LONDON BOROUGH OF BRENT

EXECUTIVE – 22 SEPTEMBER 2003

REPORT FROM THE DIRECTOR OF FINANCE

For Decision | **Wards Affected**
None Specifically

THE TREASURY MANAGEMENT ANNUAL REPORT 2002/03

1 SUMMARY

1.1 The report details treasury management activity and performance during 2002/03.

2 RECOMMENDATIONS

2.1 Members are asked to recommend the report to full Council.

3 FINANCIAL IMPLICATIONS

3.1 As at 31st March 2003 the Council had external loans outstanding of £456.3m (1st April 2002 £481.8m) and cash investments of £64.4m (1st April 2002 £99.1m). In 2002/03 the Council incurred £39.7m in external interest charges (2001/02 £39.7m) and received £3.9m as interest on cash investments (2001/02 £3.4m).

4 STAFFING IMPLICATIONS

4.1 None.

5 DETAIL

5.1 Full Council adopted the 2002 CIPFA Code of Practice on Treasury Management in Local Authorities in September 2002. The Code stipulates that the Chief Financial Officer should set out in advance to Full Council the treasury strategy for the forthcoming financial year, and subsequently report the treasury management activities during that year. This report details treasury management activities during 2002/03.

5.2 Treasury management in this context is defined as 'the management of the local 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 the optimum performance consistent with those risks.' This means that the pursuit of additional returns must be placed within the framework of the prudent protection of the council's cash balances and a rigorous assessment of risk.

Economic Background During 2002/03

5.3 As in 2001/2, international concerns dominated the economic background. Interest rates continued to fall in a scenario of slow growth, financial scandals, concerns about deflation and international tension. The USA Federal deposit rate fell from 1.75% to 1.25% (1% June 2003), European Central Bank rate from 3.25% to 2.5% (2% June 2003), and Bank of England base rate from 4% to 3.75% (3.5% July 2003).

5.4 Long-term interest rates fell during the year as investors sought the safe haven status of government bonds, and put their confidence in a low inflation economic scenario. The table below shows ten and twenty-five year Public Works Loans Board (PWLB) rates during the year.

Table 1 – PWLB Interest rates during 2002/3

	April 2002 %	July %	November %	March 2003 %
10 year	5.5	5.25	4.875	4.55
25 year	5.375	5.125	4.875	4.8

STRATEGY AGREED FOR 2002/03

5.5 The Council agreed the following limits under Section 45 of the Local Government and Housing Act 1989:

* The overall borrowing limit £600m
* Maximum short term borrowing £150m
* Maximum proportion of interest on borrowing at variable rates 40%

There has been compliance with these limits.

5.6 On the basis of advice from economists and our own research, the Treasury Management strategy anticipated that base rate would rise to 5% - 5.25%. It was expected that in-house balances would be fairly low, but that balances would be lent for longer periods when it was felt that the market was too pessimistic about rising rates. The borrowing strategy assumed that long-term rates would also rise during 2002/3. It was therefore considered likely that there would be little borrowing activity apart from to maintain debt at the authority's credit ceiling and to take advantage of debt restructuring opportunities. (The credit ceiling is the difference between the authority's total liabilities in respect of capital expenditure financed by credit and the provision that has been made to meet those liabilities. Research by our treasury adviser, Sector, indicates that it is the most economical level for the authority's long-term debt.)

OUTTURN 2002/03

5.7 The Council's treasury portfolio as at 31 March 2003 was as follows:-

	31.3.02	31.3.2003	
	Actual £m	Planned £m	Actual £m
Fixed rate loans – PWLB	461.3	441	404.8
Variable rate loans – PWLB	20.5	20	16.0
Variable rate loans - Market	-		35.5
Short-term loans - Market	-	-	15.0
Total Debt	**481.8**	**461**	**471.3**
INVESTMENTS	**99.1**	**44**	**64.4**
NET DEBT	**382.7**	**397**	**406.9**

