

REVIEW OF TREASURY MANAGEMENT STRATEGY

Report of the Chief Financial Officer

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1. Purpose of report

To report on Treasury Management activities and strategy in 1999/00 and the first six months of 2000/01 and to seek Cabinet endorsement to the proposed Treasury Management strategy for 2001/02 in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) "Code for Treasury Management in Local Authorities".

It is proposed that the Resources Select Committee on 25 January be given the opportunity to comment prior to the strategy being brought back to the Cabinet / Executive Committee for final approval on 29 January 2001.

2. Summary

1999/00

Average daily balances were £49.3m and short term lending earned interest at an average rate of 5.60%. This was in excess of the average 1 month London Interbank Deposit (LIBID) rate of 5.35%.

Long term borrowing increased by £6.1m to £109m during 99/00 and the average weighted interest rate was reduced from 6.7% to 6.08%.

2000/01

Average daily balances from April to September 2000 were £61.5m and short term lending earned interest at an average rate of 6.08%. The average 1 month London Interbank Deposit (LIBID) rate was 5.90% in the period.

No loans are due to mature in 2000/01 and there are no restructuring plans but PWLB rates will be continually reviewed to identify any opportunities for reducing interest payments through restructuring in the future.

2001/02

The strategy in 2001/02 will be to invest core balances for longer periods when longer term interest rates are higher than short term rates, to maximise interest receivable.

There are no loan maturities in 2001/02. PWLB rates will continue to be monitored to identify any savings to be made from debt restructuring. However, due to the static nature of PWLB rates currently, there are likely to be less opportunities than in previous years.

3. Conclusion

Treasury Management strategy in 1999/00 resulted in interest earned outperforming the F.T. 1 month LIBID rate, and a reduction in the average PWLB rate.

The aim of the strategy in 2000/01 is to continue to maximise interest earned on investments by investing for longer periods where possible whilst taking full advantage of any opportunity to reduce the rate of interest paid on long term borrowings.

The strategy in 2001/02 will be to maximise interest earned on investments by investing core balances for longer periods and to keep the level of borrowing under review to be ready to take any opportunities to reduce the rate of interest paid.

1. Background

1999/00 Strategy

The 1999/00 Treasury Management Strategy was reported to Policy Operations Sub-Committee on 11 March 1999. It anticipated interest receivable of £1.9m and PWLB interest payable of £6.3m, equating to 6.13%.

2000/01 Strategy

The 2000/01 Treasury Management strategy was reported to Policy Operations Sub Committee on 13 April 2000. The Strategy anticipated interest receivable of £2.8m. No additional borrowing was planned and PWLB interest payable was expected to be £6.4m, equating to 6.05%.

2001/02 Strategy

The CIPFA Code for Treasury Management in Local Authorities states that before the start of the financial year, the Treasury Management strategy for the year should be reported to the Council

2. Treasury Management Activities and Strategy during 1999/00

Short term lending

Provisional figures were reported to the Policy Committee 13 April 2000. The actual figures are confirmed below.

Table 1 – Summary of interest rates achieved

	1999/00	1998/99
Average daily balances	£49.3m	£45.7m
Average weighted interest earned	5.60%	6.89%
Average base rate	5.83%	6.85%
Average local authority 7-day rate	5.18%	6.70%
Average F.T.1 month LIBID	5.35%	6.71%

The average weighted interest earned outperformed both the local authority 7 day rate and the F.T.1 month LIBID. (The F.T. 1 month LIBID is the benchmark rate being used in the current year. Butlers, our Treasury management advisors, suggested this is a more realistic benchmark than the Local Government 7 day rate which is much lower).

The average weighted interest earned was less than the average base rate during 1999/00. During that year the higher rates were seen in the later part of the year when balances are lower and therefore there are fewer investment opportunities. When the budget for interest earned is set, the rate used is

0.25% less than average expected base rate, as this is a realistic target. In 99/00 average interest earned was 0.25% in excess of the F.T. 1 month LIBID rate, which reflects rates achievable in the London money market.

Long Term Borrowing

Total outstanding debt increased by £6.1m over 1999/00. Table 2 sets out the loan repayments and new borrowings during the year.

Table 2 - Loan Movements 1999/00

	£m
Total debt outstanding 1.4.99	102.9
Long-term debt repaid prematurely (Debt restructuring exercises)	(3.9)
Long-term debt renewed	7.0
Long Term debit borrowed 27.3.00 @ 4.875 and 5.0%	3.0
Total debt outstanding 31.3.00	<u>109.0</u>

All outstanding loans at 31st March 2000 were with the Public Works Loan Board (PWLB). The average weighted rate of interest on external loans was reduced from 6.7% in 1998/99 to 6.08% in 1999/00.

This was achieved by:-

- a) Taking two loans totalling £7m in September 1999 @ 5% for 42/43 years
- b) premature repayment of a 16 year loan @ 5.75%, resulting in an early repayment discount of £137k.
- c) taking two further loans in March 2000 of £2.4m @ 5% and £0.7m @ 4.875% both for 16 years.

3. Treasury Management Strategy 2000/01

Short Term Lending

Average daily balances for April to September 2000 were £61.5m. £8.3m higher than for the corresponding period in 1999.

The average rate of interest earned in the first six months of 2000/01 was 6.08% compared to an average base rate of 6.0% and an average F.T.1 month LIBID rate of 5.90%.

