AGENDA ITEM No. 7 NORTH LANARKSHIRE COUNCIL

REPORT

To: POLICY & RESOURCES (FINANCE) SUB-COMMITTEE	Subject: TREASURY MANAGEMENT ANNUAL ACTIVITY REPORT, 2004/05
From: DIRECTOR OF FINANCE	
Date: 27 July, 2005 Ref: JV/KH/HN	

1. **Introduction**

1.1 The purpose of this report is to inform Committee of the Treasury Management activity undertaken during 2004/05 and the resulting impact on the Council's borrowing and investment strategy.

1.2 The report also details the Council's performance during the year in those mandatory Treasury Indicators which are set out in the Prudential Code for Capital Finance in Local Authorities.

2. **Background**

2.1 The Council has adopted the CIPFA Code of Practice in Treasury Management and operates its treasury services to mitigate the effect of possible risk in this function, while undertaking borrowing and investment activities that are prudent, affordable and sustainable.

2.2 The Code of Practice requires the Council to produce reports on its Treasury Management policies, practices and activities including, as a minimum, an annual strategic plan at the beginning of the financial year followed by an annual report on the measurement of success at the year end. To ensure compliance with the Code of Practice, Treasury Management procedures are continually reviewed with any amendments reported to Committee as appropriate. Quarterly monitoring reports on the treasury activity are also submitted to Committee on a regular basis.

2.3 In accordance with the Council's Treasury Management policy, the report focuses on activities undertaken during the year in the following key areas:-

- External Borrowing
- Interest Rates
- Interest Payments
- Debt Maturity Profiles
- Sources of Borrowing
- Debt Rescheduling
- Temporary Investments
- Leasing
- Compliance with the Prudential Code

3. External Borrowing

3.1 *Capital Borrowing Requirement*

3.1.1 The Strategy Statement for 2004/2005 approved by Policy & Resources (Finance) sub-committee on 23 March 2004 highlighted a capital programme of £92.8m, and an anticipated long-term borrowing requirement of £39.2m.

3.1.2 The total investment in council assets during 2004/05 amounted to £106.7m, with actual borrowing required to support this capital investment totalling £22.4m.

3.1.3 Members have received various reports throughout the year advising them of anticipated variations to the capital expenditure programmes and resource levels. In addition, Council approved the provisional outturn reports during the May 2005 cycle of committee meetings.

3.1.4 Although reasons for variations to resource levels are not detailed within this report, it is appropriate to highlight that actual long-term borrowing requirement of £22.4m was £16.8m lower than originally anticipated. This resulted from additional capital grants and capital receipts previously notified to members as part of current capital monitoring procedures.

3.2 *Capital Financing Requirement*

3.2.1 Given that the Council was generally in a surplus cash flow position throughout 2004/05, very little borrowing was actually undertaken. Surplus cash flow balances were primarily used to fund capital expenditure, and on those occasions where temporary shortfalls arose, short-term borrowing was undertaken.

4. Interest Rates in 2004/2005

4.1 The Annual Strategy Statement highlighted that short-term rates were expected to increase moderately during 2004/05, and that longer- term rates were also expected to gradually increase.

4.2 During 2004/05, interest rates increased 3 times, with base rates peaking at 4.75% in August 2004. With base rates remaining unaltered for the balance of the year and the Monetary Policy Committee adopting what appeared to be a neutral stance many economists became optimistic that the rate cycle had peaked, causing money market and longer-term rates to slip lower.

4.3 However, with tighter labour market conditions and rising raw material prices evident in the last few months, plus lackluster performance of key international bonds, economic commentators became less confident on which direction rates would take, hence rates returned to a rising trend in the closing months of the year.

4.4 Appendix 1 illustrates the movements in both short-term and long-term interest rates throughout the year.

5. Interest Payments in 2004/2005

5.1 Interest payments of £32.9 m (£33.9 m in 2003/2004) were made during the year. An internal indicator is used to assess performance, which is based on the comparison of external interest payments to the total debt outstanding. This is termed the average loans fund rate and is calculated to compare year on year effectiveness of treasury activity.