5.8 During 2002/03 the authority has restructured long-term debt, repaying PWLB loans to the value of £35.5m (average rate 9.16%) and borrowing market loans (known as LOBOs – or Lenders Option, Borrowers Option. These loans are fixed at an average rate of 5.392% for an initial period (2 – 3 years, following which the lender may request a change to the rate. If this happens, the borrower may repay the loan rather than pay the increase. The rates of interest include an additional element to cover the PWLB premium assumed by the lender. The restructuring sought to take advantage of very low market rates to repay high coupon PWLB debt. In addition, £21m debt at 4.93% was replaced by £16m at variable rate, starting at 4% but currently 3.56%. The average rate of interest payable by Brent Council fell from 8.37% in 2001/2 to 8.15% in 2002/3 (and is expected to fall further in 2003/4 as expensive debt matures)

5.9 As at 31st March 2003, the debt portfolio was as follows:-

Maturing Within	£m	Average Rate (%)
1 Year	11.6	9.8
1 – 2 years	16.0	4.0
2 – 3 years	-	-
3 – 4 years	5.0	10.125
4 – 5 years	9.5	9.039
5 – 6 years	17.5	8.304
6 – 10 years	29.5	10.267
10 – 15 years	156.9	10.014
Over 15 years	174.8	6.814
Variable	35.5	5.392

5.10 The in-house team has lent a total of £1042m (2001/2 £1429.4m) at rates between 3% and 5.125%, and at an average rate of 4.46%. The lending strategy followed was to lend money for short periods, then seek opportunities to lend for longer as the market anticipated sharply rising interest rates. Economic research and advice from Sector indicated that rates would not rise in the near-term. Loans were made to high quality counterparties included on the Treasury Lending list.

5.11 Other budgetary details for 2002/3 were as follows:

	Budget £m	**Actual £m**
Interest paid on external debt	39.0	39.7
Interest received on deposits	2.3	3.9
Debt management expenses	0.2	0.2

The additional interest paid reflects an increase in average debt outstanding during the year, offset by savings arising from debt restructuring. The General Fund has been further disadvantaged by a reduction in the share of interest charged to the Housing Revenue account. The additional interest received on deposits reflects the increased level of balances, offset by sharply falling rates.

EXTERNAL CASH MANAGERS

5.12 Aberdeen Asset Management and Dresdner RCM Global Investors were appointed in 1998 to manage two portfolios with the aim of achieving an improved return (0.5% above the benchmark) at an acceptable level of risk. Morley Fund Management replaced Dresdner in 2002 when the latter exited the treasury management business, passing clients to Morley. The value of the Morley's portfolio was £22.8m as at 31st March 2003, whereas Aberdeen's was £11.3m. Actual performance for 2002/03 (2001/02 in brackets), and the three years to 2002/3 has been as follows: -

	Aberdeen %	**Dresdner/ Morley %**	**Brent in-house %**	**7 Day LIBID Benchmark %**
2002/2003	4.28(5.30)	3.98(5.01)	4.46(4.72)	3.9(4.49)
Three Years	5.3	5.3	5.0	4.7

5.14 It can be seen that both managers outperformed the benchmark in 2002/03. The margins of outperformance were limited by concerns that gilt markets had become overvalued and that the risk of capital loss had increased. The in-house team did not have access to the same wider range of lending instruments as the managers (gilts or certificates of deposit), but was able to outperform more significantly by lending on the money market for longer periods at appropriate times. The three-year records indicate that managers have achieved their benchmark over the longer period.

DEVELOPMENTS SINCE THE END OF THE YEAR

5.15 Short-term interest rates have continued to be very low during 2003/04, with overnight rates occasionally falling below 3%. It is thought that base rate may fall further towards 3%. Longer-term rates have risen as investors have regained confidence following the conclusion of the war in Iraq, and on expectations of economic recovery.

5.16 Concerns about the long-term future of Aberdeen Asset Management were addressed in an in-depth visit to the manager’s offices. The performance of Morley Fund Management continues to be closely monitored.

5.17 It is anticipated that there will be opportunities in 2003/4 for debt restructuring by moving more of the portfolio into variable rates to take advantage of low short-term rates and regulatory changes.

6 BACKGROUND INFORMATION

Loans Register.

Logotech Loans Management System.

Sun Accounting Database.

Treasury Policy Statement.

Sector Quarterly and special reports on treasury management.

Morley Fund Management and Aberdeen Asset Management quarterly reports.

Executive – Treasury Management Annual Report 2001/02 – September 2002.

If members wish to discuss any aspect of this report please contact the Exchequer and Investment Team, Room 115, Brent Town Hall (extension 1472/1474).

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