AGENDA ITEM NO. 5

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 9TH MARCH 2005

REPORT OF THE FINANCIAL SERVICES MANAGER
(This matter is the responsibility of Councillor Williams, Leader of the Council)

TREASURY MANAGEMENT & INVESTMENTS STRATEGY FOR 2005/2006

EXECUTIVE SUMMARY

The Council is required to consider an annual Treasury Management Strategy, the key points of the 2005/06 Strategy are as follows,

- This year's documentation incorporates the Annual Investments Strategy.
- External Borrowing remains relatively static at £19.5m, with average cost reducing due to refinancing. (5.31% current, 6.18% last year). Possibility exists for further reductions in 05/06.
- Return on investments up from 3.85% last year to 4.21% currently. Expectation of small reduction on 05/06 or no change.
- Uncertainty over precise timing of peak and then decline in short term interest rates, but consensus is downward expectation.
- Borrowing / refinancing and investment strategy based on seeking out favourable (temporary) movements in interest rates due to market reaction to economic data.
- Summaries on Prudential Indicators, economic data and approach to investments provided in Appendices.

1. PURPOSE OF REPORT

1.1 The purpose of this report is to present the strategy for treasury management activity for the financial year 2005/06.

2. INTRODUCTION

2.1 The Council has customarily considered an annual Treasury Strategy Statement under the requirement of the CIPFA Code of Practice on Treasury Management, which was adopted by the Council on 26/02/02. The 2003 Prudential Code for Capital Finance in local authorities has introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.

2.2 The Prudential Code requires the Council to set a number of Prudential Indicators over the forthcoming three-year period. These were considered and approved by Council on the 22nd February 2005 as part of the budget setting process. Details of the Prudential Indicators can be found in Appendix A.

2.3 The suggested strategy for 2005/06 in respect of the following aspects of the treasury management function is based upon the Treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor. The strategy covers:

- The current treasury position;
- Prospects for interest rates;
- The borrowing strategy;
- The investment strategy;
- Prudential Indicators

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position at 24/02/05 comprised:

		Principal	Principal	Average Rate
		£m	£m	
Fixed rate funding	PWLB	19.5		
TOTAL DEBT			**19.5**	**5.31%**
TOTAL INVESTMENTS			**18.8**	**4.21%**

4. PROSPECTS FOR INTEREST RATES

4.1 There is some doubt and discussion as to whether short-term interest rates have peaked or not, however, there is more of a consensus that the trend will be downward in the future. Amongst the lowest figures predicted is 3.5% by the end of the next financial year. Should this prove to be the case pressure would be on investment returns however, some offset would be possible through cheaper debt. Further details of estimates provided by our Treasury Management advisors and other forecasters can be found in Appendix B.

4.2 Long term rates (25yrs +) are not expected to rise as much as previously thought, hovering around anything between 4.5% and 4.75%, dependant on forecaster.

5. BORROWING STRATEGY

5.1 The Council's strategy for borrowing remains looking for favourable movements in interest rates that will offer the opportunity to take discounts when redeeming debt or refinancing it.
Alternatively, with the expected trend towards reducing short-term rates (base rate), there may be opportunities to move into variable rated debt, thus relieving the debt cost to the authority. Either way, with no immediate plans to repay debt in full, the focus remains on minimising the cost to the General Fund and ultimately the taxpayer.

5.2 It is expected that the Council will be able to take advantage of the scenario described above when loans to the value of £1.5m mature during 2005/06.

6. INVESTMENTS STRATEGY

6.1 With short terms interest rates expected to slide during the forthcoming year, the expectation is that investment returns will not exceed much beyond budgeted levels, as we saw in the current 2004/05 financial year. This however will not change our tactics of seeking value out of favourable, but temporary, 'blips' in the market, as it reacts to sentiment and data from various economic sources. The policy has achieved us much success in the past by 'piggybacking' the advice received from advisors and is considered prudent to follow in the future.

6.2 The investment tools used for Council's cash flows remain unchanged from Annual Investment Strategy Report dated 11/02/04, as does much of the criteria and level of exposure chosen prior to investment. These have been summarised in Appendix C.

7. IMPACT ON CORPORATE PRIORITIES

7.1 Treasury Management supports the entire range of services within the Council and consequently has an impact on all Corporate Priorities.

8. RECOMMENDATIONS

8.1 The Executive is requested to approve the proposed Treasury Management Strategy outlined in this report.

Background Papers
Executive 09/02/05 – General Fund Revenue Estimates 2005/06
Executive 11/02/04 – Annual Investments Strategy

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Appendix A

PRUDENTIAL INDICATOR	2003/04 £'000	2004/05 £'000	2005/06 £'000	2006/07 £'000	2007/08 £'000
	actual	probable outturn	estimate	estimate	estimate
Capital Expenditure					
General Fund	£3,794,266	£3,893,834	£4,432,430	£2,052,000	£1,991,500
HRA	£4,016,529	£7,395,201	£5,109,800	£4,335,000	£4,335,000
TOTAL	£7,810,795	£11,289,035	£9,542,230	£6,387,000	£6,326,500
Ratio of financing costs to net revenue stream					
General Fund	-0.71%	-2.88%	0.79%	1.14%	1.62%
HRA	9.66%	4.74%	4.46%	4.14%	3.95%
Net borrowing requirement					
brought forward 1 April	£8,692,159	£5,029,550	£6,532,227	£6,020,166	£5,011,702
carried forward 31 March	£5,029,550	£6,532,227	£6,020,166	£5,011,702	£5,005,938
in year borrowing requirement	-£3,662,609	£1,502,677	-£512,061	-£1,008,464	-£5,764
Capital Financing Requirement as at 31 March					
General Fund	£8,067,714	£7,441,053	£8,067,714	£7,808,193	£7,817,621
HRA	£14,291,342	£14,291342	£14,291,342	£14,291,342	£14,291,342
TOTAL	£22,359,056	£21,732,395	£22,359,056	£22,099,535	£22,108,963
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D)	-£0.78	-£3.36	£0.97	£1.44	£2.10
Authorised limit for external debt -					
TOTAL	£40,000,000	£40,000,000	£40,000,000	£40,000,000	£40,000,000
Operational boundary for external debt -					
TOTAL	£30,000,000	£30,000,000	£30,000,000	£30,000,000	£30,000,000
Upper limit for fixed interest					

