Committee:	**Performance Select Committee**	**Agenda Item**
Date:	5th February 2008	**6**
Title:	**Annual report on Treasury Management and Prudential Indicators 2006/07**	
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Summary

The annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity for 2006/07, and the actual Prudential Indicators for 2006/07.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

Recommendations

The Committee is recommended to:

- Note the actual 2006/07 prudential indicators within the report.
- Note the treasury management stewardship report for 2006/07.

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	There are no specific communication implications contained in this report.
Community Safety	There are no specific community safety implications contained in this report.
Equalities	There are no specific equalities implications contained in this report.
Finance	This report sets out the treasury management

	activities during 2006/07, the interest earned on the Council's balances and its compliance with the Prudential Indicators
Human Rights	There are no specific Human Rights implications contained in this report.
Legal implications	The treasury management function complies with the legislation as set out in Section 23 of this report
Ward-specific impacts	There are no specific ward implications contained in this report.
Workforce/Workplace	There are no specific workforce/workplace implications contained in this report.

Situation

Introduction

1 This report summarises:

- The Council's capital expenditure for the year;
- How this expenditure was financed;
- The impact on the Council's indebtedness for capital purposes;
- The Council's overall treasury position;
- The reporting of the required prudential indicators;
- A summary of interest rate movements in the year;
- Debt activity; and
- Investment activity.

The Council's Capital Expenditure and Financing 2006/07

2 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through capital receipts, capital grants and revenue contributions
- If insufficient financing is not immediately available the expenditure will give rise to a borrowing need.

3 Part of the Council's treasury activities is to address any borrowing need, through either borrowing from external bodies such as the Public Works Loan Board, (PWLB), or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, any

previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then to optimise the return on performance. Wider information on the regulatory requirements is shown in Section 10.

4 The actual capital expenditure forms one of the required prudential indicators. The table below also shows how this was financed:

	2006/07 Revised Estimate £'000	2006/07 Actual £'000
Non-HRA capital expenditure	2,668	2,199
HRA capital expenditure	4,527	4,345
Total capital expenditure	**7,195**	**6,544**
Resourced by:		
Capital receipts	(3,767)	(3,138)
Capital grants	(90)	(88)
Capital reserves	(2,770)	(2,750)
Revenue	(568)	(568)
Unfinanced capital expenditure (additional need to borrow)	**0**	**0**

The Council's Overall Borrowing Need

5 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. This Council has fully financed its current and historic capital expenditure and so it currently has no borrowing need. The Council's CFR for 2006/07 was therefore zero, **(but see Paragraph 8 below),**

CFR (£m)	31 March 2007 Original Indicator	31 March 2007 Actual
Opening balance	0	0
+Unfinanced capital expenditure	0	0
- Minimum revenue provision	0	0
Closing balance	**0**	**0**

Treasury Position at 31 March 2007

6 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Council's in-house treasury function can manage any possible actual borrowing position by either:

- borrowing up to the Capital Financing Requirement; or
- choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing); or
- borrowing for future increases in the CFR (borrowing in advance of need).

7. During 2006/07 the Council did not take up any long term borrowing to finance the capital programme, (**but see Paragraph 8 below**). This situation was anticipated in the 2006/07 Treasury Management Strategy approved by Full Council on 21 March 2006.

8. **At the last meeting of this Committee Members received a report from the District Auditor as part of the Final Accounts process, relating to the interpretation of a lease the Council had taken out in 2006/07 for the purchase of waste collection vehicles. The District Auditor determined that the lease had been incorrectly interpreted as an Operating Lease rather than a Finance Lease. As a result the Council was no longer debt free. This Committee agreed that they would recommend to Council that the Accounts for 2006/07 would not be amended, and accepted the District Auditor's interpretation.**

As Members will recall, the views of the District Auditor on the interpretation of the type of lease was received just before the meeting on 11th December 2007. The financing of the Capital Programme was completed in April/May 2007 based on the interpretation that the purchase of the refuse vehicles was not classed as capital expenditure, and the lease was not a form of borrowing (Finance Lease).

