
TREASURY MANAGEMENT ANNUAL REPORT 2003/04

**Responsible Cabinet Member(s) - Councillor Don Bristow,
Resource Management Portfolio**

Responsible Director(s) - Paul Wildsmith, Director of Corporate Services

Purpose of Report

1. To inform Members of the Treasury Management activities of the Council and to consider its performance throughout 2003/04.

Summary

2. The Treasury Management function of the Council covers both the short and long term transactions in respect of borrowing and investments. Measured against the Revenue MTFP budget for financing costs savings of £1.670m have been made, £1m relates to the early repayment of LGR debt, £0.450m due to increased investment income and £0.220m to reduced debt repayments. Debt that was previously managed by Durham County Council of £12.410m on behalf of Darlington Borough Council was transferred to the Authority by mutual consent during 2003/04. In total the Authority's long term borrowing increased by £2.214m with the average rate of interest on all loans falling from 4.91% to 4.75%. Investment interest rates compare well with general market interest rates.

Background

3. The Authority 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. The prime objective of the treasury management activity is the effective management of risk. The Code requires as a minimum the regular reporting of treasury management activities to :-
 - (a) Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report).
 - (b) Review actual activity for the proceeding year (this report).
4. This report covers the last year of the treasury operations before the introduction of the Prudential Code and the new investment guidance which both started on 1 April 2004. In future years this report will also provide comparisons against the relevant prudential indicators.

5. This report sets out :-
- (a) A summary of the strategy agreed for 2003/04 (paragraph 4)
 - (b) Service Plan Targets set for 2003/04 (paragraph 5)
 - (c) The Council's treasury position at the year end (paragraph 6)
 - (d) Debt decisions taken during 2003/04 and their revenue effects (paragraph 7)
 - (e) Investment decisions taken during 2003/04 and their revenue effects (paragraph 8)
 - (f) A summary of the economic factors affecting the strategy over 2003/04 (paragraphs 9-13)
 - (g) Compliance with the Council's Procedures and External Requirements (paragraph 14)
 - (h) The associated risks of any of these decisions (paragraphs 15 - 16)

Information and Analysis

The Strategy Agreed for 2003/04

6. The agreed 2003/04 Treasury Management Strategy was developed in conjunction with the Council's Treasury Management advisers, Butlers and is summarised below :-
- (a) The Officers will continue the policy of long term borrowing from the Public Works Loan Board (PWLB) or the money market and short term borrowing through the Money Market. The performance of the Money Market brokers will continue to be monitored;
 - (b) There will be regular discussions with the Council's appointed Treasury Management advisers on debt rescheduling. Based on their advice, PWLB loans may be repaid to reduce the Council's debt servicing costs. That advice may also recommend that longer term money should be borrowed on the Money Market;
 - (c) Surplus funds will continue to be invested with approved financial institutions and within the limits set down in the schedules associated to the Treasury Management Practices, this may include some forward dealing where it is prudent to do so;
 - (d) A half yearly report will be submitted to Members, and Officers will continue to regularly monitor the borrowing and investment procedures and returns within the Council's Treasury Management function;
 - (e) Levels of debt will continue to be managed having regard to the Council's overall credit ceilings;
 - (f) Surplus capital receipts may also be used to prematurely repay debt where it is thought beneficial to do so;
 - (g) To write-off the Council's Provision for Credit Liabilities memorandum account on an annual basis.
 - (h) As a consequence of Local Government Reorganisation Durham County Council currently manages around £14m of debt on behalf of this Council. The transfer of this debt to the control of this Council may be possible by mutual agreement of both parties. Officers will continue to monitor the cost of repayment of this debt and review the

situation as part of the overall strategy.

Service Plan Targets for 2003/04

7. This service has the following service plan targets.
 - (a) The consolidated rate of interest on borrowings
 - (b) The actual rate of interest returned on investments against the average performance indicator
 - (c) The results of these are contained in paragraphs 7 and 8 respectively.