The Bank of England Monetary Policy Committee (MPC) increased base rate to 6.0% in February and has left the rate on hold for eight months. This resulted in a decrease in long-term rates (up to 1 year). Overnight rates fluctuated between 5.37% and 6.37% as a result of uncertainty in the markets about future base rate rises. This fluctuation has resulted in the achievement of some very high rates, and has contributed to an average rate of interest earned in excess of average base rate during this period.

The advice from Butlers and from other economic forecasters is that they expect one further rise in UK base rates and a slight easing in short-term interest rates towards the end of next year.

The decision was therefore taken to continue investing some of the County Council's balances for 364 days. The strategy has been to monitor long term rates and be prepared to take advantage of intra-day peaks in the rates. Small amounts have been placed each time there has been an upward movement which met the target rate set for longer term investment.

Date	Lender	£M	Rate
15/05/00	Depfa Bank Europe	1	6.75
12/06/00	Irish Life & Permanent plc	1	6.59
27/07/00	Irish Life & Permanent plc	1	6.50
21/08/00	Norwich & Peterborough B. Society	1.4	6.40
30/08/00	Irish Life & Permanent plc	1.0	6.50

The remaining balances have been lent for periods up to 6 months in order to maximise interest earned whilst ensuring that cash is available to meet the County Council's liabilities on a daily basis.

Although the majority of forecasters are now predicting one further increase in base rate (to 6.25%) the mildly positive yield curve out to one year tends to reflect consensus opinion that the UK is at or close to the top of the present base rate cycle.

Funds will continue to be invested for the longest possible periods, up to the maximum of 364 days to take advantage of the higher interest rates offered by the interest yield curve whilst still ensuring sufficient cash is available to meet short term requirements.

Long Term Borrowing

The County Council's Treasury Management advisors, Butler's, current forecast, along with those of other economic forecasters, indicates that long-term PWLB rates will remain around the present level, subject to short-lived fluctuations, with short-term rates continuing to rise. Any new borrowing will therefore be for longer maturity periods, up to 25 years.

There are no loan maturities in 2000/01.

There are no plans at this stage to take out any additional borrowing to fund capital expenditure, but the effect of this policy on cash balances will be monitored and possibly reviewed if balances fall below the average level needed to meet the County Council's regular monthly commitments, without resorting to significant short term borrowing.

Butlers will advise of any savings to be made during the year from restructuring debt more than 1 year old. This advice will be considered and, where significant cost savings are identified, will be acted upon.

The total level of debt at 31 March 2001 is still expected to remain within the range of £100 to £115 million.

4. Treasury Management Strategy 2001/2002

Short Term Lending

Forecasters are now predicting that base rates will reach a peak of 6.25% by end of 2000 and remain at that level until the summer of 2001, before starting to fall again. The accuracy of this scenario depends on the level of UK growth, inflation and sterling exchange rate in addition to interest rate movements in Europe and the US.

Whilst longer term rates remain higher than the short term ones, the strategy will be to invest core balances of around £15m for periods of three months to 364 days to lock into the more attractive rates, whilst ensuring significant short term borrowing is not required.

Cash flow forecasts indicate an average daily balance of approximately £50m, similar to that in 1999/00.

Long Term Borrowing

Current economic forecasts indicate that long-term PWLB rates will remain around the present level, subject to short-lived fluctuations. It is expected that short-term rates will remain higher than longer term ones and therefore any borrowing will be for longer maturity periods up to the PWLB's maximum period of 25 years.

The debt portfolio will be continually reviewed, in conjunction with Butlers, our Treasury Management advisors, to identify restructuring opportunities, which will reduce interest levels and generate discounts for early redemptions.

Debt restructuring involves the repayment of existing borrowing using funds generated by new borrowing at lower interest rates, usually for a different maturity period, thus generating interest savings.

A significant amount of restructuring has been undertaken over the past three years to reduce the interest level of the portfolio. As a result of this and the current static nature of PWLB rates, restructuring opportunities are less likely in 2001/2002, however this will be kept under review and where significant cost savings are identified, action will be taken.

There are no loan maturities in 2001/02. There are no plans at this stage to take out additional borrowing to fund capital expenditure, but the effect of this on cash balances will be monitored. If balances fall below the average level required to meet the County Council's regular monthly commitments, without resorting to significant short term borrowing, this policy will be reviewed.

The total level of borrowing is expected to remain within the range of £100 to £120 million. The County Council's maximum borrowing limit is over £200m.

5. Financial Implications

2000/2001

The estimated interest payment on PWLB loans in 2000/01 is £6.5m, giving an average interest rate on the loan portfolio of 6.01%.

The anticipated interest receivable from short term lending in 2000/01 is £3.1m of which £2.7m is allocated to schools as interest on their balances. This is higher than previously projected, as a result of increased balances, partly due to pension funds to be paid to Fund Managers in October 2000.

2001/2002

The estimated interest payments on PWLB loans in 2001/02 is £6.56m, giving an average interest rate on the portfolio of 6.02%.

The anticipated interest receivable from short term lending in 2001/02 is £2.9m.

Background Papers used in preparing this report:

1996	CIPFA Code of Practice on Treasury Management
13 April 2000	Policy Committee Agenda Item 7 "Treasury Management Strategy for 200/01"
October 1999	Butler Asset Finance – Debt Restructuring for Hertfordshire County Council