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Meeting	Cabinet Resources
Date	23 September 2004
Subject	**Treasury Management Outturn Report 2003/04**
Report of	Cabinet Member for Resources
Summary	To consider the extent to which the Council adhered to the Treasury Management Strategy for 2003/04.

Officer Contributors	Borough Treasurer, Clive Medlam
Status (public or exempt)	Public
Wards affected	Not applicable
Enclosures	Appendix A – Investment Rates 2003/04 Appendix B – Long Term Interest Rates 2003/04 Appendix C – Investment Counter Party List
For decision by	Cabinet Resources Committee
Function of	Executive
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

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1 RECOMMENDATIONS

1.1 That the performance against the Treasury Management Strategy in 2003/04 be noted.

2. RELEVANT PREVIOUS DECISIONS

2.1 Cabinet Resources 23 January 2003 – approval of Treasury Management Policy Statement and Strategy.

3 CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 This report has been produced in accordance with the Code of Practice for Treasury Management in the Public Services, issued by CIPFA in 2001 and formally adopted by the London Borough of Barnet on 07 January 2003 (Council, Item 73 (3), Minutes)

4 RISK MANAGEMENT ISSUES

4.1 In order for the Council to be able to deliver effective services within the Council's policy framework to members of the public it is necessary to have a sound financial base. An annual report of the performance of the Treasury Management function allows the foundations of this financial base to be examined.

5 FINANCIAL, STAFFING, ICT AND PROPERTY IMPLICATIONS

5.1 One of the primary objectives of CIPFA's Code of Practice on Treasury Management and subsequent Treasury Policy Statements is to ensure that, by using prudent and proper practices, the financial resources of local authorities are protected and best used.

6 COMMENTS, IF ANY, OF THE COUNCIL'S STATUTORY OFFICERS (Head of Paid Service, Chief Finance Officer, Monitoring Officer)

6.1 None.

7 BACKGROUND INFORMATION

7.1 Treasury management in local government was regulated during 2003/04 by the 2001 revision of the CIPFA Code of Practice on Treasury Management in the Public Services. The Council has adopted the 2001 Revised Code and complies with its requirements.

7.2 The key recommendations of the Code are;

- The creation and maintenance of a Treasury Management Policy Statement, stating the policies and objectives of the authority's treasury management activities (this was adopted by the Council on 2nd December 2002).

- the creation and maintenance of Treasury Management Practices which set out the means by which the authority intends to achieve those policies and objectives, and describing how it will manage and control those activities.
- the presentation to the appropriate committee of an annual strategy report for the year ahead and an annual outturn report of the previous financial year.

7.3 The Council's Treasury Policy Statement defines the Council's treasury activities as:

> "The management of the 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".

7.4 This annual treasury report covers:

- the Council's current treasury position
- performance measurement
- the borrowing strategy for 2003/04
- the borrowing outturn for 2003/04
- compliance with treasury limits
- investment strategy for 2003/04
- investment outturn for 2003/04
- debt rescheduling
- Other issues

7.5 Current portfolio position

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

	31 March 2004		31 March 2003	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Total Debt				
PWLB	£0.00m	n/a	£39.00m	9.77%
Annuity	£0.00m	n/a	£0.00m	n/a
Temporary	£27.21m	4.31%	£0.14m	4.10%
Total Investments				
In house	£.36.10m	4.02%	£48.79m	3.52%

7.6 Performance Measurement

7.6.1 One of the key changes in the first revision of the Code in 1996 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 complex area. Table 7.5.1 above shows the average rates of interest on loans and investments as at 31 March 2004, compared with the same categories as at 31 March 2003.

7.7 The strategy for 2003/04

7.7.1 Our treasury strategy for 2003/04 was based on a view of the UK economy being weighed down at the start of the year by continuing weak growth in the US and by world fears of war in Iraq which together produced an expectation of overall weak world economic growth. These war fears helped to dampen consumer confidence, demand, manufacturing production and capital investment and to depress share prices which had already been hit by accounting scandals in the US in the first half of 2002. Base rate was therefore forecast to stay at 4.0% during 2003, although there were concerns that if growth prospects weakened further then it could be cut.

7.7.2 Inflationary pressures were weak and RPIX (headline inflation less mortgage interest rates) was expected to be near or below the target rate of 2.5%. On the other hand, the level of increase in consumer and corporate borrowing was a cause for concern as this could make borrowers highly sensitive to any increase in base rate. Unemployment was expected to continue to remain at historically low levels but wage inflation was benign. House prices were increasing at an alarmingly high rate. The manufacturing sector was continuing to contract. Looking forward, however, expectations of robust consumer demand, confidence and borrowing together with strong growth in planned public expenditure, were expected to provide solid underpinning to the strong growth rate in the UK economy. This was, therefore, a different situation from that in the US and did not require further cuts in base rate in order to maintain a reasonably healthy and consistent rate of growth in 2003.