The Council's Treasury Position at the Year End

8. The treasury position at the 31 March 2004 compared with the previous year was:

	31 March 2004		31 March 2003	
	Principal	Average Rate	Principal	Average Rate
PWLB and Money Market Debt	£62.443m	4.755%	£60.229m	4.908%
Total Debt	£62.443m		£60.229m	
Surplus Cash Investments	£9.670m	3.63%	£8.370m	3.81%
Capital Investments	£19.90m	3.74%	£18.50m	4.21%
Total Investments	£29.57m		£26.87m	

Debt Decisions Taken During 2003/04

9. Details of the debt transactions undertaken by the Authority are detailed below.

(a) Transfer of debt managed by Durham County Council

When the new unitary Council was established in April 1997, part of Durham County Council's debt became the responsibility of Darlington Borough Council, this debt related to assets of the transferred services i.e. Education, Social Services etc. The debt was managed by Durham County Council and this authority paid interest and principal direct to DCC. As detailed in the Treasury Management Strategy officers have sought to transfer this debt to Darlington Borough Council to enable the debt to be more effectively managed. The transfer of this debt (£12.410m) to the control of this Council was agreed by mutual consent of both parties on the 12th March 2004. This allows the Authority to manage the debt that was previously administered by Durham County Council and also allows the Authority to reschedule/repay this debt as future opportunities arise.

(b) Repayment of Local Government Re-organisation Debt

To enable Councils to prepare to establish new Local Authorities in 1997, the Government allowed revenue expenditure incurred to be capitalised, so that the full cost did not fall in the preparation period. The repayment of this debt had to be repaid over a shorter period than normal debt; therefore it has a significant impact on the revenue budget. Capital outstanding on that debt was £6.144m. It was agreed in the Revenue MTFP that this debt should be repaid early utilising Capital Receipts to gain revenue savings for future years. On 25th March 2004 the Council repaid £7.022m at

an average rate of 5.98% with early repayment costs of £0.275m relating to the general fund, which will be repaid over a 25 year period. This brought forward annual savings of over £1m.

(c) **Rescheduling**

On 15th October 2003 the Council repaid £4.299m at an average rate of 8.20% with early repayment costs of £0.714m relating to the General Fund, which again will be repaid over 25 years. Part of the repaid loans were replaced with one variable loan amounting to £1.125m currently at a rate of 4.125%. As a result of this transaction revenue savings of £0.141m were achieved during 2003/04.

(d) **Capital Expenditure**

During 2003/04 Capital expenditure of £8.217m was incurred which required to be financed by loans. However, as a result of slippage and increased reserved capital receipts during 2002/03, the Authority's borrowing was in-excess of what was required at the time. As a result no additional borrowing was required to be undertaken during 2003/04 for capital expenditure. This has resulted in a balance between debt outstanding at the end of 2003/04 and the Council's borrowing need.

(e) **Summary of Debt Transactions**

The table below summaries the debt transactions throughout 2003/04

	Balance 01/04/03	New Debt	Repayment	Balance 31/03/04
	£m	£m	£m	£m
Public Works Loan Board	50.629	1.125	7.551	44.203
DCC Managed Debt (PWLB)		12.422	3.782	8.640
Total PWLB	50.629	13.547	11.333	52.843
Money Market	9.600			9.600
Total Debt	60.229			62.443
Consolidated Rate of Interest	4.908%			4.755%

10. The overall position of the debt activity resulted in net revenue savings of £1.360m. The Revenue MTFP has already been adjusted by £1.000m to reflect the early repayment of LGR Debt. The consolidated rate of interest paid on debt is one of the lowest of all authorities in the country.

Investment Decisions taken during 2003/04

11. Investments held by the Council consists of temporary surplus cash balances and capital receipts and other funds as detailed below.

(a) **Temporary Surplus Cash Balances**

The table below shows actual activity against budget for 2003/04

	Budget	Actual
Average Monthly Investment	£7.000m	£11.900m
Average Rate of Investment	4.00%	3.63%
Interest Earned	£0.280m	£0.436

(b) Capital Receipts and Funds

The table below shows actual activity against budget for 2003/04

	Budget	Actual
Average Monthly Investment	£14.362m	£23.100m
Average Rate of Investment	4.00%	3.76%
Interest Earned	£0.574m	£0.870m

Capital investments held by the Council at 31st March 2003 amounted to £19.9m. These investments have increased from £18.5m in April 2003 to £19.9m in March 2004 due to increased capital receipts and reductions due to repayment of LGR debt.

(c) Summary of average investment rates achieved.

A representative set of indicators has been used in the table below to measure investment performance. As can be seen from the table, the actual investment rate achievements for 2003/04 exceeds the average of comparative rates for both long term and short term investments. It is considered that the service plan target relating to rate of return on investments has been achieved.

