

Report to: **Cabinet**

Date: **8 June 2004**

By: **Deputy Chief Executive & Director of Corporate Resources**

Title of report: **Treasury Management – Stewardship Report**

Purpose of report: **To present the County Council's performance on treasury management for the year 2003/04.**

RECOMMENDATION

The Cabinet is recommended to note the treasury management performance in 2003/04

1. Financial Appraisal

1.1 The annual stewardship report reviews the Council's treasury management performance and is required by the Code of Practice for Treasury Management. There are no direct financial consequences of this report.

2. Supporting Information

Introduction

2.1 The Cabinet, on 28 May 2002, received a report on the Treasury Management Policy Statement for 2002/03. This set out the arrangements to conform to the Code of Practice for Treasury Management in the Public Services. There were no fundamental differences to the arrangements in place but a Treasury Management Policy Statement (see Annex 1) defining the activities was set up and full documentation (Treasury Management Practices) was required.

2.2 The Treasury Management Practices include an explanation of how the County manages its activities in relation to borrowing and investment. The County Council Financial Regulations require reports to be submitted on its Treasury Management policies, practices and activities including, as a minimum, an annual strategy and plan in advance for the year and an annual report after its close, in the form prescribed in the Treasury Management Practices. This report fulfils that latter requirement.

2.3 The Treasury Management Practices for the County Council were fully documented during 2002/03 and updated during 2003/04. They have been independently verified by the County Council's Treasury Management advisors and are now fully operational with regular updates to the information held.

The market conditions compared to our original strategy for 2003/04

2.4 The original strategy and the economic conditions prevailing in 2003/04 are set out in paragraphs 1, 2 and 3 of the Appendix attached to this report. In summary the advice received in January 2003 on interest rates for 2003/04 was:

- "short term rates, currently standing at 4%, will stay at 4% in the early months, but are likely to increase to 4.5% by the end of the year.
- long term interest rates will be 0.625% higher than the lowest rate achieved in this current financial year (minimum 4.625%). The estimated rate is, therefore, 5.25%.
- the advice is subject to changes in the world and political climate, especially the price of oil, which could alter the interest rates significantly."

Short term lending

2.5 The amount received in interest on short term lending during 2003/04 was £4.21m at an average rate of 3.77%. This was above the average of base rates in the same period (3.71%).

Long term borrowing

2.6 Details of our long term borrowing are included in paragraph 4 of the attached Appendix.

2.7 The important points are summarised as:

- The County Council borrowed £21.2m from the Public Works Loans Board (PWLB) during 2003/04. The total outstanding loan debt at 31 March 2004 is £217.4m.
- All of the Council's PWLB quota was used.
- The average interest rate of all the Council's PWLB debt at 31 March 2004 was 5.99% compared to 6.13% at 31 March 2003.
- The rates offered by PWLB varied due to the economic conditions during the year.

Debt restructuring

2.8 In 2003/04, although interest rates were monitored proactively to look for opportunities for savings through early repayment and refinancing of loans, no opportunities arose during the year. The monitoring of interest rates will continue in this and future years and the debt will be restructured if and when conditions are favourable.

Debt maturity profile

2.9 New borrowing was undertaken giving due consideration to the debt maturity profile, ensuring that an acceptable amount of debt is due to mature in any one financial year. This helps to minimise the authority's exposure to the risk of having to replace a large amount of debt in any one year or period when interest rates may be unfavourable. The bar chart in Annex 2 shows the maturity profile. There are only two years, 2022/23 and 2023/24 where the amount of debt maturing is more than £12m out of a total of £217m. The exposure in each of these is currently under 8% (last year it was 9%) of the total which is not excessive and the percentage will reduce as further loans are taken out.

Borrowing limit

2.10 The estimated actual position as at 31 March 2004 is well within the borrowing limits set by the County Council in February 2003. The full details are set out in paragraph 5 of the Appendix.

Short term borrowing rates

2.11 The County Council borrowed on a short term basis from the market for only 29 days in 2003/04. The interest amounted to £15,570 and was at an average rate of 3.90%.

3. Conclusion and reason for recommendation

3.1 This report fulfils the requirement in the County Council Financial Regulations to submit an annual report in the form prescribed in the Treasury Management Practices. The report includes the latest borrowing and lending transactions, including the economic climate and interest rate conditions prevailing in the period.

3.2 The Cabinet will wish to note that the proactive approach adopted means that new borrowing has reduced the average rate on long term debt, short term lending has achieved better than base rate and that exposure to future risk continues to be minimised through managing the loan maturity profile.