7.7.3 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 weak outlook for growth for the UK and US economies would prompt the MPC to leave the base rate at 4%. The risk remained that growth was not as feeble as forecast and a quick recovery in the US would remove pressure to keep rates low. If this was the outcome, then UK base rates could rise by the end of 2003.

- **Longer-term interest rates** - The view was that long term PWLB rates would fall slightly to 4.40% (equivalent to long term gilt yield of approximately 4.25%) and remain around that level for the year.

7.8 The Adopted Treasury Strategy - The agreed strategy put to committee, based upon the above forecast, was that:

7.8.1 The overall approach would be of caution, monitoring the interest rate market and adopting a pragmatic approach to changing circumstances, reporting any decisions to Cabinet Resources Committee as a part of the annual review process.

7.8.2 The net borrowing requirement raised by new capital expenditure would initially be met by the realisation of capital receipts temporarily invested. In the longer term the funding may be met from PWLB quota loans should the interest rate profile be advantageous to the Council.

7.8.3 Temporary investments will continue to be made to cover cash flow needs, market conditions will be monitored and investments made to optimise returns. Investments will be made in accordance with Approved Investment Regulations (1990) and subsequent amendments, and with the institutions identified in the Council's approved counter party investment list.

7.8.4 Any debt rescheduling is likely to take place when fixed interest rates are anticipated to be at their highest as this will minimise the penalty premium payable. The situation will be continually monitored, in consultation with our treasury advisors, in order to take advantage of any perceived anomalies in the yield curve. The reasons for any debt rescheduling will include:

- The generation of cash savings at minimum risk;
- In order to amend the maturity profile and/or the balance of volatility of the long-term debt portfolio.

7.9 Outturn for 2003/04

7.9.1 Shorter-term interest rates – Base rate was unexpectedly cut from 4.0% to 3.75% in February 2003 as Iraq war fears dampened growth prospects. A further cut to 3.5% in July was the bottom of this interest rate cycle. Rapidly improving growth prospects in the US from late July provoked a turn around in market expectations to increases in base rate, the first of which duly came in November to 3.75%, to be followed by a further increase in February 2004 to 4.0%.

7.9.2 Longer-term interest rates – The PWLB lower quota 25-30 year rate started the year at 4.80% but fell to a bottom of 4.40% in Mid June 2003. However, the rapid increase in growth prospects in the US in July pushed this rate back up to a range of 4.90 - 5.50% until late December, after which it eased back to 4.75% by the end of March 2004.

7.10 Debt performance – As highlighted in section 7.5.1 above, the average debt portfolio interest rate has moved over the course of the year from 9.77% to 4.10%. The approach during the year was to fund borrowing from surplus cash and to take advantage of opportunities to reschedule debt as and when favourable conditions arose.

7.10 Compliance with Treasury Limits

7.10.1 During the financial year the council operated within the treasury limits set out in the Council's Treasury Policy Statement and Treasury Strategy Statement.

7.11 Investments Strategy for 2002/03

7.11.1 The London Borough of Barnet manages its investments in-house and invests within the institutions listed in the authority's approved lending list. The authority invests for a range of periods from overnight to 364 days, dependent on its cash flows and the interest rates on offer.

7.11.2 Temporary investments would be made to cover cash flow needs. Market conditions would be monitored and investments made to optimise returns. Appendix B shows the investment returns available during the year.

7.12 Investment Outturn for 2002/03

7.12.1 Detailed below is the result of the investment strategy undertaken by the Council:

	Average Investment	**Rate of Return**	**Benchmark Return**
Internally Managed	**£60.6 m**	**3.75%**	**3.52%**

7.12.2 The benchmark return for internally managed funds is the average 7 day LIBID rate (uncompounded) sourced from the Financial Times. As can be seen from the above, the Council exceeded the benchmark return for 2003/04 by 0.23%. Based on the average balance invested for the year, this produced £139,380 in interest receivable. This was achieved by investing available balances over a range of periods (to 364 days) and monitoring fluctuations in interest rates to achieve the best return possible.