5.2 For financial year 2004/2005, the average loans funds rate was 6.96%, a decrease of 0.31% when compared with the average rate (7.27 %) for 2003/2004, and is largely attributable to debt rescheduling exercises and the resulting reduced interest payments. It is pleasing to report a downward movement in the average interest rate of the Council's loans portfolio which, in the longer term, will manifest itself in lower debt costs.

6. Debt Maturity Profile

6.1 Debt maturity profiles are continually monitored in accordance with the CIPFA Code of Practice and the Councils Treasury Strategy. This is illustrated in graphical format at Appendix 2.

6.2 The graph highlights that debt maturity periods are by and large evenly spread up to 2048. Thereafter, loans totalling approximately £70m are due for repayment by 2058 and the Department will continue to seek opportunities to smooth the maturity profile of these years.

6.3 A summary of the debt maturity profile is contained in Table 2 below.

	2004/2005		**2003/2004**	
	£ 000's	**% age**	**£000s**	**% age**
Temporary Borrowing (up to one year)	27,722	5.88	25,069	5.38
Long Term Borrowing :-				
Maturing within 1 Year	2,365	0.50	2,735	0.59
Maturing in 1 – 2 Years	14,606	3.10	2,365	0.51
Maturing in 2 – 7 Years	26,278	5.57	40,589	8.72
Maturing in 7 – 15 Years	117,896	25.01	120,676	25.92
Maturing in more than 15 Years	282,563	59.94	274,139	58.88
	471,430	**100.00**	**465,574**	**100.00**

Table 2

7. Sources of Borrowing

7.1 The main source of borrowing continues to be the Public Works Loans Board supplemented by money market loans where opportunities exist. In addition, the Council continued to make use of Municipal bank deposits, bank overdraft facilities and, to a lesser extent, short-term temporary loans.

7.2 Table 3 highlights the source of borrowing and the value of loans outstanding as at the 31 March 2005.

Source of Borrowing	2004/2005			2003/04	
	£000's	%age		£000's	%age
Public Works Loan Board	315,781	66.98		334,105	71.76
Money Market Loans	112,250	23.81		89,050	19.13
Covenants	4,972	1.06		6,016	1.29
Temporary Loans	0	0		0	0
Municipal Bank, Long-term	10,000	2.12		10,000	2.15
Municipal Bank, Short-term	17,431	3.70		16,167	3.47
Bank Overdraft	10,285	2.18		8,896	1.91
Other Authorities & Internal Investments	711	0.15		1,340	0.29
	471,430	**100.00**		**465,574**	**100.00**

Table 3

8. Debt Rescheduling

8.1 Debt rescheduling is defined as the reorganisation of existing debt in such a way as to amend the debt repayment profile of the authority, reduce the principal sum borrowed, alter the degree of volatility of the debt or vary the interest charge payable.

8.2 During the year the portfolio was continuously monitored for rescheduling opportunities and resulted in two beneficial restructuring exercises being undertaken. The benefits which accrued to the Council included:-

- A saving of £336,000 in interest costs in 2004/05
- Continued interest savings of approx. £711,000 per annum from 2005/06 onwards
- Surplus investment balances reduced by approx. £2m
- A smoother maturity profile, particularly in 2013/14 and 2014/15, where loan repayments were initially scheduled to be very high
- Achievement of good professional practice and a well-balanced loan portfolio.

8.3 It is anticipated that opportunities for debt rescheduling will continue to be researched throughout 2005/06, with details being reported to Committee through the quarterly Treasury Management Monitoring Reports.

9. Temporary Investments

9.1 North Lanarkshire Council continues to retain a healthy positive cashflow position and encouraging investment balances. This cashflow position has arisen as a result of positive debt repayment profiles, the maintenance of prudent reserves and contingencies, and much-improved debt recovery procedures.

9.2 During 2004/2005 the Council had substantial surplus funds which were invested in accordance with the Treasury Policy Statement and advice received from Butlers, the Council's appointed Treasury Consultants. As at 31 March 2005, the total balance of investments amounted to approximately £70m, an increase of approximately £10m from last year's position, primarily due to timing differences of revenue and capital commitments, reflected in working capital balances and reserves held at the year-end.

9.3 Surplus funds were invested with approved institutions for periods of up to 364 days as per the agreed Treasury Policy strategy.

