

## **TAUNTON DEANE BOROUGH COUNCIL**

**EXECUTIVE 7<sup>TH</sup> MARCH 2007**

### **REPORT OF THE PRINCIPAL ACCOUNTANT**

**(This matter is the responsibility of Councillor Williams, Leader of the Council)**

#### **TREASURY MANAGEMENT & INVESTMENTS STRATEGY FOR 2007/2008**

##### **EXECUTIVE SUMMARY**

- Council debt at time of issue of report £18m, outstanding investments £14.8m.
- Short-term interest rates to peak by summer 07 (5.5%) and fall again to 4.5% by Dec 08.
- Long-term rates more stable at 4.25% (50yrs).
- World and UK economies and impact of inflation, fuelling concern and caution regarding future interest rate movement.
- Borrowing and debt restructuring, if undertaken, to take advantage of prevailing low long-term rates.
- Investment maturities to be extended in light of current high (relative) rates, whilst maintaining liquidity of cash.

## **1. PURPOSE OF REPORT**

- 1.1 The purpose of this report is to present the treasury management and investment strategies for the financial year 2007/08.

## **2. INTRODUCTION**

- 2.1 The Local Government Act 2003 and supporting regulations require that local authorities have 'regard to' the Prudential Code and set Prudential Indicators for a three year period to ensure that capital investment plans are affordable, prudent and sustainable. Full Council approved these at their meeting on 20 February 2007.
- 2.2 It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992, for authorities to produce a balanced budget. In particular, Section 32 requires a local authority to calculate, in

its budget requirement for each financial year, the revenue costs that flow from capital financing decisions.

This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue, such as:

- Increases in interest charges due to borrowing to finance additional capital expenditure. or
- Increases in running costs, derived from the capital projects...

...are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2.3 Therefore, in the context of the above, authorities are obliged to set out a treasury strategy for borrowing and to prepare an Annual Investment Strategy (section 10) (as required by Investment Guidance issued subsequent to the above Acts); this sets out the policies for managing investments and for giving priority to the security and liquidity of those investments.

2.4 The proposed strategy at this Council for 2007/08 is set out below and based on the opinion of Council treasury officers, supplemented by data, forecasts and opinions of the Councils treasury advisors, Sector Treasury Services Ltd. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy;
- any extraordinary treasury issues

### **3. TREASURY LIMITS FOR 2007/08 TO 2009/10**

3.1 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 the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

- 3.2 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'.
- 3.3 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 ie leasing. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.
- 3.4 Limits in place for 2007/08 and the following two financial years are:
- Authorised Limit of £40,000,000
  - Operational Boundary of £30,000,000

The Operational Boundary reflects both current debt levels and the need to provide operational "elbow room" for short-term borrowing as the need arises. The Authorised Limit is the upper limit of external debt deemed necessary by the Authority.

#### 4. PRUDENTIAL INDICATORS FOR 2007/08 – 2009/10

- 4.1 As identified in section 2.1 above, authorities are required to calculate and incorporate Prudential Indicators to assist in its decision making in determining the affordability, prudence and sustainability of its capital investment decisions. The indicators for 2007/08 – 2009/10 have been incorporated into a table found in Appendix A.

#### 5. CURRENT PORTFOLIO POSITION

- 5.1 The Council's treasury portfolio position at 19/02/07 comprised:

		Principal £'m	£'m	Avg. rate %
<b>Fixed Rate Funding</b>	PWLB	18.014		5.55
	Other	<u>00.080</u>		6.25
<b>TOTAL DEBT</b>			18.094	5.55
<b>TOTAL INVESTMENTS</b>			14.820	5.18

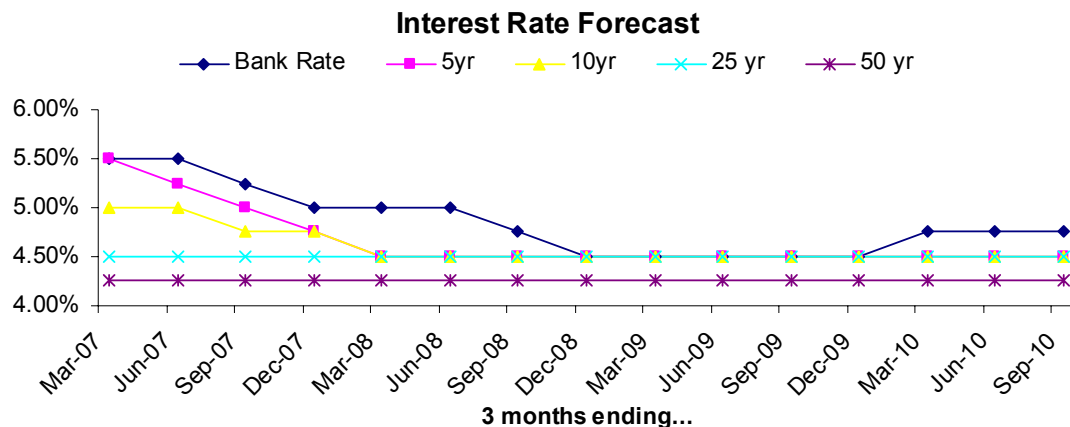
## 6. BORROWING REQUIREMENT

	2005/06 £'000 actual	2006/07 £'000 probable	2007/08 £'000 estimate	2008/09 £'000 estimate	2009/10 £'000 estimate
New Borrowing	794	535	550	550	550
Replacement Borrowing	1,511	9	6	6	0
<b>TOTAL</b>	<b>2,305</b>	<b>544</b>	<b>556</b>	<b>556</b>	<b>550</b>