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

7.13 Debt Rescheduling

7.13.1 The Borough Treasurer, in consultation with the Cabinet Member for Resources and the Cabinet Member for Housing and Environmental Health, and after seeking independent financial advice from Sector, our treasury management specialists, decided under delegated powers to redeem the PWLB debt on 31 March 20004. This decision was reported to Cabinet Resources on 22 April 2004. The reasons for this debt repayment were:-

- To reduce interest costs on overall borrowing by undertaking new borrowing at current (lower) rates – the year end PWLB rates averaged 4.75%. Although this results in a reduction in interest charges to the general fund, this could be offset if there is a need to increase prudential borrowing

- To smooth the Council's debt maturity profile
- To become debt free on 31 March 2004 so that the Council could qualify for a transitional reduction in the payment of HRA capital receipts into the national pool

The movement in interest rates for the year is given as Appendix A to this report.

7.14 Amendments to the Council's Approved List of Investment Counterparties

7.14.1 The Council's Treasury Policy Statement places responsibility for the management of all cash flows, investments and borrowings with the Borough Treasurer.

When the Council does not immediately require funds to meet expenditure those funds are invested through the London Money Markets. In order to minimise the risk of the Council losing any of the funds lent, the Council maintains a strictly controlled list of the institutions to which it may lend money.

The Borough Treasurer formulates suitable criteria for assessing and monitoring the credit risk of investment counterparties, in conjunction with its treasury advisors, and constructs a lending list comprising type, sector and specific counterparty limits.

The Borough Treasurer wishes to amend the current counterparty list by changing the number of building societies to whom it may lend money, from the top 30 to the top 15 as rated by the Butlers Building Society Guide. The amendment is required to reflect the reduction in the Council's cash balances available for investment purposes over the last few years and the need for such a large counterparty list. The change will also allow the Council only to deal with societies that are rated by credit rating agencies such as Moody's and Fitch and have group assets in excess of £2,000M. In addition the limits will be changed as defined in appendix C.

The credit rating criteria and limits for other counterparties will remain unchanged.

