HERTFORDSHIRE COUNTY COUNCIL

THURSDAY 14 FEBRUARY 2002 AT 10.30 AM

Agenda Item No:

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TREASURY MANAGEMENT STRATEGY INCLUDING BORROWING STRATEGY

Report of the Finance Director considered by the Cabinet on 28 January 2002

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Executive Member:- David Beatty

1. Purpose of the report

To seek Council approval to the, Treasury Management Strategy for 2002/03, including the Borrowing Strategy.

2. Background

2.1 The new CIPFA Code of Practice for Treasury Management in the Public Services sets out a framework for policies and procedures. This consists of four key clauses, a treasury policy statement and treasury management practices, which need to be adopted by the authority.

2.2 Average daily balances from April to December 2001 were £75m and short term lending earned interest at an average rate of 5.04%. The average 1 month London Interbank Deposit (LIBID) rate was 4.88% in the period.

2.3 In April 2001, on the advice of the County Council's Treasury Management advisors, Butlers, £7m of PWLB debt with an interest rate of 5% was repaid and replaced with a loan from Barclays Bank at a rate of 4.6%. During August, on Butlers advice, £10m was borrowed from the PWLB. The debt portfolio is now £119m with an average interest rate of 5.94%.

2.4 As interest rates are expected to rise during 2002/03, an appropriate strategy is to invest funds not immediately required for longer periods to achieve higher returns.

2.5 There are no loan maturities in 2002/03. No new funds are required at present, however the cash position will be carefully monitored. Any debt rescheduling opportunities likely to provide significant benefits in the medium/long term will be taken.

2.7 In 2001/02 interest was earned above the benchmark rate and the average rate paid on borrowing reduced from 6.02% in 2000/01 to 5.94%.

2.8 The aim of the strategy in 2002/03 should be to continue to maximise interest earned on investments by investing for longer periods where possible whilst taking advantage of any opportunity to reduce the rate of interest paid on long term borrowings.

The Cabinet on 28 January resolved:

1. *"That the new CIPFA Code of Practice, providing a clear framework for treasury management policies and decision making, be adopted.*

2. *That the treasury management strategy for 2002/03 be approved."*

The approval of the County Council is required as the Borrowing Strategy, included within the Treasury Management Strategy , forms part of the Council's Policy Framework.

3. Recommendation from Cabinet:

That the Council approves the Treasury Management Strategy for 2002/03.

1. Background

1.1. In December 2001 CIPFA published "Treasury Management in the Public Services: Code of Practice." This replaces the last issue of the Code of Practice published in 1996. The reasons for the new publication were to reflect the increasing size of treasury management activities, to address risk management, performance measurement and best value.

1.2 The Code of Practice recommends that a review of treasury management performance is undertaken after the end of the financial year. This review was circulated to members in October 2001 for 2000/01. This report provides an update on the performance to the end of December in 2001/02.

1.3 Both the new and previous versions of the Code of Practice recommend that an annual strategy for treasury management be prepared and approved in advance of the new financial year.

2. CIPFA Code of Practice

2.1 The Code of Practice sets out a clear framework for the policies and procedures in Treasury Management. The top level of this is a set of four clauses that it recommends are adopted by authorities:

"1. This organisation adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 4 of that Code.

2 Accordingly, this organisation will create and maintain, as the cornerstones for effective treasury management:

- *a treasury management policy statement, stating the policies and objectives of its treasury management activities,*
- *suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control these activities.*

3. This organisation will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, and an annual report after its close, in the form prescribed in its TMPs.

4. This organisation delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Cabinet, with scrutiny by Resources, Prosperity Partnership and Consultation Committee, and for the execution and administration of treasury management decisions to the Finance Director, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management"

2.2 The next level of the framework is the Treasury Management Policy Statement, referred to in the second clause above. This has been shortened in the new Code of Practice to be a more strategic document. Approval is not required for this statement, but it is provided in Appendix A for members' information.

2.3 The final part of the framework is the set of Treasury Management Practices (TMPs). This is designed to be a set of policies and procedures covering all the areas of treasury management. It will form a document for reference on a day-to-day basis. The TMPs are currently being drawn up to replace the existing Treasury Systems Document, which was required under the old Code of Practice. It is planned that this work will be completed by the end of March 2002, in time for the new financial year.

3. Performance in 2001/02 to Date

Short Term Lending

3.1 Average daily balances for April to December 2001 were £75m. This was £17m higher than for the corresponding period in 2000 and there are several contributory factors:

- £5m invested for the Pension Fund for 364 days
- £15m was received in respect of the Sir John Newsom School
- £10m borrowed in anticipation of capital expenditure later in the year

3.2 The average rate of interest earned in the first nine months of 2001/02 was 5.04% compared to an average base rate of 4.89% and an average F.T.1 month LIBID rate of 4.88%.

3.3 The Bank of England Monetary Policy Committee (MPC) made six base rate reductions between April and December, from 5.75% down to 4.0%. This resulted in a decrease in long-term rates (up to 1 year). Overnight rates fluctuated between 6.25% and 3.25% as a result of uncertainty in the markets about future base rate cuts.