6.1 This table reflects the expected need for ongoing long-term borrowing to fund capital expenditure, primarily for General Fund Housing Services such as Private Sector Renovation Grants. Central Government provide revenue support for this borrowing via the Revenue Support Grant formula. If this borrowing is not taken out then the Authority funds it by drawing down on the level of cash investments it holds.

## 7. PROSPECTS FOR INTEREST RATES

7.1 Forecasting interest rates is a highly specialised activity, requiring constant analysis of the market and economic data, as it arises across the world. Consequently, this is an area officers are reliant upon specialist consultants to provide analysis and the table below summarises the current expectations of the Councils advisors.



7.2 The above forecast takes account of the recent moves by all the worlds major economies attempts to control inflation against a backdrop of recently strong (and in some cases, still to peak) economies. In the US, where it is generally accepted that the economic cycle is ahead of the rest of the world, the assumption is that rates have peaked and thus can be assumed that the UK and other markets will also follow, albeit with a further rise first, as the 'peak' in the economic cycle reaches here.

- 7.3 As inflation is controlled and the UK and world economy slows, the pressure will be to reduce rates to reverse the negative impact that rising rates have on the economy (increases borrowing costs, stifling investment and consequential growth), thus we see a trend of lowering rates by the end of 2007.
- 7.4 The risk to this forecast is dependant upon the ability to influence inflation and in particular lower it. Therefore, much interest will be taken in the consequences of rate changes on the housing market, annual wage demand and consumer spending. The US experience has been a significant downturn in the housing market, resulting in a slide in the economy in general, as householders see their 'wealth' (in property) decrease, increasing a desire to cut spending and increase savings.
- 7.5 Although the UK housing market remains robust, avoiding a 'crash' that may stimulate a vicious circle of curbing consumer spending and economic downturn generally, which itself may fuel further, household / consumer caution, will be key to the MPC's decision making processes over the coming period.

## **8. BORROWING STRATEGY**

- 8.1 The chart presented in 7.1 above, incorporated the rates for borrowing from 5-50 years and therefore central to the Councils strategy for borrowing to finance its capital programme.
- 8.2 It is clear that the least expensive rate of borrowing is for 50 years and this is to set to continue over the foreseeable future. Therefore, any requirement to borrow in the coming financial year will seek to time this borrowing, if and when rates fall further or, over 50 year time period, to minimise the cost to the authority.
- 8.3 No advantage can be seen in alternative borrowing currently, however, as rates would change significantly, should the UK and world economy either 'overheat' and or experience recession, alternative strategies will be considered in light of the information available at the time and reported to members in due course.

## **9. DEBT RESTRUCTURING**

- 9.1 As discussed above, currently, the least expensive borrowing is around the 50yr time period and thus attractive to authorities wishing to restructure their debt portfolios as well as undertake new borrowing.

However, this approach is restricted by the potential penalty of premiums, that may be payable on any debt repaid in advance of its normal maturity date.

- 9.2 This Council has a portfolio of loans that currently attract premium, however, internal debt currently amounts to in excess of £3m and could demonstrate a route to revenue savings should external interest rates move favourably as expected. Consequently, monitoring of rates will continue throughout the financial year and restructuring will take place when optimum benefit can be obtained. Any restructuring undertaken will be reported to members at the earliest opportunity following the event.

## **10. ANNUAL INVESTMENT STRATEGY**

### **10.1 Investment Policy**

The Council applies Central Government and CIPFA guidance in its approach to managing investments with priority given over to the security of capital and liquidity of its cash flows, whilst seeking to optimise returns commensurate with these 'limitations'.

- 10.2 Achievement of target returns are made through investment instruments identified for use in the financial year and is listed in Appendix B, under 'Specified' and 'Non-Specified' Investments categories.

- 10.3 Counterparties used for these investments and the limits set to mitigate risk with each, will be as set through the Council's Treasury Management Practices document.

### **10.4 Investment Strategy**

The Councils cash funds are managed internally and derive entirely from the flux in cash coming in and out of the Council across the financial year. Consequently, liquidity is key to effective management of these funds and no investment will be made without consideration as to the timing of its return.

- 10.5 Keeping the above in mind and the forecast of a decrease in investment rates (see Bank Rate in chart in 6.1), officers will seek to lengthen the period of investment where possible and lock into more attractive rates now, with the expectation that they will diminish in the future.