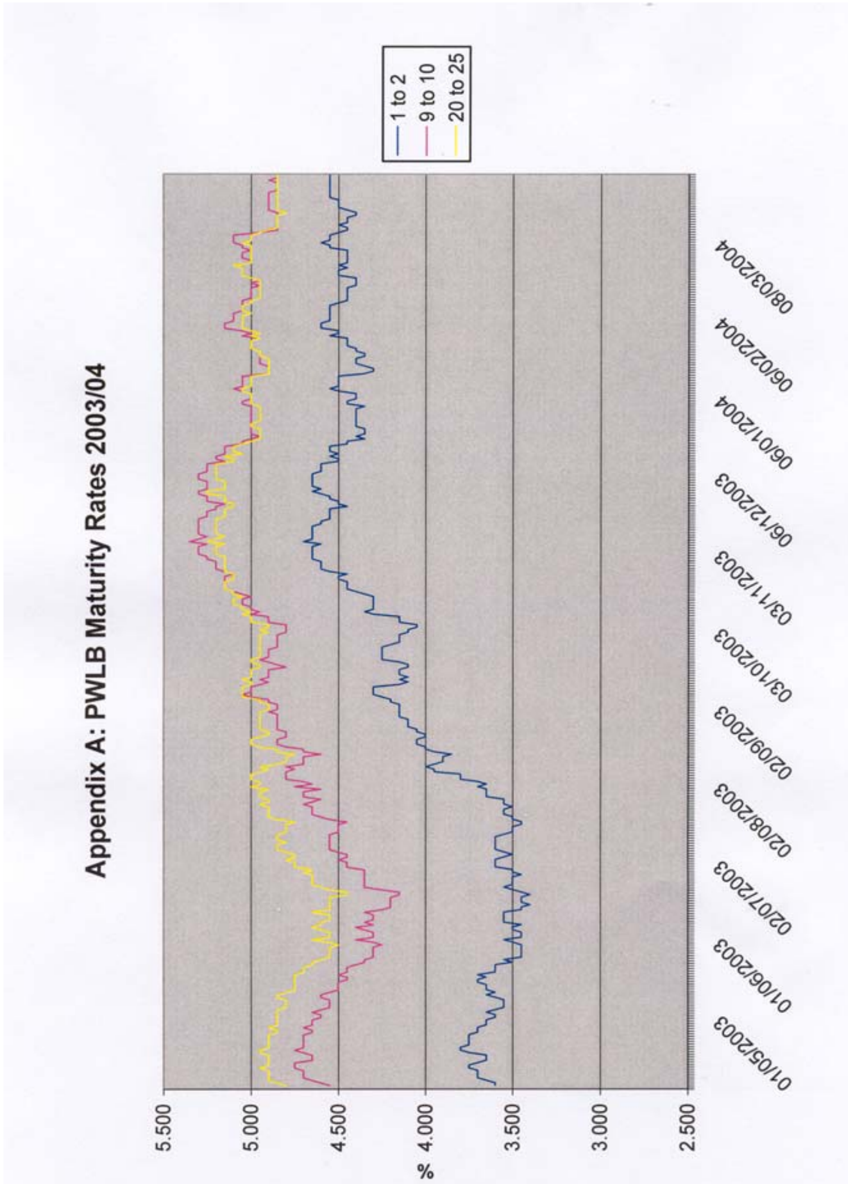
8 LIST OF BACKGROUND PAPERS

8.1 Treasury Management in Local Authorities – CIPFA's Code of Practice 1996 and revision 2001.

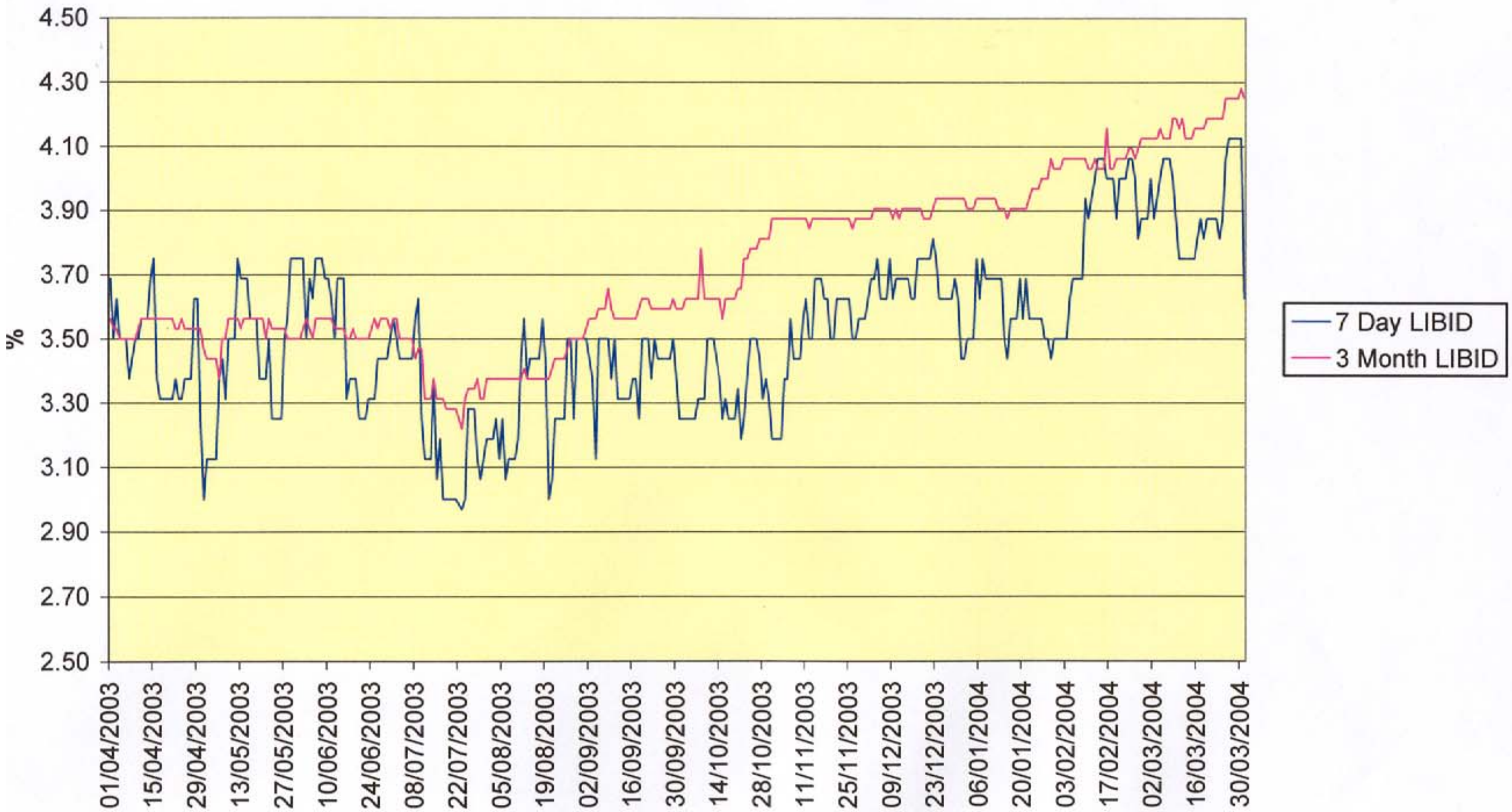
8.2 Any person wishing to inspect these papers should telephone 020 8359 7119.

