

# Treasury Management Strategy Statement 2006/07

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**Committee:** Council

**Agenda Item**

**Date:** 21 March 2006

**2**

**Title:** Treasury Management Strategy Statement  
2006/07

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Item for  
decision

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### Summary

As part of CIPFA'S Prudential Code and the CIPFA Code of Practice on Treasury Management, Members are requested to consider the treasury management strategy for 2006/07 which includes both the investment and borrowing strategy for the forthcoming year.

### Recommendations

That the treasury management strategy outlining the Council's annual investment strategy and its borrowing requirement for 2006/07 be approved.

### Background Papers

- CIPFA Code of Practice on Treasury Management
- Interest rate forecasts and other guidance provided by the Council's external treasury consultants
- Treasury management working papers held within Financial Services

### Impact

Communication/Consultation	None
Community Safety	None
Equalities	None
Finance	The report sets out the parameters for the forthcoming year's investments which will impact on the investment interest earned by the Council on its cash balances
Human Rights	None
Legal implications	The setting of this strategy complies with the Local Government Act 2003
Ward-specific impacts	None
Workforce/Workplace	None

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#### **Situation**

#### **Background**

- 1 The Council considers its annual Treasury Management Strategy Statement in line with the requirement of the CIPFA Code of Practice on Treasury Management, which was adopted by the Council in March 2002.
- 2 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy that sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2006/07 in respect of the following aspects of the treasury management function is based upon the views of officers on interest rates, supplemented with leading market forecasts provided by the Council's external treasury advisor. The strategy covers:

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators
- Current treasury position;
- Borrowing requirement
- Prospects for interest rates;
- Investment strategy;

#### **Treasury Limits for 2006/07 to 2008/09**

- 3 It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales this 'authorised' limit represents the legislative limit specified in section 3 of the Local Government Act 2003.
- 4 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

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- 5 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. A credit arrangement is where a council obtains, or is taken to have obtained, the benefits of expenditure without paying for it in full at the time when the arrangement starts. Members may recall that it was the threat of creating a credit arrangement which ultimately caused the Council to abort the planned leasing of wheelie bins required for the Waste Strategy. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

### Prudential Indicators for 2006/07 – 2008/09

- 6 The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy. These indicators were adopted by Full Council on 16/02/06 as part of the budget process.
- 7 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted in March 2002 by Full Council.

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09
	£000s	£000s	£000s	£000s
<b>Capital Expenditure</b>				
Non - HRA	2,122	3,705	805	232
HRA	3,647	4,176	2,276	2,233
<b>TOTAL</b>	<b>5,769</b>	<b>7,881</b>	<b>3,081</b>	<b>2,465</b>
<b>Ratio of financing costs to net revenue stream</b>				
Non - HRA	-11.01%	-10.20%	-9.84%	-9.84%
HRA	-0.70%	-0.67%	-0.67%	-0.65%
<b>Net borrowing requirement</b>				
General Fund	N/a – debt free	N/a – debt free	N/a – debt free	N/a – debt free
HRA	N/a – debt free	N/a – debt free	N/a – debt free	N/a – debt free
<b>Capital Financing Requirement as at 31 March</b>				
Non – HRA	0	0	0	0
HRA	0	0	0	0
<b>TOTAL</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

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PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09
	£000s	£000s	£000s	£000s
	£ p	£ p	£ p	£ p
<b>Incremental impact of capital investment decisions</b>				
Increase in council tax	£1.34	£2.62	£0.55	£0.14
Increase in average housing rent per week	£6.33	£4.42	£2.95	£2.95

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09
<b>TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	£000s	£000s	£000s	£000s
<b>Authorised limit for external debt -</b>				
Borrowing	3,000	5,000	5,000	5,000
Other long term liabilities	0	0	0	0
TOTAL	5,000	5,000	5,000	5,000
<b>Operational boundary for external debt -</b>				
Borrowing	2,000	2,000	2,000	2,000
Other long term liabilities	0	0	0	0
TOTAL	2,000	2,000	2,000	2,000
<b>Upper limit for fixed interest rate exposure:</b>				
Net principal re fixed rate borrowing / investments	26,500	23,100	23,360	23,360
<b>Upper limit for variable rate exposure:</b>				
Net principal re variable rate borrowing / investments	3,500	3,500	3,500	3,500
<b>Upper limit for total principal sums invested for over 364 days</b>	5,300	5,500	5,800	6,100

