Agenda No 16

AGENDA MANAGEMENT SHEET

Name of Committee	**Cabinet**
Date of Committee	**8 September 2005**
Report Title	**Treasury Management Outturn Report 2004/2005**
Summary	This report sets out the outturn of the treasury management process during 2004/2005
For further information please contact:	Phil Triggs Group Manager Tel: 01926 412227 philtriggs@warwickshire.gov.uk
Would the recommended decision be contrary to the Budget and Policy Framework? [please identify relevant plan/budget provision]	No.
Background papers	• CIPFA publication "Treasury Management in the Public Services: Code of Practice and Guidance notes for Local Authorities" • Treasury Management Strategy 2004/2005 approved by Cabinet on 29 January 2004 and County Council on 3 February 2004

CONSULTATION ALREADY UNDERTAKEN:- Details to be specified

Other Committees	☐	....
Local Member(s)	☐	
Other Elected Members	☒	Cllr Booth; Cllr McCarney
Cabinet Members	☒	Cllr Cockburn – "Approved for consideration"
Chief Executive	☐	....
Legal	☒	Jane Pollard – Assistant County Solicitor
Finance	☒	David Clarke – reporting officer
Other Chief Officers	☐	....

District Councils	☐	....
Health Authority	☐	....
Police	☐	....
Other Bodies/Individuals	☐	

FINAL DECISION YES

SUGGESTED NEXT STEPS:		Details to be specified
Further consideration by this Committee	☐	....
To Council	☐	....
To Cabinet	☐	....
To an O & S Committee	☐	....
To an Area Committee	☐	....
Further Consultation	☐	....

Agenda No 16

Cabinet – 8 September 2005

Treasury Management Outturn Report 2004/2005

Report of the County Treasurer

Recommendation
That Cabinet note the report.

1 Introduction

1.1 Warwickshire County Council fully complies with the requirements of The Chartered Institute of Public Finance and Accountancy's Code of Practice (COP) on Treasury Management 2001. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- receipt by the Cabinet of an annual treasury management strategy report for the year ahead and an annual review report of the previous year;
- delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.

Therefore, under the CIPFA Code, the Cabinet is required to receive a report on the outturn of the annual treasury management activity for the authority. This report ensures compliance with the CIPFA Code.

1.2 Treasury management in the context of this report is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." *(CIPFA Code of Practice)*

1.3 This **annual treasury outturn report** covers:

2 Current Treasury Position

2.1 The Council raises long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. At 31 March 2004, the Council had £178.2m of long-term borrowing and this had increased to £207.4m by 31 March 2005 as detailed in section A in Table 1.

2.2 At the same time as borrowing for capital purposes, the Council also has an investment portfolio. This consists of the Council's reserves and short-term cash flows. This cash is invested partly by an external cash manager and partly in house. As at 31 March 2004, the Council had £62.7m of cash investment and this had increased to £79.6m as detailed in section B of Table 1.

2.3 The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position at 31 March 2005

	Principal at 31.03.05	**Rate/ Return**	**Principal at 31.03.04**	**Rate/ Return**
A: Fixed Rate Funding	£m	%	£m	%
PWLB	207.2	6.38	177.9	6.71
European Investment Bank	0.2	6.27	0.3	6.99
Total Debt	**207.4**	**6.38**	**178.2**	**6.71**
B: Investments				
In House	46.9	4.59	30.0	3.61
External Managers	32.7	4.72	31.8	2.71
Total Investments	79.6	4.65	62.7	3.14

3 Performance Measurement

3.1 One of the key changes in the recent revision of the CIPFA Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in Table 1).

4 Strategy for 2004/2005

4.1 Our treasury strategy for 2004/2005 was approved by Council on 3 February 2004 and was based on the view of the UK, US and world economic growth rates continuing to strengthen as the recovery from the downturn caused by the Iraqi war in the first half of 2003 gathered momentum. In the UK, the base rate had risen from a low of 3.5% to 4.0% by February 2004. This was still a low rate by historic standards, which was acting to stimulate the economy. The Monetary Policy Committee was therefore expected to eliminate that stimulus by gradually raising base rate back to more normal levels (near to 5%) during the year.

4.2 Similarly, the US Federal Reserve was expected to raise rates from the exceptionally low rate of 1.0% to reduce the major stimulus to the economy but by way of a phased series of gentle increases as there were still concerns about the upturn being a “jobless recovery”.

4.3 The Eurozone growth rate was expected to improve, but not substantially, as the dollar was expected to weaken against the Euro and so negatively impact Eurozone exports. The European Central Bank was therefore expected to leave rates unchanged at 2.0% so as to continue to provide some stimulus for the economy in the absence of major inflationary concerns.