rate exposure					
Net interest re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net interest re variable rate borrowing / investments	50%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days					
(per maturity date)	£2m or 25%	£2m or 25%	£2m or 25%	£2m or 25%	£2m or 25%

Appendix B

Interest Rate Forecasts

The tables below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of Sector Treasury Services (the Councils' advisors) UBS and Capital Economics (all independent forecasting consultancies). The final table represents summarised figures drawn from the population of all major City banks and academic institutions.

Sector View interest rate forecast – February 2005

	Q/E1 2005	Q/E2 2005	Q/E3 2005	Q/E4 2005	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007
Base rate	4.75%	5.00%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.25%	4.50%	4.50%	4.75%
5yr Gilt Yield	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.75%	4.75%	5.00%
10yr PWLB Rate	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%
25yr PWLB Rate	4.75%	4.75%	4.75%	4.75%	4.50%	4.75%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%

UBS Economic interest rate forecast (for quarter ends) - January 2005

	Q/E1 2005	Q/E2 2005	Q/E3 2005	Q/E4 2005	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006
Base Rate	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
10 yr PWLB rate	4.70%	4.60%	4.65%	4.70%	4.70%	4.70%	4.70%	4.70%
25 yr PWLB rate	4.55%	4.55%	4.60%	4.65%	4.65%	4.65%	4.65%	4.65%

Capital Economics interest rate forecast – January 2005

	Q/E1 2005	Q/E2 2005	Q/E3 2005	Q/E4 2005	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006
Base Rate	4.75%	4.50%	4.25%	4.00%	3.75%	3.50%	3.50%	3.50%
5yr gilt yield	4.40%	4.30%	4.20%	4.00%	3.80%	3.60%	3.70%	3.80%
10 yr PWLB rate	4.55%	4.45%	4.45%	4.35%	4.25%	4.15%	4.25%	4.35%
25 yr PWLB rate	4.50%	4.40%	4.50%	4.45%	4.50%	4.50%	4.55%	4.55%

HM Treasury – 16.02.2005 summary of forecasts of 26 City and 14 academic analysts for Q4 2005 and 2006. (2007 – 2009 are as at February 2004 but are based on 18 forecasts)

	Repo	Quarter ended		annual average repo rate		
		Q4 2005	Q4 2006	ave. 2007	ave. 2008	ave. 2009
Indep. forecasters BoE Base Rate	4.75%	4.69%	4.55%	4.58%	4.76%	4.70%
Highest base rate	4.75%	5.75%	5.75%	5.25%	5.31%	5.30%
Lowest base rate	4.75%	4.00%	3.50%	4.00%	3.83%	3.75%

Appendix C

Extracts from Treasury Management Practices Document

1.5 Credit & Counterpart Policies

1.5.1 Criteria to be used for creating / managing approved counterparty lists and limits

i) The Chief Financial Officer will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising time, type, sector and specific counterparty limits.

ii) Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties. The complete list of approved counterparties will be included in the annual Treasury Management Strategy report.

iii) This Council will use credit criteria in order to select creditworthy counterparties for placing investments with.

iv) Credit ratings will be used as supplied from one or more of the following credit rating agencies supplied via its Treasury Management advisers, Sector Treasury Services Ltd.: -

Fitch

vi) The minimum level of credit rating, using Fitch's, for an approved counterparty will be as follows: -

'AA' Long Term

'F2' Short Term

'C' Individual

& '3' Support

vii) When lending to UK Building Societies, no specific rating criteria are to be used, however lending will be limited to the top 20 societies based on asset size.

viii) The maximum exposure to any single counterparty and / or wholly owned subsidiaries (in aggregate) shall be no more than £2,000,000 (two million, pounds), or 25% of the investment pool, whichever the lower, at the outset of the transaction.

ix) The maximum period for investments will be 2 yrs.

x) The maximum period for investment for subsidiaries of counterparties that do not have credit ratings in their own right, but do have unconditional guarantees from a parent, is 2 yrs, in line with the maximum period outlined above.

xi) Country of origin shall not be a bar on entering in to transactions with counter-parties.

xii) Dealing shall be conducted, either directly or via a broker, having first consulted the FSA register of organisations authorized to accept deposits within the UK. (See Section 1.7.3 below)

4.2 Approved instruments for investments

4.2.1 In accordance with powers given by virtue of The Local Government Act 2003 the instruments approved for investment and approved for use at this Council:

- Deposits with banks, building societies or local authorities (and certain other bodies) for up to 2 yrs.
- Business Reserve Accounts
- Money Market Funds
- Debt Management Account Deposit Facility (DMADF)