AGENDA ITEM No. 8.

NORTH LANARKSHIRE COUNCIL

REPORT

To: POLICY & RESOURCES (FINANCE) SUB-COMMITTEE	Subject: TREASURY MANAGEMENT ANNUAL ACTIVITY REPORT, 2005/06
From: DIRECTOR OF FINANCE	
Date: 31 July, 2006 — Ref: JV/JQ/HN	

1. **Introduction**

1.1 The purpose of this report is to inform Committee of the Treasury Management activity undertaken during 2005/06 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 throughout 2005/2006 were 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 2005/2006 approved by Policy & Resources (Finance) sub-committee on 22 March 2005 highlighted a capital programme of £103.2m, and an anticipated long-term borrowing requirement of £37.0m.

3.1.2 The total investment in council assets during 2005/06 amounted to £117m, with actual borrowing required to support this capital investment totalling £47.7m.

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 out-turn reports during the May 2006 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 £47.7m was £10.7m higher than originally anticipated. This is primarily a result of less capital receipts settling than budgeted, which was previously notified to members as part of current capital monitoring procedures. These receipts will be realised during 06/07, which will result in a corresponding reduction in the borrowing requirement budgeted for this year.

3.2 *Capital Financing Requirement 2005/2006*

3.2.1 The 2005/2006 capital financing requirement of £47.7m was funded by utilising £32.7m of surplus cash-flow balances with the balance being met by additional external borrowing of £15m. This additional borrowing was undertaken at a time when the PWLB 25-30 year rates fell to historically low levels and will ensure that cashflow balances remain at prudent levels in 2006/2007 and 2007/2008.

4. Interest Rates in 2005/2006

4.1 The Annual Strategy Statement highlighted that there was a risk of a moderate increase in short-term rates, with a possibility of a minor rise to the base rate in the early part of 2005/2006. Economic forecasters predicted a low probability of this occurring and expecting them to remain generally steady. In terms of the medium to long-term rates these were expected to move marginally, with a possible increase towards the end of 2006.

4.2 However this scenario failed to materialise during 2005/2006 and in fact changed markedly during the summer of 2005. Lower than anticipated domestic growth activity, rapid deceleration in house price inflation and slowing retail sales growth caused an about turn in official interest rate policy

4.3 On the 4th August 2005, the Bank of England at it's monthly MPC meeting reduced base rates by 0.25% from 4.75% to 4.50%. The first change in the base rate since there was a 0.25% increase in August 2004. In turn both the short term and long term rates fell as a result of this decision by the end of the summer.

4.4 Short-term rates remained relatively steady after the initial impact of the base rate cut, but by the end of 2005/2006, long term rates had fallen to historically low levels. Economists attributing this to a combination of more optimistic views based on US interest rate prospects on the international front and the investment of surplus cash on the domestic front.

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

5. Interest Payments in 2005/2006

5.1 Interest payments of £32.8 m (£32.9 m in 2004/2005) 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 2005/2006, the average loans funds rate was 6.74%, a decrease of 0.22% when compared with the average rate (6.96%) for 2004/2005, 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 totaling approximately £80m 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 1 below.

	2005/2006		**2004/2005**	
	£000s	**% age**	**£000s**	**% age**
Temporary Borrowing (up to one year)	30,060	6.18	27,722	5.88
Long Term Borrowing :-				
Maturing within 1 Year	13,306	2.73	2,365	0.50
Maturing in 1 – 2 Years	2,319	0.48	14,606	3.10
Maturing in 2 – 7 Years	29,817	6.13	26,278	5.57
Maturing in 7 – 15 Years	115,572	23.76	117,896	25.01
Maturing in more than 15 Years	295,325	60.72	282,563	59.94
	486,399	**100.00**	**471,430**	**100.00**

Table 1

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 2 highlights the source of borrowing and the value of loans outstanding as at the 31 March 2006.

