Treasury Management Strategy Statement 2007/08

Full Council

Committee:	**Council**	**Agenda Item 13**
Date:	**15 February 2007**	
Title:	**Treasury Management Strategy Statement 2007/08**	
Author:	**Linda Grinnell 01799 510313**	Item for decision

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 2007/08 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 2007/08 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 2007/08 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 2007/08 – 2009/10

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 its Affordable Borrowing 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'.

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. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential Indicators for 2007/08 – 2009/10

6 The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy. These indicators will be considered in a separate report to Full Council on 15th February 2007 (see Agenda Item 12) as part of the overall 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	2006/07	2007/08	2008/09	2009/10
	£000	£000	£000	£000
Capital Expenditure				
Non - HRA	2,668	3,709	1,814	603
HRA	4,527	2,444	2,399	2,212
TOTAL	7,195	6,153	4,213	2,815
Ratio of financing costs to net revenue stream				
Non - HRA	-8.28%	-8.45%	-6.58%	-5.51%
HRA	-0.43%	-0.41%	-0.31%	-0.31%
Net borrowing requirement				
General Fund	N/a – debt free	N/a – debt free	1,185	554
HRA	N/a – debt free	N/a – debt free	318	0
TOTAL	N/a – debt free	N/a – debt free	1503	554
Capital Financing Requirement as at 31 March				
Non – HRA	0	0	1,185	1,799
HRA	0	0	318	318
TOTAL	0	0	1,503	2,117

PRUDENTIAL INDICATOR	**2006/07**	**2007/08**	**2008/09**	**2009/10**
	£000	**£000**	**£000**	**£000**
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax	2.18	2.76	3.71	1.49
Increase in average housing rent per week	4.50	3.44	1.60	1.66

PRUDENTIAL INDICATOR	**2006/07**	**2007/08**	**2008/09**	**2009/10**
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£000**	**£000**	**£000**	**£000**
Authorised limit for external debt -				
Borrowing	5,000	5,000	5,000	5,000
Other long term liabilities	0	0	0	0
TOTAL	5,000	5,000	5,000	5,000
Operational boundary for external debt -				
Borrowing	2,000	2,000	4,000	4,000
Other long term liabilities	0	0	0	0
TOTAL	2,000	2,000	4,000	4,000
Upper limit for fixed interest rate exposure:				
Net principal re fixed rate borrowing / investments	20,000	15,000	11,000	11,000
Upper limit for variable rate exposure:				
Net principal re variable rate borrowing / investments	12,000	12,000	11,000	11,000
Upper limit for total principal sums invested for over 364 days	0	3,000	2,000	2,000

Maturity structure of fixed rate borrowing during 2007/08	**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

Current Portfolio Position

8 The Council's treasury portfolio position as at 7/02/07 comprised:

		Principal	Average. rate 2006/07
DEBT		£m	%
Fixed rate funding	PWLB	0	
	Money Market	0	
		0	0
Variable rate funding	PWLB	0	
	Money Market	0	
		0	0
Other long-term liabilities			
TOTAL DEBT			
INVESTMENTS			
	In-house:	13,855	5.27
	External	0	
		13,855	
TOTAL INVESTMENTS			

Borrowing Requirement

	2006/07 Revised Estimate	2007/08 Estimate	2008/09 Estimate	2009/10 Estimate
	£000	£000	£000	£000
New borrowing	0	0	2,000	2,000
Alternative financing arrangements	0	0	0	0
Replacement borrowing	0	0	0	0
TOTAL	**0**	**0**	**2,000**	**2,000**

Prospects for Interest Rates

9. The Council has appointed Butlers as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The table below shows their current forecast for short-term or variable (the base rate) and longer-term interest rates.