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BACKGROUND DOCUMENTS

Cabinet 30 January 2003 Borrowing Limit and Treasury Management Strategy for 2003/04

Cabinet 28 May 2002 Treasury Management updated Strategy for 2002/03

CIPFA Treasury Management in Public Services: Code of practice and cross sectional guidance notes

1. Original strategy for 2003/04

1.1 The Cabinet at its meeting on 30 January 2003 agreed its treasury management strategy for 2003/04, taking account of the current economic scene and the current and forecast levels of interest rates.

1.2 The main points of the advice received before the start of the year on interest rates for 2003/04 were:

- short term rates, currently standing at 4%, will stay at 4% in the early months, but are likely to increase to 4.5% by the end of the year.
- long term interest rates will be 0.625% higher than the lowest rate achieved in this current financial year (minimum 4.625%). The estimated rate is, therefore, 5.25%.
- the advice is subject to changes in the world and political climate, especially the price of oil, which could alter the interest rates significantly.

1.3 It was agreed that the strategy should continue to aim to borrow long term to finance the capital programme at the lowest rate available during the year and for short term borrowing and lending to be undertaken at the best rates available consistent with low risk. Opportunities should be taken to restructure long term debt when they arise.

2. Economic conditions prevailing in 2003/04

Interest Rate Forecast

2.1 The year started with the mounting concern that the year was likely to be dominated by fears of deepening recession in America and Europe and to a lesser degree in the UK. Shorter term and PWLB interest rates remained under downward pressure throughout the first quarter of 2003/04 with a widely held view that this situation would persist for a very long time. This was reflected in the market prices and PWLB rates fell to lower levels.

2.2 Sentiment changed dramatically in the early summer. Initially, this was triggered by a less aggressive than expected monetary policy signal from the US Federal Reserve, including an indication that it did not intend to resort to more extreme forms of monetary relaxation. Bond markets fell very sharply as a result and PWLB rates returned to a strongly rising trend. This return to a more pessimistic view on rates was supported by evidence of a more buoyant UK economic performance and an unexpected rise in US economic activity (which rose to an annualised rate in excess of 8% in the July/September quarter).

2.3 In the UK, money market and the base rate came closer during the summer and early autumn. While period rates, notably beyond the six-month area, firmed in response to deteriorating expectations, the very short end of the maturity range was held back by the Bank of England Monetary Policy Committee's decision to maintain an unchanged policy stance from that adopted in July, when base rates had been cut to 3.5%.

2.4 The July base rate cut (viewed with hindsight as a "cut too far") was eventually reversed in November in a move (back to 3.75%) that was widely regarded as a decisive signal that the UK interest rate cycle had finally passed its turning point.

2.5 Interest rates rose dramatically during the autumn and reached its highest point in the early winter when pessimism peaked. Thereafter markets entered a more benign phase. The return to a series of less upbeat economic statistics served to allay some of the "bearishness" that had confronted treasury managers when sentiment initially took a turn for the worse. While the Monetary Policy Committee adhered to its policy of gradually tightening domestic credit conditions (base rates were raised by a further quarter-point to 4% in February) PWLB rates slipped lower.

By the close of the year, rates had returned to levels that reflected a more balanced view of future prospects.

3. Short term lending interest rates

As mentioned above, base interest rates started at 3.75% and reduced in July to 3.5% but returned to 3.75% in November. There was a further increase of 0.25% in February 2004 to finish the year at 4%. The total amount received in short term interest for 2003/04 was £4.21m at an average rate of 3.77% (beating base average rate of 3.71%).