Source of Borrowing	2005/2006			2004/2005	
	£000's	%age		£000's	%age
Public Works Loan Board	324,681	66.74		315,781	66.98
Money Market Loans	117,250	24.11		112,250	23.81
Covenants	3,928	0.81		4,972	1.06
Temporary Loans	0	0		0	0
Municipal Bank, Long-term	10,000	2.06		10,000	2.12
Municipal Bank, Short-term	19,903	4.09		17,431	3.70
Bank Overdraft	10,151	2.09		10,285	2.18
Other Authorities & Internal Investments	486	0.10		711	0.15
	486,399	**100.00**		**471,430**	**100.00**

Table 2

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 three beneficial restructuring exercises being undertaken. The benefits which accrued to the Council included:-

- A saving of £176,000 in interest costs in 2005/06
- Future interest savings of approximately : £218,000 in 2006/2007 & 2007/2008
  £198,000 in 2008/2009 to 2010/2011
  £138,000 in 2011/2012 to 2013/2014
  thereafter £13,000 until 2025/2026
- A smoother maturity profile in 2008/2009 , 2013/14 and 2025/2026
- 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 2006/07, with details being reported to Committee through the quarterly Department of Finance Performance Monitoring.

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 2005/2006 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.

9.3 As at 31 March 2006, the total balance of investments amounted to approximately £50m, a reduction of approximately £20m from last year's position. This was primarily a result of surplus cashflow balances contributing towards the financing of the 2005/2006 Capital expenditure programme in line with the approved Annual Treasury Strategy for 2005/2006.

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

9.5 A comparison of North Lanarkshire Council investment performance for the period April 2005 to March 2006 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 2005/06 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 totaling £8m respectively met from revenue budget.

10.2 As at 31 March 2006, the Council was committed to making payments of approximately £42m (£45m in 2004/2005) under operational leases, and £248,000 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 2005/06, 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 year's 2005/06 through to 2007/08. With the Annual Accounts for 2005/06 now complete, there is an opportunity to compare the estimated and actual 2005/06 prudential indicators. Table 3 contains details of this comparison.

Capital Expenditure	2005/06 Estimate (£000s)	2005/06 Actual (£000s)	Comments
Total spend	**103,170**	**117,105**	*Slippage B/F from 2004/05 plus additional projects undertaken as a result of increased grant awards/ other funding.*
Financed By :			
Borrowing	37,085	47,686	*Increased borrowing required primarily due to less capital receipts settling than budgeted.*
Capital receipts	37,971	29,614	*Less capital receipts from the sale of council houses plus a number of receipts from the sale of land & buildings did not settle by 31/3/06.*
Ringfenced consents/Grants	16,064	22,353	*Additional resources received*
CFCR	12,050	17,452	*Additional contributions from revenue for composite capital projects*
Capital Financing Requirement	**2005/06 Estimate (£000s)**	**2005/06 Actual (£000s)**	**Comments**
CFR – Non Housing	166,162	104,016	*Estimate based on 2002/03 debt levels*
CFR – Housing	278,714	341,598	*Estimate based on 2002/03 debt levels*
Total CFR (including Premiums)	444,876	445,614	
Prudential Margin			
Net Borrowing incl. Premiums	437,322	432,363	*Investment and cash levels higher than estimated partly offset by additional borrowing.*
Capital Financing Requirement (incl. Premiums)	444,876	445,614	
Prudential Margin	7,554	13,251	*Investment and cash levels higher than estimated partly offset by additional borrowing.*
Borrowing Limits (£000s)			
Authorised Limit 0506	520,000		
Operational Boundary 0506	485,000		
Maximum Borrowing Level 0506	479,950		*During 2005/2006 the Council did not breach the Authorised Limit or Operational Boundary.*
Ratio of Financing Costs/Income			
Non-HRA	5.88%	5.82%	
HRA	21.64%	21.23%	
External Debt as 31st March 2006		*476,496*	

Table 3

11.3 Table 3 illustrates the flexibility of the prudential code whereby the Council reacted to a reduced number of land and building sales within the financial year 2005/06 by increasing its estimated borrowing levels. This ensured that the reduction in sales did not adversely affect the completion of capital projects and the Council was able to manage its capital expenditure programme efficiently. It should be noted that the shortfall in receipts in 2005/06 will be realised during 2006/07 and this will result in a reduction in estimated borrowing levels for 2006/2007.