9.4 A comparison of North Lanarkshire Council investment performance for the period April 2004 to March 2005 is shown in Appendix 3. This demonstrates that the investment rate being achieved from investing surplus funds is generally higher than the 7 day LIBID (London Inter-bank Bid Rate) rate; deemed to be a reliable benchmark for assessing performance on temporary investments.

10. Leasing

10.1 The 2004/05 Strategy Statement highlighted that leasing would be used if advantageous to the council. During the year, the Council held various operating leases for vehicles, equipment, gas central heating and tower overcladding programmes, with actual payments during the year totalling £7.5m respectively met from revenue budget.

10.2 During 2004/05, the Council also entered into two new finance leases for gas central heating and tower overcladding, with 2004/05 payments of approximately £24,000.

10.3 As at 31 March 2005, the Council was committed to making payments of approximately £45m under operational leases, and £289,000 under finance leases.

11. The Prudential Code for Capital Finance in Local Authorities

11.1 Following the introduction of the Local Government in Scotland Act 2003 and the Prudential Code for Capital Finance in Local Authorities, the Treasury Strategy Statement, 2004/05 detailed the mandatory prudential indicators essential for ensuring that the Council's capital programmes were affordable, prudent and sustainable.

11.2 The Council approved a variety of indicators, including estimates for the financial years 2004/05 through to 2007/08. With the Annual Accounts for 2004/05 now complete, there is an opportunity to compare the estimated and actual 2004/05 prudential indicators. Table 4 contains details of this comparison.

Capital Expenditure	**2004/05 Estimate (£000s)**	**2004/05 Actual (000s)**	**Comments**
Total spend	**92,758**	**106,688**	*Slippage B/F from 2003/04 and additional grant funding resources*
Borrowing	36,563	22,358	*Lower borrowing required following increases in other sources of funding.*
Capital receipts	30,043	44,183	*Increased land and house values achieved on sales*
Ringfenced consents/Grants	13,942	22,194	*Additional resources available*
CFCR	12,210	17,953	*Additional contributions regarding composite services*
Capital Financing Requirement	**2004/05 Estimate (£000s)**	**2004/05 Actual (000s)**	**Comments**
CFR – Non Housing	324,572	308,186	
CFR – Housing	139,102	113,986	
Total CFR *(including premiums)*	**463,674**	**422,172**	*Lower than estimated due to need to borrow reduced following increase in capital receipt etc*

Prudential Margin			
Net Borrowing inc. Premiums	421,004	399,563	*Investment and cash levels higher than estimated.*
Capital Financing requirement (inc. Premiums)	463,674	422,172	
Prudential Margin	**42,670**	**22,609**	*Borrowing levels appear to be within sustainable limits.*
Borrowing Limits (£000s)			
Authorised Limit Indicator 2004/05		600,000	
Operational Boundary Indicator 2004/05		570,000	
Maximum Borrowing level 2004/05		**467,020**	
Ratio of Financing Costs/Income			
Non-HRA HRA	5.35% 21.88%	4.96% 21.29%	*Debt rescheduling resulted in lower financing costs in both services*
External Debt at 31st March 2005		**461,434**	

Table 4

11.3 The table illustrates a favourable outturn in all instances. Borrowing is less than estimated with both capital grants and capital receipts experiencing upwards trends from that initially forecast. Importantly, there is a healthy prudential margin of £23m (£43m forecast) which is evidence that the Council was able to sustain the increased capital investment levels during 2004/05. The reduction in the ratio of capital financing costs to total income in both General Services and HRA is also worthy of note, demonstrating that the Council is spending marginally less in debt financing when compared to its overall revenue budget.

12. Conclusion

12.1 The Council's Treasury Management arrangements continue to be governed by the CIPFA Code of Practice, and from 1 April 2004 now also reflect the treasury management requirements of the Local Government in Scotland Act, 2003.

12.2 Performance throughout 2004/05 was generally effective, with reductions in long-term borrowing costs, and a reduction in the average loans fund rate being achieved, when compared with the previous year.

12.3 It is anticipated that 2005/06 will bring additional debt restructuring opportunities, details of which will be reported to Committee throughout the coming year.

Director of Finance

For further information please contact Mrs Katrina Hassell, Treasury Manager on tel. ext. 302235.

