Report considered by Cabinet – 20 February 2007

Key Decision		**Yes**
Listed on Forward Plan		**Yes**
Within Policy		**Yes**
Policy Document	**Treasury Strategy 2007/08 to 2009/10**	

TREASURY STRATEGY 2007/08 TO 2009/10

Accountable Cabinet Member: Councillor Crooks

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1. Purpose

1.1 To bring to Cabinet and Council the proposed Treasury Strategy for 2007/08 to 2009/10.

1.2 In the context of paragraph 1.1 above, to inform Cabinet and Council of the treasury issues over that timeframe.

2. Recommendations

2.1 That the Council be recommended to approve the Treasury Strategy for 2007/08 to 2009/10, incorporating:

(a) The Capital Financing and Borrowing Strategy for 2007/08 to 2009/10 (paragraphs 3.3 to 3.7) as required by the Council's Treasury Management Policy Statement (TMP6).

(b) The Investments Strategy for 2007/08 to 2009/10 (paragraphs 3.8 to 3.12) as required by the Guidance on Local Government Investments.

(c) The Affordable Borrowing Limit for 2007/08 to 2009/10 (paragraph 3.7(d)) as required by the Local Government Act 2003

2.2 That the Cabinet note:

(a) The measures being taken to manage the sensitivity of the forecasts (paragraph 3.13).

(b) The proposed Debt Financing Budget 2007-08 to 2009-10 (paragraph 3.14).

(c) Compliance with the requirement under the Local Government Act 2003 to produce a balanced budget is demonstrated within the Council Wide Revenue Budget 2007/08 to 2010/11 Report which is included else where on this agenda (paragraph 3.16).

3. Issues and Choices

Introduction

3.1 As in previous years the Council has to consider its annual Treasury Strategy under the requirements of the CIPFA Code of Practice on Treasury Management. The Code was adopted by the Council on 12 March 2002. Furthermore, the CIPFA Prudential Code for Capital Finance in Local Authorities, published in October 2003, introduced enhanced requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the requirement for an integrated treasury management strategy.

3.2 The Prudential Code requires the Council to set a number of Prudential Indicators and a report setting out the Prudential Indicators for 2007/08 to 2009/10 is included elsewhere on this agenda. This report incorporates those Prudential Indicators to which regard should be given when determining the Council's Treasury Management Strategy for the next three financial years. The Council's Treasury Management Strategy is made up of the following:

(a) the Capital Financing and Borrowing Strategy; and

(b) the Investments Strategy.

Capital Financing and Borrowing Strategy

3.3 The Capital Financing and Borrowing Strategy covers:

(a) Capital financing.

(b) New borrowing.

(c) Interest rate exposure.

(d) Prudential Indicators.

3.4 Capital Financing

(a) The capital programme is financed primarily by borrowing but also through other sources, including capital receipts, grants, third party contributions and revenue contributions.

Current practice is to use operating leases where appropriate to acquire items of plant, vehicles and equipment. The annual costs of the operating leases are treated as revenue expenditure and do not feature in the Council's capital programme, thereby maximising available capital resources.

Prior to the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations [SI 3146] all leases other than operating leases counted against the Council's capital allocations thus reducing the capacity to borrow for other capital purposes. The new legislation allows the use of finance leases without the reduction in borrowing capacity and five such leases have been arranged since 1 April 2004. These leases are classified as other long term liabilities and are included within the Affordable Borrowing Limit .

(b) The Council is required by statute to repay a minimum amount of 4% of debt principal each year. This is known as the Minimum Revenue Provision (MRP). For the next 3 years MRP is estimated at:

	2007/08 £m	2008/09 £m	2009/10 £m
Repayment of debt principal (MRP)	6.74	8.04	9.42

These figures incorporate the ongoing revenue impact of the new borrowing set out at paragraph 3.5 (i) below.