If the Council had agreed to amend the Council's Statement of Accounts for 2006/07, then the detail in Paragraphs 10 to 13 below would have had to change to reflect the Councils' borrowing from the Finance Lease. As no changes have been made to the Accounts, these paragraphs have not been changed either.

Prudential Indicators and Compliance Issues

9. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown in the paragraphs below:

Net Borrowing and the Capital Financing Requirement

10. In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2006/07 plus the expected changes to the CFR over 2007/08 and 2008/09. Since this Council does not have a positive CFR the Councils net borrowing position must be lower than the CFR. The Council has complied with this prudential indicator, (subject to paragraph 8 above).

    i.

	31 March 2006 Actual	31 March 2007 Original Indicator	31 March 2007 Actual
Net borrowing position	**£0**	**£0**	**£0**
CFR	**£0**	**£0**	**£0**

The Authorised Limit

11. The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2006/07 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary

12. The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

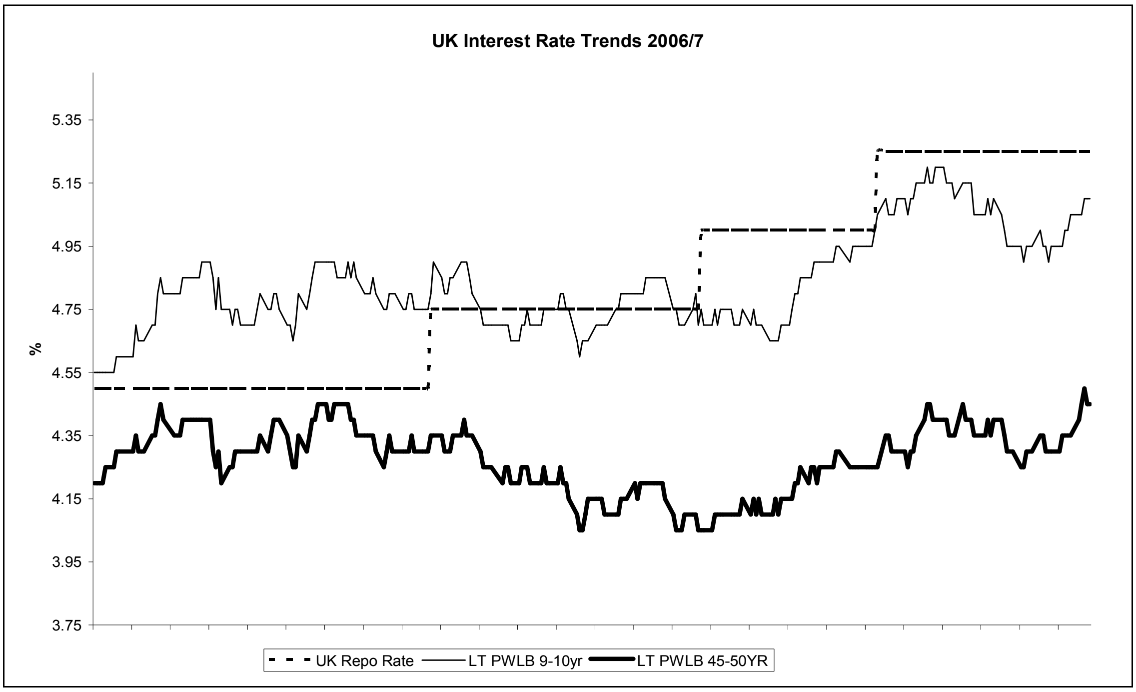
Actual financing costs as a proportion of net revenue stream

13. This indicator identifies the degree by which borrowing affects the Council's General Fund and Housing Revenue Account budgets. Since the Council is debt-free, and cash flow investments exceeded borrowing this indicator is negative.