MO (JEL)

BT (CM)


Appendix A: PWLB Maturity Rates 2003/04
5.500
5.000
4.500
4.000
3.500
3.000
2.500
%
01/05/2003
01/06/2003
02/07/2003
02/08/2003
02/09/2003
03/10/2003
03/11/2003
06/12/2003
06/01/2004
06/02/2004
08/03/2004
1 to 2
9 to 10
20 to 25

Appendix B: Investment Rates 2003/04



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Appendix C
London Borough of Barnet Amended Lending List

Counterparty type	**Key**	**Limit £'000**
Clearing Banks and their wholly owned subsidiaries	**A**	**10,000**
Banks wholly owned by the Bank of England		**10,000**
Merchant Banks who are accepting Houses Credit rating A1, Legal rating 3		**5,000**
Merchant Banks who are accepting Houses Credit rating A1, Legal rating 4	**B**	**2,000**
Other Local Authorities		**7,000**
Other Public Bodies		**5,000**
Top 15 Building Societies:-		
Top 5	**C**	**10,000**
6 to 10	**D**	**7,000**
11 to 15	**E**	**5,000**
Other Financial Institutions and Banks:- Abbey National plc Alliance & Leicester plc Bradford & Bingley plc Bristol & West plc HBOS Northern Rock Woolwich plc		**10,000**
Overseas Banks with AAA/A1+ credit rating	**F**	**10,000**

Key:

A

Bank of Scotland plc:-
- British Linen Bank
- Bank of Wales

Barclays Bank plc
Co-operative Bank Ltd
Lloyds TSB Group:-
- TSB Group Holdings

HSBC Bank plc:-
- Forward Trust
- Midland Bank Finance Corp.

Royal Bank of Scotland:-
- National Westminster Bank plc
- Lombard & Ulster Bank
- Ulster Bank Markets

B

N M Rothschild

C

Nationwide
Britannia
Yorkshire
Portman
Coventry

D

Chelsea
Skipton
Leeds & Holbeck
West Bromwich
Cheshire

E

Derbyshire
Principality
Newcastle
Norwich & Peterborough
Stroud & Swindon

F

ABN AMRO Bank
Allied Irish Bank
Australia & New Zealand Banking Group
Banco Bilbao Vizcaya Argentaria
Banco de Credito Local de Espana SA
Banco Espanol de Credito
Banco Santander Central Hispano
Bank Netherlandse Gemeenten
Bank of America NA
Bank of Ireland
Bank of Montreal
Bank of New York
Bank of Nova Scotia
Bank of Scotland plc
Bank One, N.A. (Chicago)
Banque Generale du Luxembourg
Bayerische Landesbank Girozentrale
BNP Paribas
Caixa Geral de Depositos
Canadian Imperial Bank of Commerce
CDC Ixis Capital Markets
Citibank International Bank
Citibank N.A.
Commonwealth Bank of Australia
Confederacion Espanola de Cajas de Ahorros
Credit Agricole
Credit Lyonnais
Credit Suisse First Boston
Credit Suisse First Boston International
Danske Bank
Depfa Bank plc
Deutsche Bank AG
Dexia Bank
Dexia Banque Internationale a Luxembourg
Dexia Credit Local
First Active plc
Fleet National Bank
Fortis Bank

F CONT'D

Hongkong and Shanghai Banking Corporation
HSH Nordbank AG
ING Bank
KBC Bank
Landesbank Baden-Wuerttemberg
Landesbank Berlin
Landesbank Hessen-Thuringen Girozentrale
Landesbank Rheinland
Landwirtschaftkiche Rentenbank
Mellon Bank NA
Merrill Lynch International Bank Ltd
National Australia Bank
Norddeutsche Landesbank Girozentrale
Nordea Bank Denmark
Nordea Bank Finland
Nordea Bank Norge SA
Nordea Bank Sweden
Northern Trust Company
Rabobank International
Royal Bank of Canada
Royal Bank of Scotland
Sabpaolo IMI
Societe Generale
State Street Bank & Trust Co
Svenska Handelsbanken
Toronto-Dominion Bank
UBS AS
UBS Warburg
UniCredito Italiano
WestLB Bank
Westpac Banking Corporation