3.5 New Borrowing

(a) Under the Local Government Act 2003 local authorities are able to borrow in year for the current year capital programme and for the following two years. It is estimated that the new borrowing requirement for the 2007/08 programme will be £36.92m. As a precaution against increasing rates in 2007/08 £6.50m of this total has been forward funded in 2006/07. Consequently it is estimated that £30.42m will need to be funded by borrowing in 2007/08 for that year's programme.

The Council's new long term borrowing requirement for the next 3 years is estimated at:

		2007/08 £m	2008/09 £m	2009/10 £m
(i)	New borrowing to cover new capital expenditure	37.16	48.96	44.05
(ii)	Replacement of PWLB loans maturing in year	0.00	3.00	0.00
(iii)	Less: debt repayment (see paragraph 3.7(b) above)	(6.74)	(8.04)	(9.42)
	Total New Borrowing	30.42	43.92	34.63

(b) The Council is entitled to use Public Works Loan Board (PWLB) loans for its long term borrowing needs. In addition loans are available from major banks via the Money Market and these may be considered when they are cheaper than PWLB. Decisions on the timing and type of the borrowing will be taken in consultation with the Council's treasury advisors, Sector Treasury Services.

(c) As is the current practice, the debt portfolio will be kept under review throughout 2007/08 and beyond, with debt rescheduling opportunities being investigated for potential interest savings. Rescheduling decisions will be based on appropriate advice and the maturity profile of the portfolio. **Annex A** details the forecast maturity profile as at 31 March 2007.

Officers are monitoring the position with regard to potential changes in accounting practice relating to financial instruments that are currently out for consultation and taking account of related risks.

(d) A relevant percentage of any interest savings arising from debt rescheduling will be passed on to the Housing Revenue Account (HRA). However, the overall effect on the HRA will be neutral, as any saving will be matched by an equivalent reduction in Housing Subsidy.

(e) The Council also has a £0.5m overdraft facility with its bankers. However, this is only used on rare occasions when unforeseen events occur. Interest is charged at 1% above base rate for the use of this facility.

3.6 Interest Rate Exposure

(a) Long Term Rates - PWLB interest rates are revised daily and the 45-50 year rate has fluctuated between 4.05% and 4.45% during 2006/07 and averaged 4.25%. Rates are currently projected to remain at around these levels for the next three years.

Interest rates for shorter period loans are higher and are projected to remain so over the period.

The table below illustrates this:

PWLB Maturity Loan Rates			
Interest Rate	**10-15 Years**	**25-30 Years**	**45-50 Years**
Actual at 1 April 2006	4.55%	4.30%	4.20%
Actual at 17 January 2007	5.00%	4.55%	4.30%
Forecast 2007-08 (average)	4.75%	4.50%	4.25%

Borrowing Strategy 2007/08 - fixed rate borrowing will be used where long term rates are favourable. Where variable rate borrowing is used, short term loans will be arranged in order that they can be replaced by long term fixed rate loans at a later date.

(b) Short term rates - inflation concerns have caused the bank base rate to increase three times during 2006/07 and it currently stands at 5.25%. It is predicted to increase again to 5.50% by March 2007 before starting to reduce in 2007/08 when it is forecast to be at 5.00% by March 2008.

These current forecasts contrast significantly with those made at this time last year when bank base rate for 2006-07 was expected to average around 4.25%.

The table below illustrates this:

Bank Base Rates			
	Forecast Jan 2006	Actual (where appropriate)	Forecast Jan 2007
30 September 2006	4.25%	4.75%	
31 December 2006	4.00%	5.00%	
31 March 2007	4.50%		5.50%
2000/08 (average)	4.75%		5.25%

3.7 Prudential Indicators

The Prudential Indicators which relate to the Capital Financing and Borrowing Strategy are reproduced at **Annex B (Item 1)**. These are:

(a) Authorised limit for external debt for 2006/07 (revised), 2007/08, 2008/09 and 2009/10.

(b) Operational boundary for external debt for 2006/07 (revised), 2007/08, 2008/09 and 2009/10.

(c) Maturity structure of borrowing.

