

**ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2004/05**

**EXECUTIVE MEMBER:** Councillor Elaine Woodburn  
**LEAD OFFICER:** S Borwick  
**REPORT AUTHOR:** C Nicholson

**Summary:** The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury activity for 2004/05. The report also covers the actual Prudential Indicators for 2004/05 in accordance with the requirements of the Prudential Code.

<b>Recommendation:</b>	Approve the actual 2004/05 prudential indicators within the report.  Note the treasury management stewardship report for 2004/05.
------------------------	---

**Impact of delivering Corporate Plan objectives:** Ensure financial control to ensure resources are used efficiently, economically and effectively.

**Impact on other statutory objectives (e.g. Crime & Disorder, LA21):** -

**Financial and Human Resource Implications:** None of this report.

**Project & Risk Management:** Treasury management practices (TMPs) are in place to reduce risk and investment advice from Treasury Consultants, Butlers.

**Key Decision Status**

- **Financial:** Yes  
- **Ward:** No

**Other Ward Implications:** None specifically by this report.

## **1. INTRODUCTION AND BACKGROUND**

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2004/05);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM has issued Investment Guidance to structure and regulate the Council's investment activities.

1.2 This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector 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.

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

- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report ); and
- Review actual activity for the proceeding year (this report).

1.4 This report sets out:

- A summary of the strategy agreed for 2004/05;
- The Council's treasury position at 31 March 2005;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2004/05;
- The treasury decisions taken and their revenue effects;
- The associated risks of any of these decisions;
- Risk and performance.

## **2. THE STRATEGY AGREED FOR 2004/05**

2.1 The 2004/05 financial year was the first to operate within the Prudential Code. This effectively abolished credit approvals and gave Local Authorities the ability to borrow for capital purposes. However Copeland Borough Council's strategy for 2004/05 was not to undertake any additional borrowing. The reason for this was that the Council's budget was cash limited and therefore not able to fund unsupported borrowing.

2.2 The Council's investment strategy continued to place approximately £10million of surplus cash with external investment managers Investec. The strategy and our budget was based on an expectation that interest rates

would continue to rise to 5%. Rates did rise from 4.5% to 4.75% and remained at this level. The strategy for 2004/05 also assumed Copeland retained the housing stock when in fact the transfer was completed on 9<sup>th</sup> June.

### 3. TREASURY POSITION AT 31 MARCH 2005

3.1 The treasury position at the 31 March 2005 compared with the previous year was:

	31 March 2005		31 March 2004	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£5.00m	7.55%	£19.63m	6.90%
Variable Interest Rate Debt	£0.00m	0%	£0.00m	0%
<b>Total Debt</b>	<b>£5.00m</b>	<b>7.55%</b>	<b>£19.63m</b>	<b>6.90%</b>
Fixed Interest Investments	£6.73m	4.65%	£4.08m	3.59%
Variable Interest Investments	£10.58m	4.80%	£10.25m	2.74%
<b>Total Investments</b>	<b>£17.31m</b>	<b>4.72%</b>	<b>£14.33m</b>	<b>3.12%</b>

3.2 The change in the treasury position was due to the housing stock transfer. At the time of transfer all the fixed rate debt relating to housing was repaid.

3.3 Variable interest investments relate to those managed by the external fund managers Investec.

### 4. PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

4.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year end. Appendix A provides a schedule of all the mandatory prudential indicators. Certain of these indicators provide either an overview or a limit on treasury activity, and these are shown below:

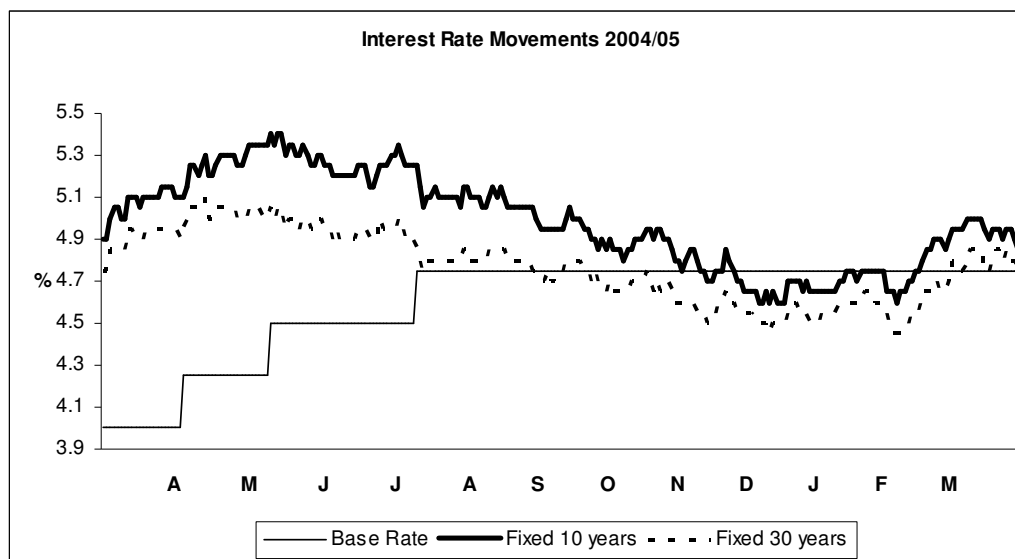
	31 March 2005 Actual	31 March 2005 Original Indicator
<b>Net borrowing position</b>	<b>£-12.53m</b>	<b>£9.84m</b>
<b>Capital Financing Requirement</b>	<b>£18.93m</b>	<b>£18.93m</b>

4.2 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 will only be for a capital purpose, net borrowing should not, except in the short term, exceed the CFR for 2004/05 plus the expected changes to the CFR over 2005/06 and 2006/07. The table above highlights that the Council has complied with this requirement.

