest rates falling successively down to 4%.
7.2	For the current year we are actively pursuing debt rescheduling opportunities when market conditions allow, and debt redemption in order to align this with our credit ceiling. We are also seeking other ways in which we can minimise the pressure of treasury management costs on the General Fund. Where we implement these Members will be informed through the monthly Members newsletter and through the bi-monthly budget monitoring report to Cabinet.

Sue McHugh

Director of Finance and Corporate Services

Background Papers:

The Background Papers used in compiling this report were as follows:

Borrowing Limit, Treasury Policy Statement and Strategy 2001-2002 – Report to Cabinet 7th February 2001.

Treasury Management – Annual Report for 2000-2001 and

Interim Review of 2001-2002 – Report to Cabinet 26th September 2001.

To inspect or obtain copies of background papers please refer to the contact officer listed above.

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