4.4 Inflation in all three areas was expected to be well contained. The effect on interest rates for the UK was therefore expected to be as follows:

Shorter-term interest rates: The “average” City view anticipated that the strengthening growth rate in the UK, US and world economies would lead to gentle increases in UK base rate from 4.0% to reach about 5.0% by the end of 2004, and then remain there for most of 2005.

Longer-term interest rates: The view on longer-term fixed interest rates was that long-term PWLB rates would be fairly stable around the 5.0% level for most of the financial year (equivalent to a long-term gilt yield of approximately 4.85%).

4.5 The 2004/05 strategy reported to the Council, based upon the above forecast, was that the Council operated both borrowing and investment portfolios and, as a consequence, was at lower risk from being impacted by a sharp, unexpected rise in short-term variable interest rates. The strategy for the year was therefore to maintain a balance of funding at short-term rates to match short-term investments thus maintaining balanced treasury risk.

5 Outturn for 2004/2005

5.1 The Monetary Policy Committee (MPC) raised the base rate from 4.0% in 0.25% steps in May, June and August 2004 to reach 4.75%, where the rate then stayed for the rest of the financial year. The surge in base rate in the first half of 2004 was prompted by major concerns at the pace of increase in house prices, which was running at about 20% by mid summer. Associated with this was strong economic growth (GDP was up from 2.2% in 2003 to 3.1% in 2004) stoked by increases in government and consumer expenditure, both partly financed by robust increases in borrowing.

5.2 There were major concerns that these rates of increase were unsustainable and that the MPC had to act quickly to cool the economy. During the autumn, it became clear that the increases in base rate had had the desired effect and that the housing market had turned; increases in house prices were then on a falling trend, reaching around 10% per annum by February 2005. The base rate was then on a knife edge during Q4 2004 and Q1 2005 as to whether or not a further increase to 5.0% was needed to rein in the economy and keep inflation on target.

5.3 However, the steep increases in oil prices, particularly towards the end of 2004 and in Q1 of 2005, reduced consumer spending power and negatively impacted consumer sentiment and expenditure. That debate and tension around raising the base rate continued into the start of 2005/06. Inflation has been well below the 2.0% MPC target for Consumer Prices Index (CPI), averaging 1.3% in 2004, but the sharp increase in oil prices and the consequent anticipated quick feed into the prices of goods and services caused an increase in inflation expectations around the beginning of 2005. Wage inflation has not been a cause for concern during 2004/05 despite unemployment remaining at historically very low levels.

5.4 In the US, the Federal Reserve raised rates in 0.25% increments from 1.0% starting in June and reaching 2.75% in February 2005 on the back of strong GDP growth of 4.4% in 2004 and low inflation. There was a temporary soft patch of growth in the autumn of 2004. In the Eurozone, the ECB left its rate unchanged at 2.0% all year. GDP growth improved from 0.5% in 2003 to 1.8% in 2004 but faltered in the second half. Unemployment was stable at just under 9% all year.

6 Compliance with Treasury Limits

6.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Treasury Management Strategy.

6.2 The Council approved the Treasury Management Strategy 2004/05 on 3 February 2004. Table 2 compares actual performance against the 2004/05 borrowing limits and shows that all treasury activity was conducted within the set limits.

Table 2: Actuals Compared with Strategy Limits 2004/05

	Limit	Actual
Authorised Limit for External Debt	£280,411,000	£207,881,215
Upper Limit for Interest Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	25%	0%
Upper Limit for total principal sums invested for over 365 days	£0	£0
Maturity Structure of Fixed Rate borrowed during 2004/05		
Under 12 months	0-20%	0%
12 months and within 24 months	0-20%	1%
24 months and within 5 years	0-60%	3%
5 years and within 10 years	0-100%	6%
10 years and above	0-100%	90%

6.3 Full details of the prudential indicators set for 2004/05 and the results for the year are shown in Appendix A.

7 Investment Outturn for 2004/05

7.1 The Council manages its short-term cash balances in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2004/2005.

Table 3: Investment Outturn 2004/05

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed	£40.5m	4.59	4.50
Externally Managed	£32.7m	4.72	5.50

7.2 Because of the short-term nature of in-house investments, the performance target is lower than that set for the external cash manager. The target for in house investments is to earn the average 7-day investment rate. During 2004/05 in house investments slightly out-performed the 4.50% target by achieving a return of 4.59%.