Interest rate forecast – January 2007

	End Period	Base Rate	Gilt Yields			
			5 yr	10 yr	20 yr	50 yr
2006	Dec	5.00	5.0	4.7	4.5	4.0
2007	Jan	5.25	5.3	5.0	4.7	4.2
	Mar	5.50	5.3	5.0	4.7	4.2
	Jun	5.50	5.3	5.0	4.7	4.2
	Sep	5.50	5.2	4.9	4.7	4.1
	Dec	5.50	5.0	4.8	4.6	4.0
2008	Mar	5.25	4.9	4.7	4.5	4.0

Expected Movement in Interest Rates

10 The Bank of England Monetary Policy Committee increased base rate by 0.25% on 3 occasions during 2006/07. The last of these occurred in January 2007 when base rate was increased to 5.25%. Butlers believe that interest rate uncertainty is set to persist in the year ahead. In particular the threat of higher inflation is considered a real danger for the UK economy in the short term and consequently a further base rate rise of 0.25%, anticipated in March 2007, has now been reflected in the money markets rates currently on offer to investors.

11 It is currently anticipated that base rates will remain at 5.50% until the first quarter of 2008 when it is forecast they will reduce back down by 0.25% to 5.25%.

Borrowing Strategy

12 Currently it is not envisaged that the Council will undertake any long term borrowing during 2007/08 to finance its capital spending plans.

12 Both the prudential indicators and the proposed capital programme assume there will be no need to borrow during 2007/08. The revenue budget report to be presented to Council on 15th February 2007 (Agenda item 8) reflects this.

13 In 2008/09, however, it is anticipated the Council will need to borrow up to £2 million to part finance those schemes currently identified for 2008/09 and 2009/10.

14 It is also possible 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.

Annual Investment Strategy

Investment Policy

15 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.

16 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may be prudently committed. These procedures also apply to the Prudential Indicators covering the maximum principal sums invested.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
- The Council will ensure all investments are made in Sterling
- The Council acknowledges 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.

17 This Annual Investment Strategy states the categories of investments the Council <u>may</u> 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:

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a. <u>Specified Investments</u>

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 when investing through the money markets. The Council has determined the minimum long-term, short-term and other credit ratings it deems to be 'high' for investments purposes. These are:

	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 <u>potential</u> use by the Council's treasury management function in 2007/08 are listed below:

	Minimum 'High' credit criteria
Term deposits – UK Government	-
Term deposits – UK local authorities	-
Term deposits – banks and building societies	Short term F1 or P1 or A1, Support rating 3 or above
Certificates of deposits issued by banks and building societies	Short term F1 or P1 or A1, Support rating 3 or above

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 2007/08 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 to a maximum of £3m 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

At the start of 2006/07 £5.2m of the Council's funds were placed in an external fund managed by Standard Life which was set up in March 2005. The Council had agreed that this fund could utilise a range of instruments not used by the in-house treasury management function in order to capitalise on the Fund Manager's knowledge and expertise. These included UK Government gilts, Treasury Bills, Certificates of Deposit as well as cash deposits.

During 2006/07 there were no opportunities for Standard Life to enter into the gilt market and instead the entire fund was invested in cash deposits. The returns on the Standard Life Fund during the first 2 quarters of 2006/07 were 4.71% and 4.74% respectively.

It is considered that this level of return was achievable by the in-house treasury management function by placing the monies out in the money markets for just 3 months.

The Standard Life Fund had been set up initially with the view that, as a long-term fund, its return would be higher than that which could be achieved by the Council in-house. However, as the return on a 12 month money market investment during the first two quarters of 2006/07 would have yielded an average return of 4.94% and 5.10%. It was apparent that the Fund was performing below expectation and the management fees payable by the Council further compounded its under performance.

The decision was therefore taken to close the Standard Life Fund in October 2006, a decision which was endorsed by Butlers, the Council's external treasury advisors. Other Councils are known to have made similar decisions.

In place of the Standard Life fund, the £5.2 million was invested for 364 days through the money markets in October 2006 at a rate of 5.36%.

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 counterparties' 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 will be withdrawn immediately.

21 **Investment Strategy**

This Council generally invests its surplus cash balances in short-term investments through the money market or places deposits in its Abbey National Business Reserve Account, Bank of Scotland Base Plus Account and Allied Irish Treasury Account. These are generally made with reference to its cash flow requirements.

22 Expectations on shorter-term interest rates currently show a likelihood of peaking at 5.50% in the early part of 2007. It is likely therefore that, cashflow permitting, the Council will seek to lock into some longer-period investments at higher rates before the money markets start to build in any future reductions in interest rates.

23 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. This complies with the CIPFA Code of Practice on Treasury Management.

Risk Analysis

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