Maturity structure of fixed rate borrowing during 2006/07	Upper limit	Lower limit
Under 12 months	0	0
12 months and within 24 months	0	0
24 months and within 5 years	0	0
5 years and within 10 years	0	0
10 years and above	0	0

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#### Current Portfolio Position

8 The Council's treasury portfolio position as at 10/03/06 comprised:

		Principal		Average rate 2005/06
		£m		%
<b>DEBT</b>				
Fixed rate funding	PWLB	0		
	Market	<u>0</u>	0	0
Variable rate funding	PWLB	0		
	Market	<u>0</u>	0	0
Other long-term liabilities			0	
<b>TOTAL DEBT</b>			<u>0</u>	<b>0</b>
<b>INVESTMENTS</b>				
	In-house		13,160	<b>4.52</b>
	External (Standard Life)		5,201	<b>4.70</b>
<b>TOTAL INVESTMENTS</b>			<u>18,361</u>	

#### Borrowing Requirement

	2005/06 Revised estimate	2006/07 Estimate	2007/08 Estimate	2008/09 Estimate
	£000s	£000s	£000s	£000s
New borrowing	0	0	0	0
Alternative financing arrangements	0	0	0	0
Replacement borrowing	0	0	0	0
<b>TOTAL</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

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#### Prospects for Interest Rates

9. The Council has appointed Butlers as its treasury adviser and part of their service is to assist the Council to formulate a view on interest rates. The table below draws together a number of current City forecasts for short term or variable (the base rate) and longer fixed interest rates and provides a central view.

#### Interest rate forecast – February 2006

	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009
Base rate	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
5yr Gilt Yield	4.25%	4.00%	4.00%	4.25%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%
10yr PWLB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%
25yr PWLB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%
50yr PWLB Rate	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.50%	4.50%

#### Expected Movement in Interest Rates

- 10 The Monetary Policy Committee announced the long-awaited cut in base rates from 4.75% to 4.50% following its August meeting in 2005. However, the downturn in the UK interest rates cycle is expected to be prolonged and shallow, and Butlers view is that rates will fall to around the 4.25% level. GDP growth had been substantially weaker than anticipated as the slowdown in house price inflation and higher debt servicing costs combined to undermine consumer spending growth. Activity is expected to remain weak during 2006 but to stage a recovery in 2007 when rates are anticipated to increase to 4.50%.

#### Borrowing Strategy

- 11 Currently it is not envisaged that the Council will undertake any long term borrowing during 2006/07 to finance its capital spending plans.
- 12 Both the Prudential Indicators and current indicative capital expenditure plan assume there is no need to borrow during the next three financial years. Furthermore the revenue budget report presented to Council on 16<sup>th</sup> February 2006 proposes there will be no new borrowing in 2006/07.
- 13 It is possible, however, that the Council may need to borrow in the short term to cover any deficit in its cash flow. In such an event, monies would be borrowed from the money market through the Council's brokers.

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#### Annual Investment Strategy

##### Investment Policy

- 14 The Council needs to have regard to the ODPM's Guidance on Local Government Investments 2004 and CIPFA's Treasury Management in Public Services Code of Practice, and the contents of these are used to inform the following paragraphs.
- 15 The Council's investment priorities are: -
  - a. the security of capital and
  - b. the liquidity of its investments.
- 16 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.
- 17 All investments will be made in Sterling.
- 18 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.
- 19 This Annual Investment Strategy states the categories of investments the Council may use for the prudent management of its treasury balances during the financial year, split between specified and non specified investments, explanations of which are outlined below:
  - a. Specified Investments

Specified investments are those investments offering high security and high liquidity. Local authorities are free to rely on these with minimal procedural formalities. All such investments must be in sterling and with a maturity of less than one year. Investments made with the UK Government and UK local authorities will automatically count as specified investments. In addition, investments with bodies or investment schemes with 'high' credit ratings will count as specified investments. The ODPM has left each Local Authority to determine their own definition of 'high' credit rating and therefore their definition of a specified investment.