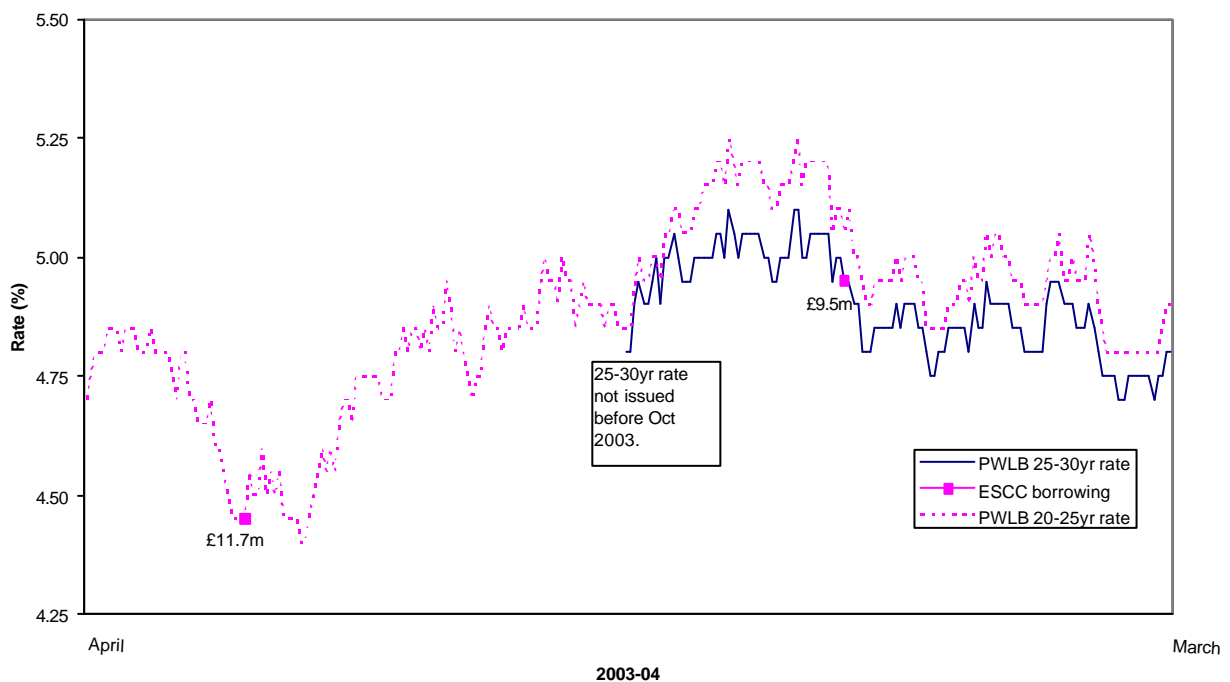
4. Long-term borrowing

4.1 The Public Works Loan Board (PWLB) is a body set up by the Government that makes loans available for local authorities to borrow long term for capital spending and to refinance existing loans. Their rates are the cheapest available in the market on a like-for-like basis. The PWLB quota of every local authority each year is based on its credit approvals. If the quota is exceeded or not used in full, the balance is carried forward into the next financial year.

4.2 During the year, all of the available quota was used.

| Date of Loan | Amount £m | Rate | Length of loan |
|--------------|--------------|-------|----------------|
| 30 May | 3.8 | 4.45% | 24 years |
| 30 May | 3.7 | 4.45% | 25 years |
| 30 May | 4.2 | 4.45% | 25 years |
| 11 December | 5.1 | 4.95% | 26 ½ years |
| 11 December | 2.3 | 4.95% | 27 ½ years |
| 11 December | 2.1 | 4.95% | 28 ½ years |
| | 21.2 | | |