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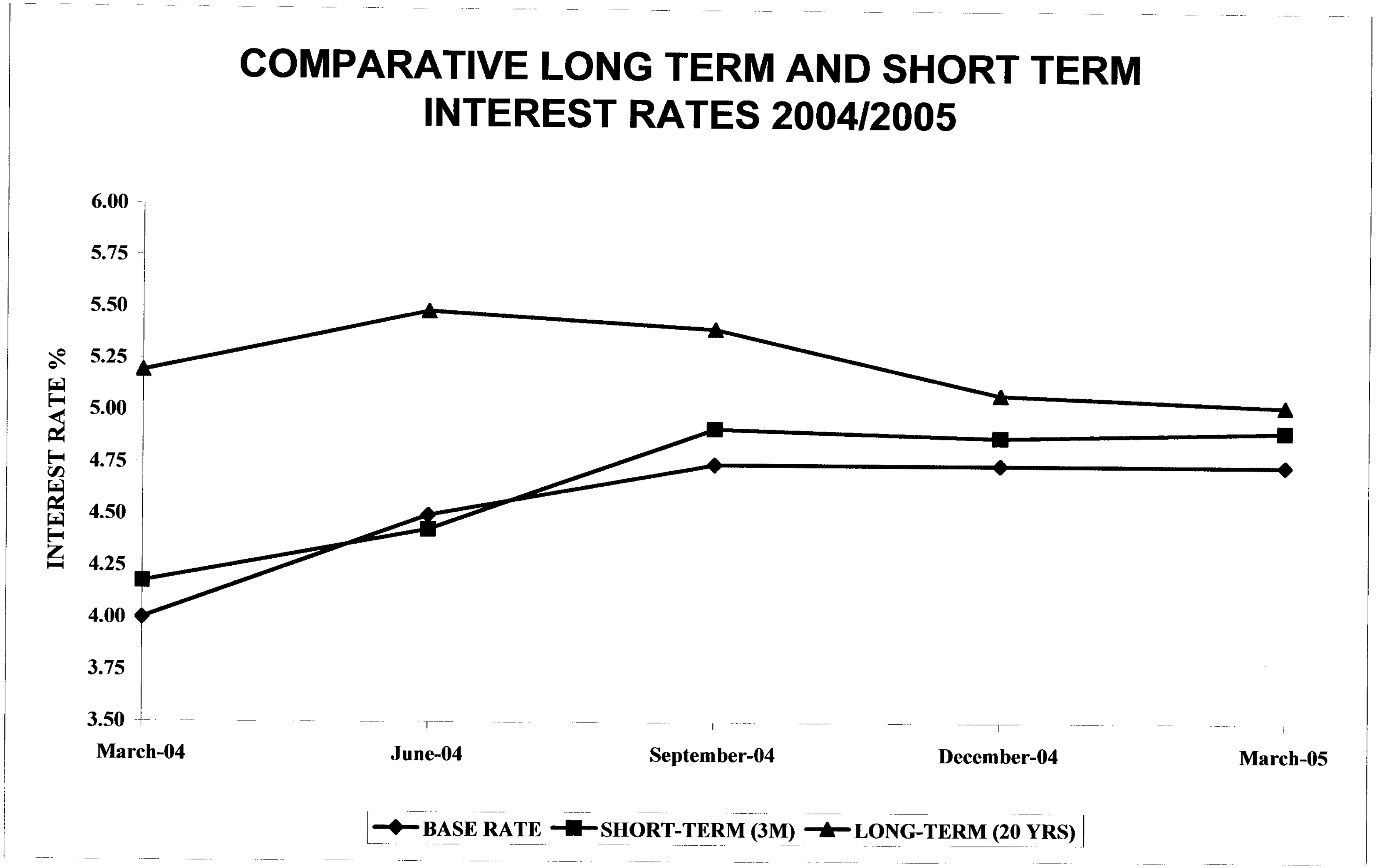
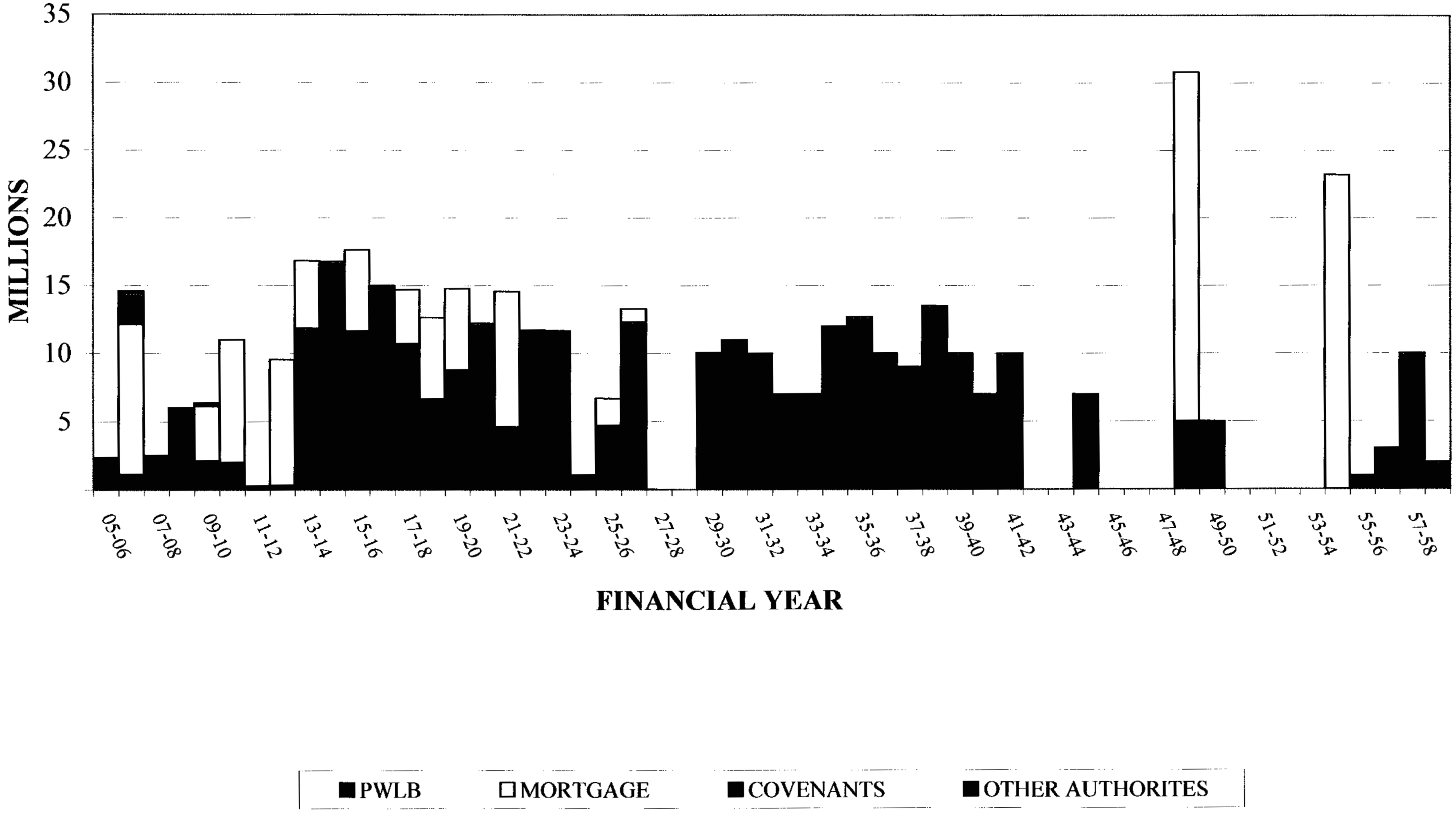
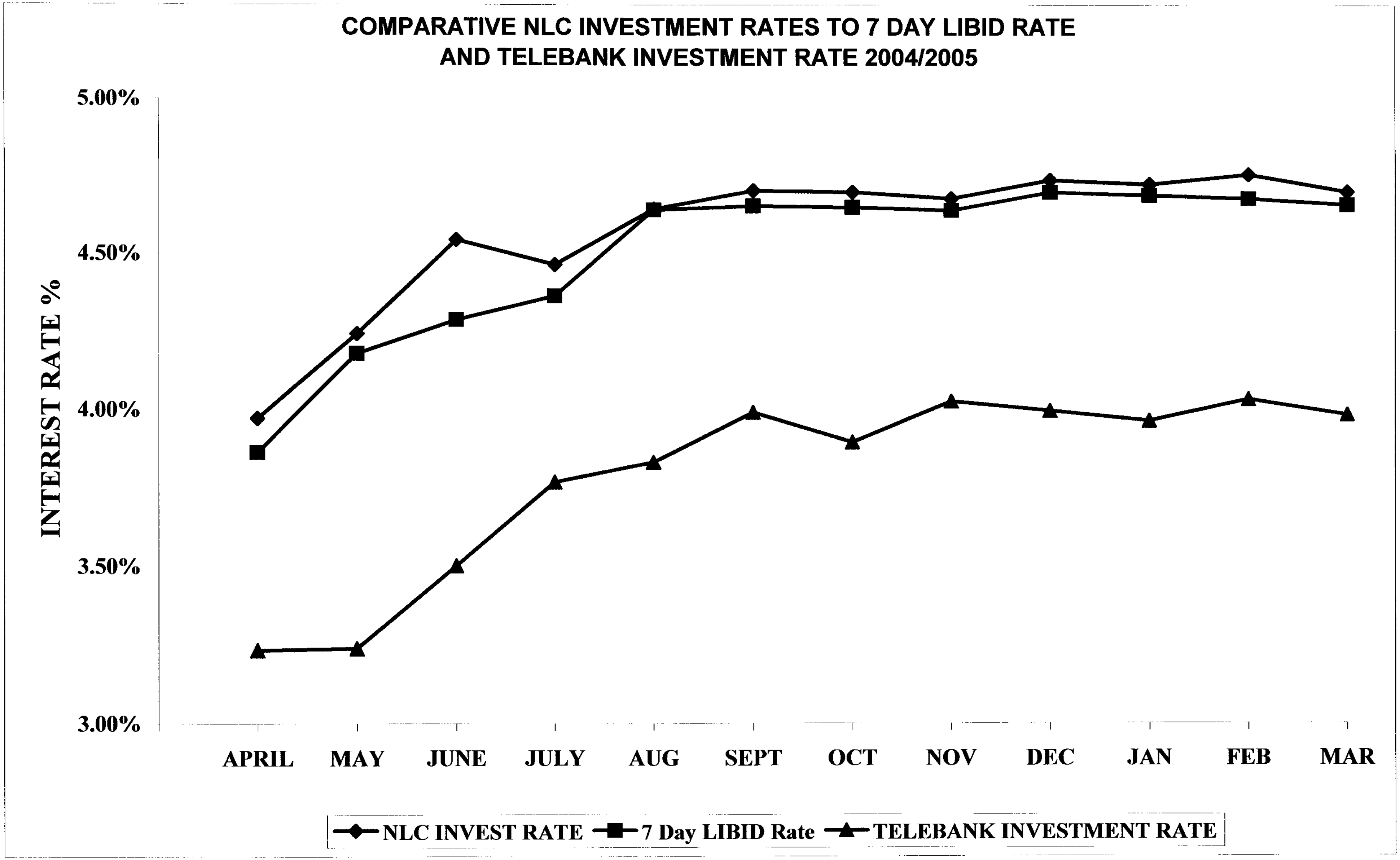

COMPARATIVE LONG TERM AND SHORT TERM INTEREST RATES 2004/2005
INTEREST RATE %
6.00
5.75
5.50
5.25
5.00
4.75
4.50
4.25
4.00
3.75
3.50
March-04
June-04
September-04
December-04
March-05
BASE RATE
SHORT-TERM (3M)
LONG-TERM (20 YRS)

LONG TERM DEBT MATURITY AS AT 31st MARCH, 2005



APPENDIX 3


COMPARATIVE NLC INVESTMENT RATES TO 7 DAY LIBID RATE
AND TELEBANK INVESTMENT RATE 2004/2005
INTEREST RATE %
5.00%
4.50%
4.00%
3.50%
3.00%
APRIL
MAY
JUNE
JULY
AUG
SEPT
OCT
NOV
DEC
JAN
FEB
MAR
NLC INVEST RATE
7 Day LIBID Rate
TELEBANK INVESTMENT RATE