LONDON BOROUGH OF BRENT

EXECUTIVE – 12th July 2004

REPORT FROM THE DIRECTOR OF FINANCE

For Decision | **Wards Affected**
None Specifically

THE TREASURY MANAGEMENT ANNUAL REPORT 2003/04

BFS-03/04-77

1 SUMMARY

The report details treasury management activity and performance during 2003/04.

2 RECOMMENDATIONS

Members are asked to recommend the report to full Council.

3 FINANCIAL IMPLICATIONS

As at 31st March 2004 the Council had external loans outstanding of £495.9m (1st April 2003 £471.3m) and cash investments of £74.9m (1st April 2003 £64.4m). In 2003/04 the Council incurred £35.2m in external interest charges (2002/03 £39.7m) and received £3.0m as interest on cash investments (2002/03 £3.9m).

4 STAFFING IMPLICATIONS

None.

5 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 DETAIL

6.1 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 2003/04.

6.2 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 2003/04

6.3 International concerns dominated the economic background at the start of the year. The USA Federal deposit rate fell from 1.25% to 1% in June 2003, the European Central Bank rate from 3.25% to 2%, and the Bank of England base rate from 3.75% to 3.5% (July 2003) as concerns about deflation and slow growth continued. However, economic growth resumed as the year progressed, leading the Bank of England to raise rates to 4% by year end.

6.4 Long-term interest rates rose during the year as investors regained their confidence, reduced their investment in gilts and anticipated rising interest rates. The table below shows ten and twenty-five year Public Works Loans Board (PWLB) rates during the year.

Table 1 – PWLB Interest rates during 2003/4

	3 April 2003 %	**2 July %**	**3 Nov. %**	**31 March 2004 %**
10 year	4.75	4.6	5.15	4.95
25 year	4.8	4.7	5.0	4.8

STRATEGY AGREED FOR 2003/04

6.5 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 borrowing at variable rates 40%

There has been compliance with these limits.

6.6 On the basis of advice from economists and in-house research, the Treasury Management strategy anticipated that base rate would rise to around 4.5%. It was expected that in-house balances would remain fairly stable, but 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 2003/4 (to 5% - 5.25%), but that short-term rates would only rise marginally. It was therefore agreed to borrow at variable rates, 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 2003/04

6.7 The Council's treasury portfolio as at 31 March 2004 was as follows:

	31.3.03 Actual £m	31.3.2004 Planned £m	31.3.2004 Actual £m
Fixed rate loans – PWLB	404.8	388.1	338.1
Variable rate loans – PWLB	16.0	26.0	89.8
Variable rate loans - Market	35.5	35.5	50.5
Short-term loans - Market	15.0	-	17.5
Total Debt	**471.3**	**449.6**	**495.9**
INVESTMENTS	**64.4**	**63**	**74.9**
NET DEBT	**406.9**	**386.6**	**421.0**

6.8 The average rate of interest payable by Brent Council fell from 8.13% in 2002/3 to 7.34% in 2003/4 (and is expected to fall further in 2004/5). The authority was able to take advantage of regulatory changes governing the charging of early redemption premia. Brent Council has restructured long-term debt and taken out new loans as follows:

a) Borrowing £15m market loans (known as LOBOs – or Lenders Option, Borrowers Option). These loans are fixed at an average rate of 4.0 % for an initial period (2 – 5 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.

b) In addition, £86.9m debt at 8.25% was replaced by variable rate debt, starting at 4.56% but currently 4.87%. The opportunity was taken to redeem high coupon debt, and eliminate all the Council's debt with a rate of 10% or higher.

c) Used borrowing approvals to fund £33m of the Brent Housing Partnership capital programme.

The Treasury team has taken advantage of very low rates available on occasions during the year on temporary borrowing. The lowest rate achieved was 2.8125% - this may be the cheapest rate at which Brent has ever borrowed money.

6.9 As at 31st March 2004, the longer-term debt portfolio (more than one year) was as follows (previous year in brackets):

Maturing Within	£m 2003/4	£m 2002/3	%	Average Rate (%)
1 Year	6.9	(11.6)	1.4	4.4
1 – 2 years	-			-
2 – 3 years	-			-
3 – 4 years	9.5	(5.0)	2.0	9.04
4 – 5 years	15.0	(9.5)	3.1	8.0
5 – 6 years	-	(17.5)		-
6 – 10 years	27.0	(29.5)	5.6	9.36
10 – 15 years	70.0	(156.9)	14.6	9.53
Over 15 years	209.7	(174.8)	43.9	6.47
Variable – PWLB	89.8	(16.0)	18.8	4.23
Variable - Market	50.5	(35.5)	10.6	4.83
TOTAL	**478.4**			

6.10 The in-house team has lent a total of £631m (2002/3 £1042m) at rates between 3.29% and 5.125%, and at an average rate of 4.28%. 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. The highest rate was achieved as a result of lending ahead of the date on which the deposit was made. Economic research and advice from Sector indicated that rates would not rise sharply. Loans were made to high quality counterparties included on the Treasury Lending list.

6.11 Other budgetary details for 2003/4 were as follows:

	Original Budget £m	Actual £m
Interest paid on external debt	37.6	35.2
Interest received on deposits	2.2	3.0
Debt management expenses	0.3	0.2

The reduced interest paid reflects an increase in average debt outstanding during the year, offset by savings arising from substantial debt restructuring. These savings between the budget and the actual are split between the Housing Revenue Account (HRA) and the General Fund in proportion to the share of debt payable (roughly two thirds payable by the HRA). The additional interest received on deposits reflects the increased level of balances – arising in part as a result of the borrowing undertaken on behalf of the Brent Housing Partnership - offset by lower than expected interest rates.

EXTERNAL CASH MANAGERS

6.12 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 £23.6m as at 31st March 2004, whereas Aberdeen's was £11.7m. Actual performance for 2003/04 (2002/03 in brackets), and the three years to 2003/4 has been as follows:

	Aberdeen %	Dresdner/ Morley %	Brent in-house %	7 Day LIBID Benchmark %
2003/2004	3.7 (4.28)	3.48 (3.98)	4.28 (4.46)	3.63 (3.9)
Three Years	4.4	4.1	4.5	4.0

6.13 Aberdeen marginally outperformed the benchmark in 2003/04, but Morley underperformed following some gilt purchases that lost value. The year was very difficult – there were concerns that gilt markets had become overvalued and that the risk of capital loss had increased. However, gilt markets are the main area in which external managers can add value. 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 by lending on the money market for longer periods at appropriate times – in particular, by lending in advance when market expectations of rising, or even steady, interest rates had become unrealistic. The three-year records indicate that managers have not achieved their outperformance target over the longer period, and a review of Morley is planned.

DEVELOPMENTS SINCE THE END OF THE YEAR

6.14 Short-term interest rates have risen during 2004/05. It is thought that base rate may rise above 5% by the end of the year. Longer-term rates have also risen as markets anticipate further base rate increases to cool the housing market / borrowing / economic recovery.

6.15 It is anticipated that there will be opportunities for debt restructuring in 2004/5 as long-term rates rise.

7 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 2002/03 – September 2003.

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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