11.4 Importantly, there is a healthy prudential margin of £13.2m (£7.5m forecast) which is evidence that the Council was able to sustain the increased capital investment levels during 2005/06. 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.

11.5 The Council approved a variety of Treasury indicators, including upper limits for interest rate exposures for the financial year's 2005/06 through to 2007/08. With the Annual Accounts for 2005/06 now complete, there is an opportunity to compare the estimated and actual 2005/06 Treasury prudential indicators. Table 4 contains details of this comparison.

Interest Rate Exposures	**Upper Limits 2005/2006 (£m)**	**2005/06 Actual (£000s)**
Fixed Interest Rates	110%	107.76%
Variable Interest Rates	25%	-7.76%

Interest Payments and Income due on Loans Outstanding / Funds invested.	**Initial Estimate 2005/2006 (£m)**	**2005/2006 Actual (£m)**	**Variance (£m)**	**%tage**
Interest payable on Fixed Rate Debt	32.10	32.00	-0.10	-0.3%
Interest payable on Var Rate Debt	0.82	0.80	-0.02	-2.4%
Total Interest Payments	**32.92**	**32.80**	**-0.12**	-0.4%
Interest Receivable Funds Invested	-2.48	-3.0	-0.52	21.0%
Net Loan Interest Payments due	**30.44**	**29.8**	**-0.64**	-2.1%

Maturity Structure of Borrowing	**<12months**	**12months to 2 yrs**	**2 to 5 yrs**	**5 to 10 yrs**	**>10 yrs**
Upper Limit	5.00%	5.00%	10.00%	25.00%	90.00%
Current Maturity Structure	2.62%	0.30%	4.04%	12.55%	80.49%

Table 4

11.6 Table 4 shows that throughout 2005/2006 the Council remained well within the fixed and variable rate exposure limits set, limiting the council exposure to the effects of interest rate changes. Investment income levels were also higher than those initially estimated which resulted in a marginal reduction in net loan interest payments.

11.7 In 2005/2006 the Council's debt maturity structure remained comfortably within the defined limits reducing the risk of having to replace large sums of fixed rate debt at a time when interest rates may be high.