(d) The authorised limit at paragraph 3.7(b) above equates to the Council's affordable borrowing limit as required by the Local Government Act 2003. This limit is set out over the page:

Affordable Borrowing Limit			
2006/07 Limit £000	2007/08 Limit £000	2008/09 Limit £000	2009/10 Limit £000
324,000	393,000	454,000	496,000

As mentioned in paragraph 3.5(a) current accounting rules allow local authorities to forward funding for their capital programmes up to a maximum of three years. The affordable borrowing limit figures above include a provision for future forward funding should it be advantageous to do so.

Cabinet are asked to recommend to Council that they approve the above affordable borrowing limits.

Investments Strategy

3.8 The Investments Strategy covers:

(a) Investments.

(b) Liquidity of Investments.

(c) Interest Rates.

(d) Prudential Indicators.

3.9 Investments

(a) Under the Local Government Act 2003 the Council is required to have regard to the Guidance on Local Government Investments (“the Guidance”) issued in March 2004 and CIPFA’s Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”).

(b) The Guidance requires that investments are split into two categories:

(i) specified investments - broadly, sterling investments, not exceeding 364 days and with a high credit rating.

(ii) non-specified investments - do not satisfy the conditions for specified investments.

The detailed conditions attached to each of these categories are set out in **Annex C**.

All investments, with the exception of those to other local authorities, will be placed only with those building societies and authorised deposit takers under the Financial Services and Markets Act 2000 allocated a satisfactory colour rating by Sector Treasury Services, whose list is updated monthly. This list is based upon credit ratings issued by the three main rating agencies. Any changes to ratings during the month are notified to the authority immediately and action taken to remove from/add to the list as appropriate.

Partly as a consequence of forward funding part of future years' capital programmes cash balances are higher than in previous years. It has therefore been necessary to increase individual counterparty limits for those institutions with the highest quality credit ratings to £25m. This decision was made by the Head of Finance, in line with financial regulations, following consultation with Sector Treasury Services.

(c) Specified Investments

The majority of the Council's investments in 2007/08 will fall into the category of specified investments.

(d) Non-Specified Investments

Prior to the start of each financial year officers will review which categories of non-specified investments they consider could be prudently used in the coming year. In doing this they will take advice from Sector Treasury Services.

The officer recommendation for 2007/08 is that long term investments (those for periods exceeding 364 days) could prudently be used where funds are not required for short term cashflow management, for example uncommitted capital receipts which the Council has agreed to invest as part of its budget strategy.

The maximum amount which the Council will hold at any time during the year as long term investments is £25m. As the forecast range of total investments outstanding in 2007/08 is between £75m and £130m, the investment of up to £25m at any one time for a period exceeding 364 days if interest rates are favourable can be undertaken without having a adverse effect on cashflow (see paragraph 3.10(a) below). Advice will be taken from Sector Treasury Services before entering into any long term investments.

3.10 Liquidity of Investments

(a) Most short term investments are held for cashflow management purposes and officers will ensure that sufficient levels of short term investments and cash are available for the discharge of the Council's liabilities. Investment periods range from overnight to 364 days as specified investments or longer as a non-specified investment.

(b) The average period of each investment in the current financial year (up to 31 December 2006) was 109 days. When deciding the length of each investment regard is had to both cashflow needs and prevailing interest rates.

(c) As referred to in paragraph 3.9(c)(ii) above it is recommended that a maximum of £25 million be invested for periods exceeding 364 days (if interest rates are favourable) and the balance be held in short term investments (under 365 days).

3.11 Interest Rates

(a) One and three month London Interbank Bid (LIBID) rates have risen recently as illustrated below. Seven day rates are more susceptible to changes due to market forces.

Movement in LIBID Rates

Date	7 Day	1 Month	3 Month
1 April 2006	4.53125%	4.50000%	4.53125%
30 June 2006	4.56250%	4.59375%	4.65625%
30 September 2006	4.81250%	4.87500%	4.96875%
31 December 2006	5.15625%	5.18750%	5.25000%

(b) As referred to in paragraph 3.6(b) above, bank base rate currently stands at 5.25% and is forecast to peak at 5.50% before reducing in stages to 5.00% by 31 March 2008. Short term interest rates are likely to average around these levels.