- 10.6 The average return expected for the forecast rate in 2007/08 is 5.19%; therefore, officers will use this as a trigger point to determine the decision to invest and / or the period of investment. This rate will be kept under review and revised in light of any alteration to forecast rates.

## **11. OTHER ISSUES**

- 11.1 The treasury management and investment strategies, outlined above, have assumed the largely neutral impact of Project Taunton, as per all option appraisals undertaken to date. However, projects of this scale can have both a positive or negative impact on the timing of capital expenditure and thus cash flow. As the project stages are developed and approved any impact on the Treasury function will be assessed and strategies may have to be altered. Any impact on strategy will be reviewed as options are considered and reported to members throughout.

## **12. IMPACT ON CORPORATE PRIORITIES**

- 12.1 Treasury Management supports the entire range of services within the Council and thus has an impact on all Corporate Priorities.

## **13. RECOMMENDATIONS**

- 13.1 The Executive are requested to approve the proposed Treasury Management Strategies outlined in this report.

### **Background Papers**

Executive 21/06/06 – Treasury Management Outturn 2005/06 & 2006/07 Update.

Executive 07/02/07 – General Fund Revenue Estimates 2007/08

**Contact Officer:** Steve Murphy,  
Principal Accountant,  
Tel: (01823) 331448 or Ext 2515  
E-mail: [s.murphy@tauntondeane.gov.uk](mailto:s.murphy@tauntondeane.gov.uk)

## Appendix A

PRUDENTIAL INDICATOR	2005/06 £'000	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000
	out-turn	estimate	estimate	estimate	estimate
<b>Capital Expenditure</b>					
General Fund	£4,196,369	£3,279,910	£2,240,200	£1,725,200	£3,442,100
HRA	£4,991,450	£4,115,000	£4,907,700	£5,062,400	£5,265,400
TOTAL	£9,187,819	£7,394,910	£7,147,900	£6,787,600	£8,707,500
<b>Ratio of financing costs to net revenue stream</b>					
General Fund	-0.03%	-1.91%	-5.48%	-3.51%	-2.98%
HRA	5.00%	4.00%	3.93%	3.73%	3.55%
<b>Net borrowing requirement</b>					
brought forward 1 April	£3,959,700	£5,897,121	£6,633,630	£7,133,630	£7,633,630
Carried forward 31 March	£5,897,121	£6,633,630	£7,133,630	£7,633,630	£8,133,630
in year borrowing requirement	£1,937,421	£736,509	£500,000	£500,000	£500,000
<b>Capital Financing Requirement as at 31 March</b>					
General Fund	£6,400,779	£7,137,288	£7,637,288	£8,137,288	£8,637,288
HRA	£14,291,342	£14,291,342	£14,291,342	£14,291,342	£14,291,342
TOTAL	£20,692,121	£21,428,630	£21,928,630	£22,428,630	£22,928,630
<b>Incremental impact of capital investment decisions</b>					
Increase in council tax (band D)	£ p	£ p	£ p	£ p	£ p
	0.99	0.50	0.50	0.50	0.50
<b>Authorised limit for external debt -</b>					
TOTAL	£40,000,000	£40,000,000	£40,000,000	£40,000,000	£40,000,000
<b>Operational boundary for external debt -</b>					
TOTAL	£30,000,000	£30,000,000	£30,000,000	£30,000,000	£30,000,000
<b>Upper limit for fixed interest rate exposure</b>					
Net interest re fixed rate borrowing/ investments	100%	100%	100%	100%	100%
<b>Upper limit for variable rate exposure</b>					
Net interest re variable rate borrowing/ investments	50%	50%	50%	50%	50%
<b>Upper limit for total principal sums invested for over 364 days (per maturity date)</b>					
	£2m or 20%	£2m or 20%	£2m or 20%	£2m or 20%	£2m or 20%



## Appendix B

<b><u>Specified Investments</u></b>	<b><u>Credit Criteria</u></b>	<b><u>Maximum Maturity</u></b>
Debt Management Account Deposit Facility (DMADF)	Not applicable	1 year
Term Deposits – Local Authorities	Not applicable	1 year
Term Deposits – Banks and Building Societies	Fitch: AA - Long Term F2 – Short Term C – Individual 3 – Support	1 year
Callable Deposits – Banks and Building Societies	Fitch: AA - Long Term F2 – Short Term C – Individual 3 – Support	1 year.
Money Market Funds	AAA only	Not applicable, instant access available to all of deposit.
<b><u>Non-Specified Investments</u></b>		
Term Deposits with unrated counterparties	Top 20 Building Societies Only	2 years
Term Deposits – Local Authorities	Not applicable	2 years
Term Deposits – Banks and Building Societies	Fitch: AA - Long Term F2 – Short Term C – Individual 3 – Support	2 years

NB – all Investments are limited to a maximum amount of, the lesser of £2m or 20%, of investment portfolio, per Counterparty.