3.4 The decision was taken to continue investing some of the County Council's balances for 273 and 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 shown below, 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
12/06/01	Depfa Bank Europe	1.87	5.28
14/06/01	Irish Life & Permanent plc	1	5.50
01/05/01	Stroud & Swindon Building Society	1	5.19
21/05/01	Newcastle Building Society	1.5	5.27
06/06/01	Norwich & Peterborough	1.0	5.30

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

3.6 Although the majority of forecasters are now predicting one further decrease in base rate (to 3.75%) the mildly positive yield curve out to one year tends to reflect consensus opinion that the UK is at or close to the bottom of the present base rate cycle.

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

Long Term Borrowing

3.8 Butlers the County Council's Treasury Management advisors, continually monitor the debt portfolio to seek out opportunities to restructure the portfolio in order to generate savings.

3.9 In April 2001 £7m of PWLB debt with an interest rate of 5% was repaid and replaced with a loan from Barclays Bank at a rate of 4.6%. The loan is a 30 year loan, and the rate is fixed for the first two years. After two years, Barclays have the right to change the rate, and the County Council has the right to repay penalty-free if the rate is not competitive at that time. This restructuring has produced annual savings of £28,000.

3.10 Butlers advised the County Council that extra borrowing of £16m was required in 2001/02 following a study of the 2000/01 balance sheet and the capital approvals, in order to meet cash flow requirements.

3.11 In August Butlers advised that £10m of the borrowing be taken, as it was likely the longer term PWLB rates would start to rise again. This was carried out and £7m was borrowed from the PWLB at 5% and £3m at 5 1/8%. Due to reserving capital receipts in the past a limited amount can be borrowed at the PWLB's lower tier rate. The rate available currently is 5¼% .

3.12 The debt portfolio is now £119m with an average interest rate of 5.94%. The further £6m, which the County Council has been advised to borrow this year is not going to be taken, as cash balances are running high (see 3.1).

4. Strategy for 2002/03

Interest Rates

4.1 The latest interest rate forecast provided by Butlers, our Treasury Management advisors is shown below:

	Base Rate
December 2001	4.00%
March 2002	3.50 – 3.75%
June 2002	3.50 – 3.75%
September 2002	4.00%
December 2002	4.25%
March 2003	4.50%

4.2 This forecast shows that it is expected that rates will be on a rising trend by the autumn of 2002. As the performance of inflation is set to remain favourable, the rise in base rate is likely to be modest and limited.

Investment Strategy

4.3 Against this backdrop, some of the funds not required to cover immediate cash flow requirements will be placed longer term (up to 364 days) at rates above 4% in order to provide better performance than the necessary short-term deals and also provide some budgetary certainty.

4.4 In a recent consultation paper, the DTLR proposed setting up a "Debt Management Account Deposit Facility". This would be a sovereign triple A rated facility designed to take small amounts of funds, which the market is generally unwilling to consider, at market rates of interest. It is expected that this will be introduced during the 2002/03 financial year and the Finance Director recommends that HCC should include this facility on its lending list.

Borrowing Strategy

4.5 The forecast for interest rates is likely to result in longer-term rates (up to 25 years) for borrowing rising during the year resulting in short-term rates being lower and hence being more attractive. This also suggests that variable rate loans would also be attractive.

4.6 2001 has seen high cash balances for HCC (on average £75m), for the reasons set out in 3.1. Until this situation changes, it should not be necessary for HCC to borrow any new funds. There are no loan maturities in the year.

4.7 The cash flow position will be monitored closely, so that if new funds are required they are borrowed at the most advantageous interest rate. Butlers' advice on the best period over which to borrow will be taken in the event of new funds being required. The expectation for interest rates shows that shorter term borrowing will be more attractive and this would fit in with the current debt maturity profile which shows there are no loan maturities until 2014. The level of long term borrowing is currently £119m and the maximum possible in 2002/03 is £150m. The maximum proportion of variable rate loans permitted within the portfolio is 30%.

4.8 It is recommended that the Public Works Loans Board (PWLB) remains the major source of funding, but that other market sources are considered under the advice of HCC's Treasury Management advisors, Butlers.

4.9 It is also recommended that debt rescheduling opportunities are constantly sought, and taken if significant savings can be made over the medium/long term. The fact short term rates will be less than long term ones suggest there are likely to be some attractive debt rescheduling opportunities, particularly as the PWLB has relaxed its rules to allow one fixed rate loan to be replaced by another without the need for additional quota.

5. Financial Implications

5.1 The estimated interest payment on PWLB and Non PWLB loans in 2001/02 is £6.8m, giving an average interest rate on the loan portfolio of 5.94%.

5.2 The anticipated interest receivable from short term lending in 2001/02 is £3.5m of which £2.6m is allocated to schools as interest on their balances.

5.3 The interest payments on long term borrowing will be £7.03m in 2002/03 if no new funds are borrowed. This gives an average interest rate of 5.91% on the portfolio. Every £1m of new borrowing is likely to cost around £52,500 for a full year.

5.4 The anticipated interest receivable from short term lending is £2.4m in 2002/03 based on an estimated average interest rate of 4% and an average cash balance of £60m.

APPENDIX A

TREASURY MANAGEMENT POLICY STATEMENT

1. This organisation defines its treasury management activities as:

   "The management of the organisation'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".

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.