(c) The Council maintains predominately temporary, short term investments which are made with reference to cash flow requirements. However, for 2007/08 the Council has agreed (subject to approval of the Revenue and Capital Budgets) to invest £3.645m uncommitted capital receipts for the prudent management of the authority's financial affairs.

(d) For short term and overnight investment full advantage continues to be taken of Bank Business Reserve Accounts which offer competitive rates and allow instant access to funds.

3.12 Prudential Indicators

The Prudential Indicators which relate to the Investments Strategy are reproduced at **Annex B (Item 2)**. These are:

(a) upper limits on variable interest rate exposure;

(b) upper limits on fixed interest rate exposures; and

(c) investments exceeding 364 days.

3.13 Sensitivity of Forecast

As the majority of the Council's long term debt is at fixed rates, sensitivity analysis indicates that small variations in interest rates will have little impact on the budget.

The main sensitivities of the forecast are likely to be the two scenarios below and only apply to new borrowing and investments. Officers, in conjunction with the Council's treasury advisors, will continually monitor both the prevailing interest rates and market forecasts, adopting the following responses to a change of view:

(a) If it was felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation. In this event the portfolio position will be re-appraised with the likely action that fixed rate loans will be taken whilst interest rates are still relatively cheap.

(b) If it was felt that there was a significant risk of a sharp fall in long and short term rates due to growth rates weakening. In this event long term borrowings will be postponed, and potential rescheduling from fixed rate funding into variable or short rate funding will be considered.

3.14 Debt Financing Budget 2007/08 to 2009/10

The Debt Financing Budget has been prepared in accordance with the assumptions outlined above, and is attached at **Annex D** for information. The Cabinet is asked to note the proposed Debt Financing Budget, which is included in the Revenue Budget, elsewhere on this agenda.

3.15 Council Policy on Reserves and Balances

The Annual Revenue Budget Report includes the Council's policy on reserves and balances. The Debt Financing Strategy has been prepared on the basis of that policy i.e. maintaining a prudent level of reserves to prevent a serious risk of a deficit or being forced to cut services in the event of a major problem or series of events.

3.16 Balanced Budget Requirement

A new recommendation within the CIPFA Code of Practice on Treasury Management requires this report to include a reference to compliance under the Local Government Act 2003 to produce a balanced budget. Such compliance is demonstrated within the Council Wide Revenue Budget 2007/08 to 2010/11 report contained elsewhere on this agenda.

4. Implications

4.1 Policy

As identified within the body of the report.

4.2 Resources and Risk

The report focuses on the Council's overall Treasury position. Risk analysis and risk management strategies are taken into account throughout the year.

Yes	Capital	Yes	Revenue	No	Accommodation
No	IT	No	Medium Term Plan	No	Asset Management

4.3 Legal

As identified within the body of the report.

4.4 Other Implications

No	Equalities/Diversity	No	Sustainability	No	Human Rights
No	E-Government	No	Stakeholders	No	Crime & Disorder

Background Papers:

CIPFA Code of Practice on Treasury Management - published Dec 2001

Report to Council - Adoption of the above Code of Practice for Treasury Management - 12 March 2002

CIPFA Code of Practice on Treasury Management - revised guidance 2006

Sector (the Council's Treasury Advisors) Bulletins

Local Government Act 2003

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

Guidance on Local Government Investments 2004

CIPFA Prudential Code for Capital Finance in Local Authorities

CIPFA Guidance to the Prudential Code

Capital Programme 2007/08 to 2011/12 Report to Cabinet 20 February 2007

Council Wide Revenue Budget 2007/08 to 2010/11 report to Cabinet 20 February 2007

Prudential Indicators for Capital Finance 2007/08 to 2009/10 Report to Cabinet 20 February 2007