	Short Term Investments	Long Term Investment
Actual	% 3.64	% 3.76
Comparative Rates		
Local Authority 2 day rate	3.46	
Local Authority 7 day rate	3.46	
Local Authority 6 month rate		3.70
Local Authority 12 month rate		3.80
London Inter Bank Bid Rate – 7 Day	3.58	3.58
Average of comparative Rates	3.50	3.69

Economic Trends for 2003/04

- The year started on a comparatively quiet note and held no hint of the significant shifts that were to be seen later. The main driving force at the outset was the mounting concern that the

year was likely to be dominated by deepening recession across a wide selection of economies. The US showed few, if any, signs of staging a recovery from its extended growth pause, Euroland appeared to be on the brink of recession. Even in the UK there were tentative signs that activity was weakening.

13. Shorter term and PWLB interest rates remained under downward pressure throughout the April – June quarter. The widely held view that this situation would persist for a very long time was reflected in the market prices.
14. 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 a savage bounce in US economic activity (which rose to an annualised rate in excess of 8% in the July/September quarter).
15. In the UK, money market and the base rate diverged 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 MPC's decision to maintain an unchanged policy stance from that adopted in July, when base rates had been cut to 3.5%.
16. 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. The MPC adhered to its policy of gradually tightening domestic credit conditions (base rates were hiked 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.

End period		Base Rate	LIBOR			PWLB (Lower Tier)		
			3 mth	6 mth	12 mth	5-yr	10-15yr	20-25yr
2003	Mar	3.75	3.7	3.6	3.6	4.15	4.65	4.70
	Jun	3.75	3.7	3.6	3.6	4.05	4.65	4.75
	Sep	3.50	3.8	3.8	4.0	4.55	4.85	4.85
	Dec	3.75	4.1	4.2	4.4	4.80	5.00	4.95
2004	Mar	4.00	4.4	4.6	4.7	4.80	4.95	4.85

Compliance with the Council's Procedures and External Requirements

17. The Council has complied with its internal procedures and the requirements of the CIPFA Code of Practice on Treasury Management. For 2003/04 the Council was bound by the requirements of the Local Government and Housing Act 1989. These require the following limits to be set and adhered to. The table identifies the Council limits which were set and the activity against these limits. The Council complied with all limits for the course of the year.

LGHA 1989	Requirement	Council Limit	Maximum 2003/04	Position 31/3/04
S45 (a)	An overall borrowing limit, which is the maximum to Council may borrow	£85.0m	£69.47m	£62.443m
S45 (b)	A short term borrowing limit, which is the maximum the Council may have outstanding by way of short term borrowing	£15.0m	£0.287m	£0
S45 (c)	A limit on the total amount of interest payable that is at interest rates which are variable.	40%	17%	17%

Risk and Performance

18. 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 over the year. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly at fixed, long-term attractive levels.
19. 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 lending list, accurately forecast returns can be difficult.

Conclusion

20. Savings of £1.670m have been made on the Financing Costs 2003/04 budget of the Revenue MTFP, £1m relates to the early repayment of LGR debt, £0.450m due to increased investment income and £0.220m to reduced debt repayments.
21. Debt of £12.410m that was previously managed on behalf by Durham County Council was transferred to the Authority by mutual consent, however due to rescheduling/repayments of existing debt in total the outstanding debt level has increased by £2.214m. The consolidated rate of interest paid on such borrowing has fallen from 4.908% to 4.755%, this rate is one of the lowest of all authorities in the country.
- (a) Investment interest performance compares well with general market interest rates.
- (b) The Authority has complied with the Council's procedures and external requirements.

Legal Implications

22. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members.

Section 17 of the Crime and Disorder Act 1998

23. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Consultation

24. No formal consultation has been undertaken regarding this report.

Council Policy Framework

25. The issues contained within this report do not represent change to Council policy or the Council's policy framework

Decision Deadline

26. For the purpose of the 'call-in' procedure this does not represent an urgent matter

Recommendation

27. It is recommended that Cabinet note the contents of the report.

Reasons

28. The recommendations are supported to comply with the Treasury Policy Statement adopted by this Council.

Paul Wildsmith
Director of Corporate Services

Background Papers

2003/04 Final Accounts

Brian Boggon: Extension 2305