	2006/07
Original Indicator - Authorised Limit	**£5m**
Maximum gross borrowing position	**£0m**
Original Indicator - Operational Boundary	**£2m**
Average gross borrowing position	**£0m**
Minimum gross borrowing position	**£0m**
Financing costs as a proportion of net revenue stream	**-7.26%**

Economic Background for 2006/07

14. All treasury activity is directed by both the current market interest rates and expectations of future movements. For example, longer term investment rates for one and two years will reflect anticipated movements in the Bank of England Monetary Policy Committee (MPC) rate (UK Repo Rate). Longer term borrowing rates are influenced by inflation and demand and supply considerations.



15. The 2006/07 financial year featured a rising trend in short term interest rates as policy makers and financial markets responded to the twin effects of strengthening economic activity and rising inflation.

16. The optimism that prevailed in the first few months of 2006 had evaporated by the beginning of the new financial year. The rebound in economic activity since 2005 proved more robust that consensus expectations. In addition, external pressures on consumer price inflation had continued to escalate. While short-term interest rates remained steady in the first few months of the year, there were growing expectations that a rise in official interest rates would eventually materialise.

17. The first increase in the Bank Rate from 4.5% to 4.75% was announced in August 2006 as the Bank of England responded to the deteriorating inflation outlook. The economy's slow response to monetary policy tightening and concerns that deteriorating inflation expectations at home would drive prices higher prompted additional rate increases. Two quarter point increases in Bank Rate were announced in November 2006 to 5% and January 2007 to 5.25%. Further tightening measures were anticipated by the market, and attractive investment opportunities prevailed to year end.

The Strategy Agreed for 2006/07

18 The strategy provided for 2006/07 expected a downturn in interest rates. This was based on the views of Butlers, the Council's Treasury advisors, who anticipated base rate to fall to 4.25% during the early part of 2007 but to stage a recovery and peak at 4.75% during the latter part of the year.

On this basis the Council's in-house treasury strategy was to lock into some longer period investments at higher rates prior to a reduction in interest rates, cash flow balances permitting.

19 A number of changes were made to the Council's in-house treasury management procedures during 2006/07:

- On the advice given by Butler's the Council's external treasury advisors, the decision was taken to close the Council's external investment fund with Standard Life (£5.2m) as the return it was offering was lower than that being obtained by the in-house treasury function at that time, (4.74% compared with 4.85%). The £5.2m was therefore re-invested on the money markets at a rate of 5.36% for 364 days.
- A deposit account with Allied Irish Bank was opened in November 2006 as this facility offered more attractive rates than the Abbey National Business Reserve Account that had been previously used to deposit smaller amounts of surplus cash for shorter periods.
- Further advantage of the Bank of Scotland Corporate Base Plus Account (opened March 2006) was made during 2006/07. This facility is a 7 day notice account currently offering 6.01% AER on deposits.

Investment Position

Investment Policy

20. The Council's investment policy was governed by the Office of the Deputy Prime Minister (ODPM) but this is now DCLG Guidance, which was implemented in the annual investment strategy approved by Council on 21 March 2006. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources

21. The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council core cash resources comprised:

Balance Sheet Resources (£m)	31 March 2006 £m	31 March 2007 £m
Balances, incl. HRA/Collection Fund	**1,498**	**2,003**
Earmarked reserves	**3,169**	**1,679**
Provisions	**125**	**125**
Usable capital receipts	**6,770**	**4,495**
Total	**11,562**	**8,302**

Investments Held by the Council

22. The Council maintained an average balance of £7.6m and received an average return of 4.67%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.84%.

    Investments held by the Council as at 31 March 2007 were:

	31 March 2007 £m
Fixed Term Deposits	**7,400**
Abbey National Business Reserve	**0**
Bank of Scotland Corporate Base Plus A/c	**13**
Allied Irish Bank	**1,367**
	8,780

This produced Investment Income to the General Fund of £573k compared to the Revised Estimate of £653k.

Regulatory Framework, Risk and Performance

23. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

    The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

    The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2006/07);

    Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

    The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

    The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

    Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.

24. The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

25. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
That the Council does not comply with the Code of Practice on Treasury Management	Risk level 1, as treasury controls are in place to meet requirements.	Risk level 2, due to significant sums of money invested externally.	None.