4.3 The graph below shows the borrowing in 2003/04 compared to the PWLB rates offered:



4.4 All of the loans taken were PWLB loans at fixed rate and are set out in the table below:

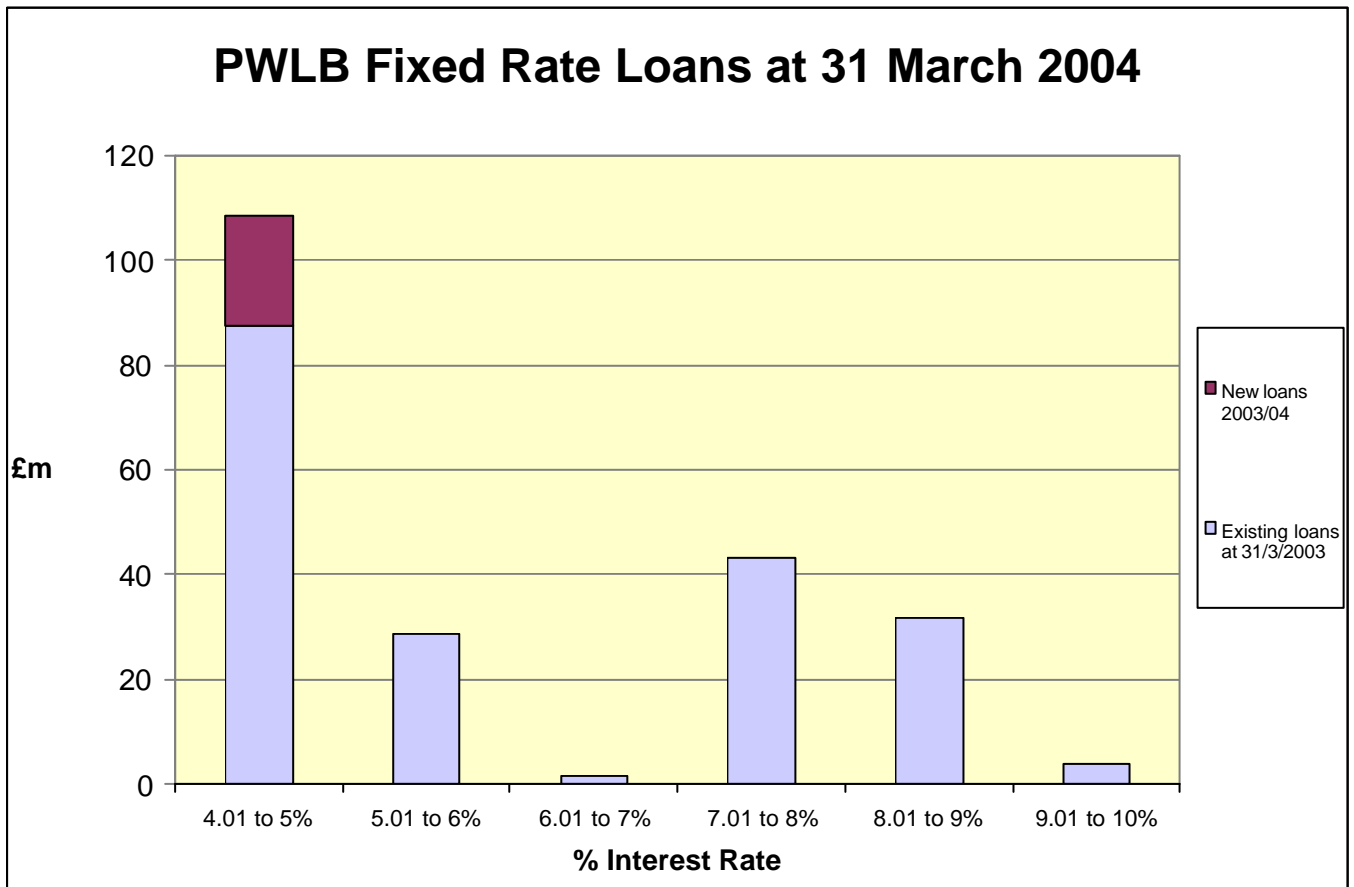
| Period in Years | Interest Rates | | | | Loans Taken |
|-----------------|---------------------------|--------------|-----------------|-----------------|----------------|
| | At 1.4.2003 | At 31.3.2004 | Minimum in Year | Maximum in Year | |
| 20-25 | 4.70% | 4.85% | 4.40% | 5.15% | £11.7m @ 4.45% |
| 25-30 | Started 1.10.2003 @ 4.80% | 4.80% | 4.70% | 5.10% | £9.5m @ 4.95% |

The average rate of long term borrowing in 2003/04 was 4.67%.

4.5 The PWLB loans are at various rates of interest. Due to taking new loans at lower rates, the interest rate profile of long term borrowing has improved:

- 63% of long term loans are currently at 6% or lower compared to 59% a year ago and 53% two years ago
- 16% of long term loans are currently at 8% or higher compared to 18% a year ago and 21% two years ago
- £108m (50%) of long term loans out of a total of £217m are at 5% or lower, compared to £87m (44%) of loans out of a total of £196m a year ago, and £68m (40%) of loans out of a total of £171m two years ago

The range of interest rates payable in all the PWLB fixed rate loans is illustrated in the graph below:



4.6 No loans matured in 2003/04.

5. Borrowing limit

In February 2003, the County Council determined a borrowing limit for 2003/04 of £239m. Of this sum, a limit of £43m (about 18%) was set for short term borrowing. The maximum proportion of the total interest which could be at variable rates was to be 18%. The estimated actual position as at 31 March 2004 will be well within the parameters set with long term borrowing of £217.4m and no short term borrowing.

Treasury Management Policy Statement

East Sussex County Council defines its treasury management activities as:

“The management of the organisation’s cash flows, its banking, money market and capital market transactions (other than those of the Pension Fund) the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The County Council regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Debt Maturity Profile at 31 March 2004