7.3 Reserves and long-term cash balances are placed with an external cash manager, Investec, who invests in a wide range of investment instruments. The fund management agreement between the Council and the Fund Manager defines the limits for maximum weighting in gilts/bonds and maximum duration of the fund. Counterparty criteria and exposure limits are also pre-defined within the agreement.

7.4 Investec's performance target is to outperform the 7-day investment rate by 1.0%. During 2004/05, Investec achieved a return of 4.72%. This is below its target of 5.50% (7-day investment rate of 4.50% + 1.00%). Investec's performance target was set in a period when interest rates were higher than they are currently. This target is due to be reviewed in 2005/06 to ensure that Investec has a target that is relevant to the current interest rate climate.

7.5 Our treasury advisors, Sector provided the following review of Investec's performance in 2004/05:

"*Investec has had a reasonable year relative to its peer group…Opportunities to make trading profits in the gilts have been missed but the policy of maintaining investments in the one year has paid off…Should interest rates fall during the coming year, Investec and the fund is quite well placed to pick up some out-performance*."

7.6 Sector began the financial year forecasting a base rate peak of 4.5%. This was changed to 4.75% in the first few months of the financial year, and again in November 2004, to a peak in the current interest rate cycle of 5% in 2005. It looks likely that the 4.75% level with be the ceiling in the current cycle.

7.7 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

8 Borrowing Outturn for 2004/2005

8.1 The PWLB 25-30 year rate started the year at 4.80% and then hovered around 5.00 to 5.10% in May and June on the back of strong economic growth figures in the US and UK which sharply increased gilt yields in the UK and Treasury yields in the US. However, the US then appeared to enter a soft patch, which brought the PWLB rate down, falling sharply in Nov/Dec 2004 to reach 4.50% towards the end of December 2004. During February and March 2005 the PWLB rate rose again to a 2005 peak of 4.90% as high oil prices renewed inflation concerns and strong US growth resumed.

8.2 The treasury borrowing comparative performance indicator for lower quota 25 to 30 years debt was 4.82% compared with the Council's performance of 4.70%. The approach taken during the year was to draw longer term fixed rate debt to take advantage of low long term rates and reduce exposure to fluctuations in short term interest rates.

9 Debt Rescheduling for 2004/2005

9.1 No debt rescheduling was undertaken in 2004/2005.

DAVID CLARKE
County Treasurer
Shire Hall
Warwick
July 2005

APPENDIX A

PRUDENTIAL INDICATORS

Affordability and Prudence Indicators

PRUDENTIAL INDICATOR	2003/04	2004/05	2004/05
(1). Affordability and Prudence Prudential Indicators			
	Actual	**Original (as per 2004/05 budget)**	**Actual**
Incremental impact of capital investment decisions	£	£	£
Increase in council tax (band D) per annum		**12.00**	**10.08**
	%	%	%
Ratio of financing costs to net revenue stream	**3.71**	**3.58**	**3.44**
	£000	£000	£000
Capital Expenditure	**57,943**	**115,125**	**74,378**
Net borrowing requirement *			
brought forward 1 April	160,002		178,210
carried forward 31 March	178,210		207,351
in year borrowing requirement	**18,208**		**29,141**
Capital Financing Requirement as at 31 March	**171,174**	**213,710**	**193,514**
Annual change in Capital Financing Requirement	**16,150**	**43,612**	**22,340**

*No indicator for net borrowing requirement was required when the 2004/05 budget was set. Therefore, there is no original 2004/05 figure.

Treasury Management Indicators and Limits

PRUDENTIAL INDICATOR	2003/04	2004/05	2004/05
2) Treasury Management Prudential Indicators			
	actual	**original**	**final**
	£000	£000	£000
Authorised limit for external debt -			
borrowing	218,390	262,411	262,411
other long term liabilities	18,000	18,000	18,000
TOTAL	**236,390**	**280,411**	**280,411**
Operational boundary for external debt -			
borrowing	181,992	218,676	218,676
other long term liabilities	15,000	15,000	15,000
TOTAL	**196,992**	**233,676**	**233,676**
	%	**%**	**%**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	**100**	**100**	**100**
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments	**25**	**25**	**25**
Upper limit for total principal sums invested for over 364 days	**£0**	**£0**	**£0**
Maturity structure of fixed rate borrowing during 2004/2005	upper limit		lower limit
Under 12 months	20%		0%
12 months and within 24 months	20%		0%
24 months and within 5 years	60%		0%
5 years and within 10 years	100%		0%
10 years and above	100%		0%

Treasury Management Prudential Indicator limits above were unchanged during 2004/05. Treasury Management activities were successfully carried out within these limits in 2004/2005.