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 2005/06 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 2006/07 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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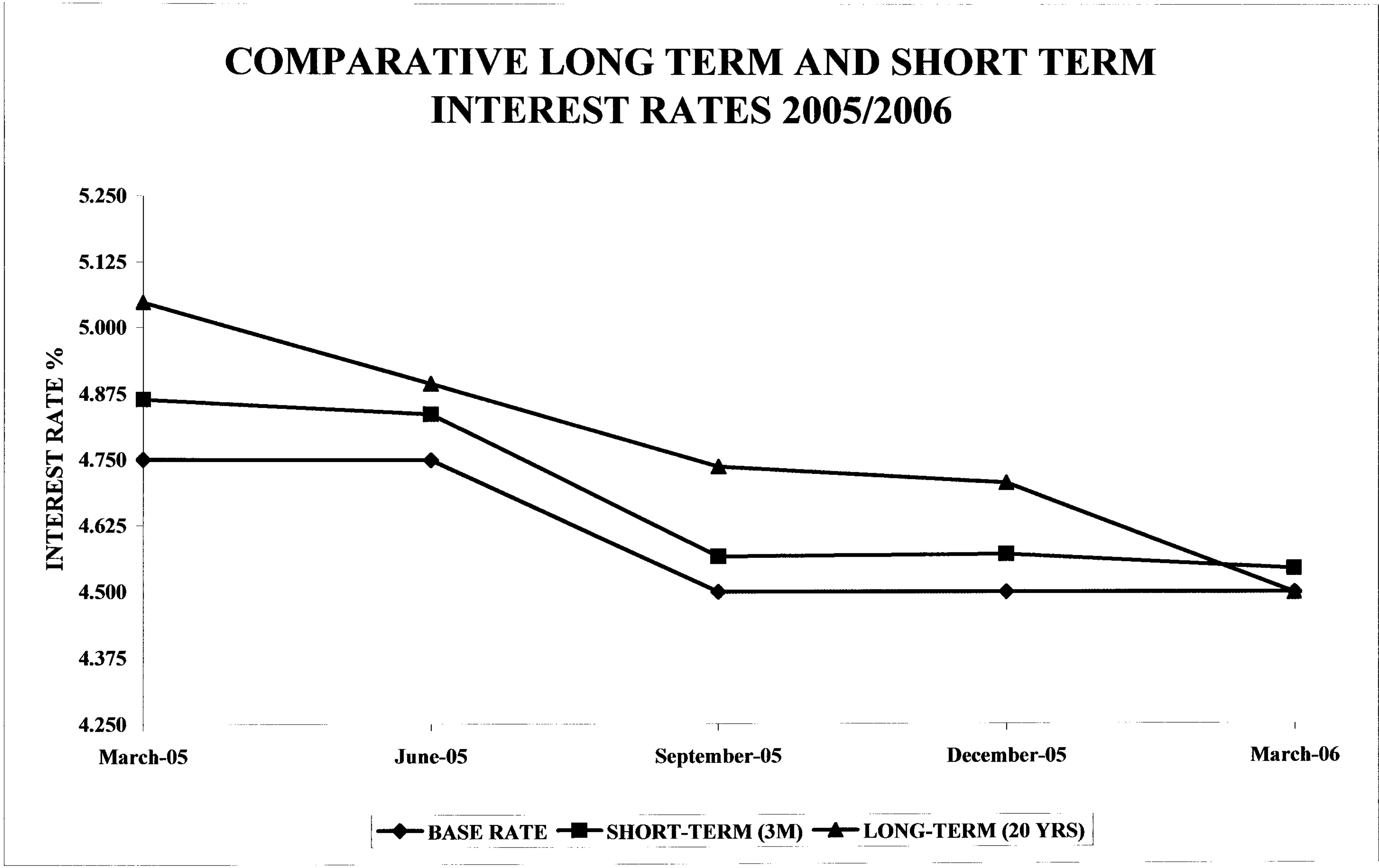
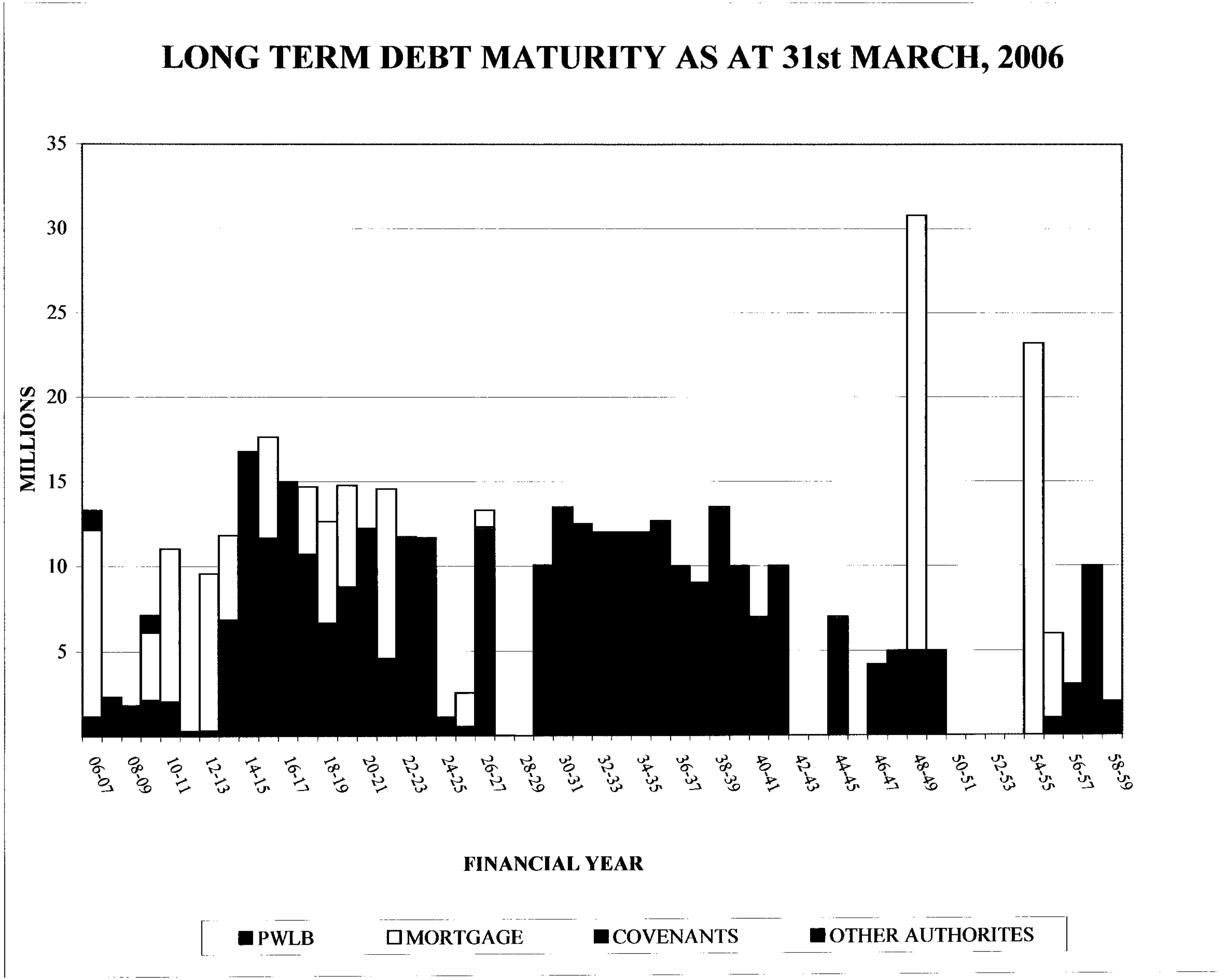
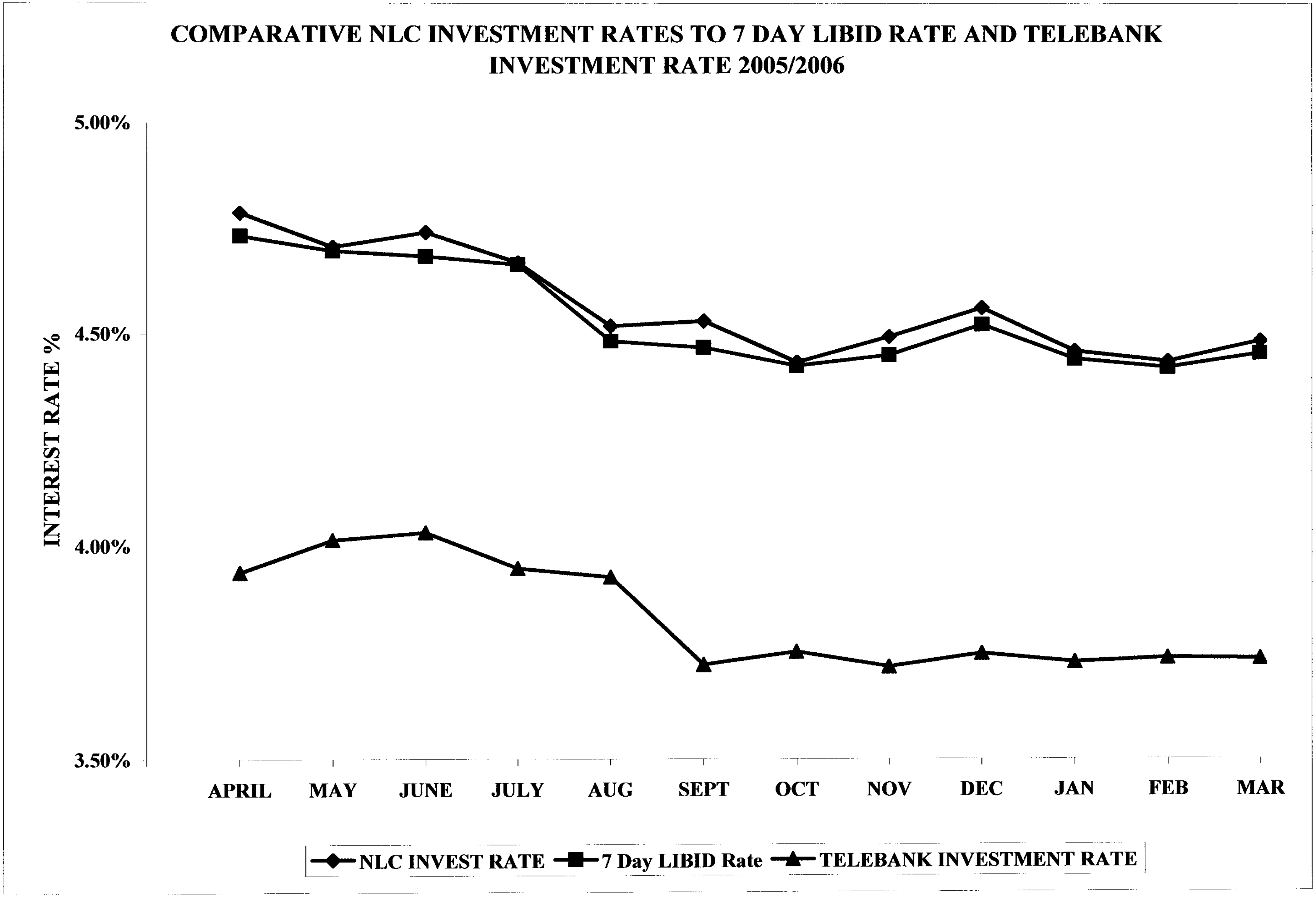
APPENDIX 1