This Council will rely on the credit ratings published by Fitch Ratings, Moody's Investors Service and Standard and Poor's Ratings to establish the credit quality of its counter parties. The Council has determined the minimum long-term, short-term and other credit ratings it deems to be 'high' for investments purposes. These are:

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	Fitch Ratings	Moody's	Standard and Poors
Short Term	F1	P1	A1
Long Term	AA-	AA3	AA-
Support Rating	3 or higher	Not applicable	Not applicable

Given that the ODPM's investment guidance states that specified investments must have a maturity of less than one year, this Council will ensure that all such investments comply with the short-term ratings of at least one of the credit ratings agencies listed above.

The specified investment instruments identified for potential use by the in-house treasury management function and the Standard Life externally managed fund in 2006/07 are listed below:

	Minimum 'High' credit criteria	Use
Term deposits – UK Government	-	In-house
Term deposits – UK local authorities	-	In-house
Term deposits – banks and building societies	Short term F1 or P1 or A1, Support rating 3 or above	In-house and Fund Manager
Certificates of deposits issued by banks and building societies	Short term F1 or P1 or A1, Support rating 3 or above	Fund Manager
Money Market Funds	AAA	In-house and Fund Manager
UK Government Gilts	AAA	Fund Manager
Supranational Bonds	Short term F1 or P1 or A1, Support rating 3 or above	Fund Manager
Treasury Bills	Short term F1 or P1 or A1, Support rating 3 or above	Fund Manager

#### b. Non-specified Investments

These investments must be dealt with in more detail given the greater potential risk. The general types of non-specified investments that may be used during the course of 2006/07 have been identified and a limit has been set on the overall amount that may be held in such investments at any time during the year. This Council considers that up



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to a maximum of £5.5m of its overall fund balances could be prudently committed to longer- term investments.

**Internally Managed Funds**

Non specified investments for in-house purposes are restricted to investments with a maturity date of greater than 364 days placed with institutions through the money market and which meet the long term ratings of at least one of the 3 credit rating agencies listed above.

**Externally Managed Funds**

£5.2m of the Council’s funds is currently externally managed on a discretionary basis by Standard Life. This is an AAA rated fund (the highest long term rating provided by Moody’s Investor Services) and in order to capitalise on their specialist expertise the following investment instruments have been agreed:

Instrument	Maximum maturity
UK Government gilts	5 years
Treasury Bills	5 years
Certificates of Deposit	5 years for A rated institutions and 2 years for A rated institutions
Cash Deposits	2 years

**20 Monitoring of Credit Ratings**

Credit ratings will be monitored by the Council each time a new investment is placed with a financial institution in-house through its money market brokers. Monthly listings of institutions’ credit ratings are issued by Butlers and these will be used to determine the suitability of a potential ‘ deposit taker’. The Council is also alerted to changes in counter parties credit ratings through regular updates from Butlers. If a downgrade results in a counter party no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately.

**21 Investment Strategy**

This Council currently invests its surplus cash balances in short term money market deposits or deposits within its Abbey National Business Reserve Account. These are generally made with reference to its cash flow requirements. Since reductions in base rate are likely during the forthcoming year, the Council’s in-house strategy will seek to lock into longer period investments at higher rates before this occurs, cash flow permitting.

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As base rates falls, the Council will seek to utilise its business account and short dated deposits in order to benefit from compounding interest.

**End of Year Investment Report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

**Risk Analysis**

Risk	Likelihood	1. Impact	2. Mitigating actions
Likelihood that Treasury Officer's forecasts of movements in base rate differ from actual movements	Low	Low	Interest receivable on the Council's investments is monitored on a regular basis and amendments to the interest receivable will be amended accordingly.