	2004/05
<b>Original Indicator - Authorised Limit</b>	<b>£26.13m</b>
<b>Original Indicator - Operational Boundary</b>	<b>£23.64m</b>
<b>Maximum gross borrowing position during the year</b>	<b>£24.55m</b>
<b>Minimum gross borrowing position during the year</b>	<b>£5.00m</b>

- 4.3 The Authorised Limit is the “Affordable Borrowing Limit” required by s3 of the Local Government Act 2003. The table demonstrates that during 2004/05 the Council has maintained gross borrowing within its Authorised Limit.
- 4.4 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 is acceptable subject to the Authorised Limit not being breached. The Operational Boundary was exceeded during the year because of the need to convert market debt to PWLB debt to take advantage of overhanging debt grant.

## 5. Economic Background for 2004/05



- 5.1 The rising trend in UK interest rates which commenced in mid-2003 continued during the 2004/05 financial year as the Monetary Policy Committee tightened policy to combat the effects rising economic activity might have upon inflation. These concerns were most in evidence during the early stages of the year and Base Rates were raised in quarter-point steps in May and June to 4.5%. Market pessimism was fuelled by this comparatively aggressive stance and longer-dated money rates rose to in excess of 5% to reflect this.
- 5.2 Official rates were raised again in August to 4.75%, the peak for the year. Thereafter, the MPC adopted a comparatively neutral stance. A steep rise in world oil prices (to in excess of \$50 per barrel) triggered a slowdown in economic activity in industrialised economies, notably the US. This, together with the low domestic inflation environment, caused the Bank of England to adopt a more optimistic view of medium-term inflation prospects, a tack that was seen as a hint that the rate cycle may have peaked. Money market rates adjusted to accommodate this assessment and longer fixed interest rates slipped lower.
- 5.3 Base Rates remained unaltered for the balance of the year but confidence that the rate cycle had peaked was undermined in the last few months of the period. Quoting stronger activity, tighter labour market conditions and rising raw material prices, the Bank of England February 2005 Inflation Report cast some doubt upon the ability of inflation to maintain a subdued performance over the medium term. Money rates rose in reaction to the view that a further tightening of monetary policy was not out of the question.

- 5.4 Long-term interest rates (PWLB rates) tended to track the movements in the money market. A rise in the early part of the year, in response to market interest rate pessimism, was reversed in the autumn and winter of 2004 as weaker economic activity placed downward pressure upon fixed interest rates across the globe. Rates returned to a rising trend in the closing months as the lacklustre performance of key international bond markets combined with a more pessimistic view on rates to drive yields modestly higher.

## 6. Actual Strategy During 2004/05

- 6.1 **Borrowing** – In accordance with the strategy no additional loans were drawn during the year to fund capital expenditure. Additional PWLB loans were taken out and used to repay market loans in order to maximise the overhanging debt grant that could be claimed on the completion of the stock transfer. Loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity	Average for 2004/05
PWLB	£4.45m	Variable interest rate	4.25%	1 years	<b>4.747%</b>
PWLB	£4.92m	Variable interest rate	4.44%	1 years	<b>4.747%</b>

- 6.2 **Repayment** - The Council repaid £8.45m of market debt at an average rate of 7.74% with breakage costs of £4.29m using income from Home Group. The Council repaid £15.55m of PWLB debt with breakage costs of £0.27m using overhanging debt grant from the ODPM.
- 6.3 **Summary of Debt Transactions** – The overall position of the debt activity resulted in a rise in the average interest rate by 0.65%, and a fall in the level of debt of £14.63m representing a net General Fund saving of £304,690.

## 7. INVESTMENT POSITION

- 7.1 **Investment Policy** – The Council's investment policy is governed by ODPM Guidance, which is implemented in the annual investment strategy approved by Council on 2<sup>nd</sup> March 2004. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
- 7.2 **Investments Held by Fund Managers** – The Council uses Investec external fund managers to invest part of its cash balances. The performance of the managers against the benchmark return was:

Fund Manager	Investments Held	Return	Benchmark*
Investec	£10.58m	4.8%	4.58%

\* The 7-day compounded LIBID rate.

- 7.3 This compares with a budget assumption of average investment balances of £10m at 4.75% investment return. The Council continues to review the performance of Investec by holding annual meetings.
- 7.4 **Investments Held by The Council** - The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds. The Council maintained an average balance of £6.73m and received an average return of 4.65%. The

comparable performance indicator is the average 7-day LIBID rate, which was 4.50%. This compares with a budget assumption of £6.6m investment balances at 4.33% interest rate.

## **8. Risk and Performance**

- 8.1 The Council has complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.
- 8.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed the debt and investments over the year. The Council has complied with its internal and external procedural requirements. Following the stock transfer the Council has only one market loan of £5m at a fixed rate of interest. Consultations are continuing with Butlers to review any possibilities of reducing this further.
- 8.3 Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.
- 8.4 Fund manager investment returns have been favourable against the benchmark comparisons. For investments managed in house returns are closer to the benchmark return. There is therefore lower risk associated with these types of investments.

### Appendix A: [Estimated and Actual Treasury Position and Prudential Indicators](#)

List of Background documents: Treasury Management Files

List of Consultees: Corporate Team  
Portfolio Holder