COMPARATIVE LONG TERM AND SHORT TERM INTEREST RATES 2005/2006
INTEREST RATE %
5.250
5.125
5.000
4.875
4.750
4.625
4.500
4.375
4.250
March-05
June-05
September-05
December-05
March-06
BASE RATE
SHORT-TERM (3M)
LONG-TERM (20 YRS)


LONG TERM DEBT MATURITY AS AT 31st MARCH, 2006
MILLIONS
35
30
25
20
15
10
5
06-07
08-09
10-11
12-13
14-15
16-17
18-19
20-21
22-23
24-25
26-27
28-29
30-31
32-33
34-35
36-37
38-39
40-41
42-43
44-45
46-47
48-49
50-51
52-53
54-55
56-57
58-59
FINANCIAL YEAR
PWLB
MORTGAGE
COVENANTS
OTHER AUTHORITES


COMPARATIVE NLC INVESTMENT RATES TO 7 DAY LIBID RATE AND TELEBANK INVESTMENT RATE 2005/2006
INTEREST RATE %
5.00%
4.50%
4.00%
3.50%
APRIL
MAY
JUNE
JULY
AUG
SEPT
OCT
NOV
DEC
JAN
FEB
MAR
NLC INVEST RATE
7 Day LIBID Rate
TELEBANK INVESTMENT RATE