Report to: **Council**

Subject: **Annual Treasury Activity Report 2004/2005**

Date: **22 June 2005**

Author: **Head of Finance**

1. PURPOSE OF REPORT

To inform Members of the Annual Treasury Activity Report as required by the Treasury Management Strategy.

2. BACKGROUND

Gedling Borough Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management 2001, which has been formally adopted by the Council. The primary requirements of the code are:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.

- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by Council of an annual Treasury Management Strategy Statement (TMSS) for the year ahead, and an Annual Report detailing the Treasury activities for the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.

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 optimum performance consistent with those risks.”

3. ANNUAL TREASURY ACTIVITY REPORT 2004/05

This report combines two previous reports, in respect of treasury borrowing and treasury investment. It covers:

- **The Council’s current treasury position**

  The Council’s debt and investment position at the beginning and end of the year is shown at Appendix 1.

- **Performance Measurement**

  One of the key changes in the revision of the Code of Practice has been the formal introduction of performance measurement relating to investments, debt and capital financing activities. The use of benchmarks such as the 12-month LIBID for investments is problematic for local authorities with relatively small cash balances, as they are generally able to place funds for only short periods and often at lower rates. The 7-day LIBID rate is considered more appropriate as the relevant benchmark for Gedling’s investments. The 7 day uncompounded LIBID rate for 2004/05 was 4.5% (4.61% compounded weekly), and the Council’s in-house managed funds achieved an overall equated rate of 4.63%.

  The Council did not undertake any borrowing activities during 2004/05.

- **The Strategy for 2004/05**

  The TMSS for 2004/05 was based on the view that UK, US and world economic growth rates would strengthen modestly as the recovery from the downturn caused by the Iraq war gathered momentum. Base rate had risen from a low of 3.5% to 4% by February 2004, which was still low by historic standards, and was acting to stimulate the economy. The Monetary Policy Committee (MPC) was expected to seek to eliminate this stimulus by gradually raising base rate back to more “normal” levels. Similarly, the US Federal Bank was expected to gradually raise rates from the exceptionally low rate of 1% to reduce the major stimulus in the economy. The Eurozone growth rate was expected to improve, but not substantially. The European Central Bank (ECB) was therefore expected to leave rates unchanged at 2% so as to provide some stimulus for the economy in the absence of major inflationary concerns. Inflation in all three areas was expected to be well contained. 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 strengthening growth rate in the UK, US and world economies would lead to an increase in UK Base rate from 4% to 4.25%.

Longer-term interest rates – The view on longer term fixed rates was that long-term PWLB rates would be fairly stable at around 5% for most of the financial year

The agreed TMSS based upon the above forecast was that best value could be achieved by borrowing short term at variable rates to minimise borrowing costs, but that due to the risks intrinsic in short term variable rates when compared with historically low long term fixed rates, the Council could maintain a more stable long term portfolio by drawing longer term fixed rate funding at marginally higher rates. Against this background, caution was to be adopted and a pragmatic approach taken to any changing circumstances.

- **The Economy in 2004/05**

  Shorter-term interest rates – Base rate rose in 0.25% steps from 4% in February 2004 to reach 4.75% in August, where it stayed for the rest of the financial year. House prices grew strongly during 2004 and consumer confidence was high, which fed through into strong increases in personal borrowing. Early in 2005, the housing market slowed sharply and consumer confidence fell as high oil prices reduced spending power and negatively impacted sentiment. This eased pressure for a further increase to 5%.

  Longer-term interest rates – The PWLB 25-30 year rate started the year at 4.9% and then hovered around 5.0%-5.15% in May and June before falling back, and falling sharply in November and December to reach 4.5% by the end of 2004. During February and March 2005, the rate rose again to a peak of 4.85% as high oil prices renewed inflation concerns.

- **Borrowing and Investment rates in 2004/05**

  12-month bid rates – the 12 month LIBID rate started the year at 4.6% but rose sharply in May and June to peak at around 5.4% on the back of an over-reaction by the money markets to strong growth, and expectations of major increases in base rate to cool the economy off. The rate subsided to hover around 5% during the autumn, but during January it briefly dipped below 4.8% before rising back up to 5.0% to 5.1% during February and March 2005.

7 day bid rate – the 7-day bid rate considered more appropriate for Gedling's investments, given our relatively small cash balances, started the year at 3.75% and ended at 4.5%.

- **The Borrowing Outturn for 2004/05**

  The Council undertook no new borrowing during 2004/05.

- **Compliance with Treasury Limits and Prudential Indicators**

  During the financial year the Council operated within the Treasury Limits And Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Management Strategy Statement, The outturn for the Prudential Indicators is shown at Appendix 2.

- **Investment Outturn for 2004/05**

  The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days, dependent on the Council's cashflows, its interest rate view and the interest rates on offer.

  Our Treasury advisors, Sector, began the financial year forecasting a base rate peak of 4.5%. This was changed to 4.75% in the first few months of the year, and again in November 1004, to a peak in the current interest rate cycle of 5% in 2005. Advice given by Sector during the year was, therefore, to lengthen internal investments and 1 year deposits were advised at 4.58% and 4.75% early on in the year. However, over the summer the 12-month rate rose to over 5.4% as the market expected rate rises of a level that Sector felt were unwarranted. As a result, the advice to lengthen deposits further became more frequent from July to September, and 1-year deposits were consequently advised at 5.21%, 5.16%, 5.26% and 5.1%. Later in the year, rates of 4.95%, 5.06% and 5.15% were advised.

  The Council's in-house managed funds are generally cash flow derived and are not therefore available for longer-term investment. However, towards the end of 2004/05 a core balance of £2 million was identified, and two 364-day investments were made, achieving rates of 4.94% and 5.12% respectively. These investments should stand the Council in good stead going into the current financial year, when rates have already eased back in anticipation of the first base rate cut towards the end of 2005.

A summary of the Councils investments during 2004/05 can be found at Appendix 1.

4. RECOMMENDATION

Members are asked to:

i. Approve the above Annual Treasury Activity Report

ii. To note the outturn in respect of the Treasury Limits and Prudential Indicators, shown at Appendix 2.