

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 8TH MARCH 2006

REPORT OF THE PRINCIPAL ACCOUNTANT

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

TREASURY MANAGEMENT & INVESTMENTS STRATEGY FOR 2006/2007

EXECUTIVE SUMMARY

- The report briefly highlights the intended approach for treasury management over the next financial year. It focuses on debt/ borrowing and investments, having given consideration of the forecasts for interest rates and the impact this has on key Prudential Indicators.

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the treasury management strategy for the financial year 2006/07.

2. INTRODUCTION

- 2.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code (adopted 26/02/02) and to set Prudential Indicators (appendix A) for the next three years to ensure the Council's capital investment plans are affordable, prudent and sustainable.
- 2.2 The Act also requires the Council to set out its treasury strategy for borrowing and to prepare an annual investment strategy (see section 6). This sets out the Council's plans for managing its investments and for giving priority to the security and liquidity of those investments.
- 2.3 The suggested strategy for 2006/07 is based on the Treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury adviser. The strategy covers:
- The current treasury position;
 - Prospects for interest rates;
 - The borrowing strategy;
 - The investment strategy;
 - Prudential Indicators (appendix A)

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position at 20/02/06 comprised:

		Principal £'m	Principal £'m	Average Rate
Borrowing				
Fixed rate funding	PWLB	19.526		
	SCC	0.078		
	Other	0.007		
TOTAL DEBT			19.611	5.78%
Investments				
Fixed Rate		15.000		
Variable Rate		3.275		
TOTAL INVESTMENTS			18.275	4.70%

4. PROSPECTS FOR INTEREST RATES

4.1 As the TM Update report (dated 11/01/06) mentioned, there is little movement expected in short-term rates with any minor movement 'correcting itself' over a three-year horizon. Most volatility is expected in 2006/07 with a low of 4.00% (4.50% current) and predicted rises possibly as high as 4.75%. Further details of interest rate estimates provided by our advisers and other forecasters are in appendix B.

4.2 Long-term rates have and are expected to remain rather flat, over 2006/07, followed by possible 0.25% increases in the final quarter of the financial year and first quarter of 2007/08. Tables from various forecasters can also be found in appendix B.

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 forecast of a cut in short-term rates, there may be opportunities to move into variable rate debt, thus reducing the debt cost to the authority. Either way, with no immediate plans to repay debt in full, the focus remains on reducing the cost to the General Fund and eventually the taxpayer.

5.2 Debt currently scheduled to mature in 2006/07, and for the following two financial years, constitutes a modest £25k. Therefore it is assumed that opportunities for significant restructuring now are low.

6. INVESTMENTS STRATEGY

- 6.1 With the forecast volatility in short-term interest rates during the forthcoming year, the expectation is that investment returns will not exceed much beyond budgeted levels, as we have seen in recent financial years. This however, will not change our strategy 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 advisers and is considered prudent to follow in the future.
- 6.2 The investment tools used for Council's cash flows remain unchanged from previous reports, as these are enough to ensure the returns we currently enjoy, as well as being of low-risk for the authority. An extract from our treasury management practices document has been provided in appendix C, listing these tools.

7. OTHER ISSUES

- 7.1 The above strategies do not currently incorporate any change of policy and or strategy because of the potential for LSVT or impact of the Vision for Taunton. Both of these issues would result in a significant change in investments and debt levels of the authority and would compel an equally significant review of current strategy. Treasury officers and advisers are constantly reviewing progress in these areas and will present changed strategies as outcomes and plans become clearer.

8. IMPACT ON CORPORATE PRIORITIES

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

9. RECOMMENDATIONS

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

Background Papers

Executive 16/11/05 –	Capital Programme Update 2006/07
Executive 11/01/06 –	Treasury Management Update 2005/06
Executive 08/02/06 –	General Fund Revenue Estimates 2006/07, Capital Programme 2006/07 to 2008/09

Contact Officer:

Steve Murphy
Principal Accountant (01823) 331448
E-Mail: j.murphy@tauntondeane.gov.uk

Appendix A

PRUDENTIAL INDICATOR	2004/05 £'000	2005/06 £'000	2006/07 £'000	2007/08 £'000	2008/09 £'000
	actual	probable out- turn	estimate	estimate	estimate
Capital Expenditure					
General Fund	£3,404,088	£9,671,133	£6,555,300	£1,839,500	£1,710,500
HRA	£5,568,192	£4,913,019	£4,472,000	£4,472,000	£4,472,000
TOTAL	£8,972,280	£14,584,152	£11,027,300	£6,311,500	£6,182,500
Ratio of financing costs to net revenue stream					
General Fund	-7.64%	0.79%	1.09%	1.37%	1.97%
HRA	5.55%	4.46%	4.00%	3.31%	3.04%
Net borrowing requirement					
brought forward 1 April	£8,692,159	£5,029,550	£2,020,166	£2,010,166	£2,000,166
Carried forward 31 March	£5,029,550	£2,020,166	£2,010,166	£2,000,166	£1,990,166
in year borrowing requirement	-£3,662,609	-£3,009,384	-£10,000	-£10,000	-£10,000
Capital Financing Requirement as at 31 March					
General Fund	£5,808,354	£6,760,602	£7,533,226	£8,275,897	£9,017,897
HRA	£14,291,342	£14,291,342	£14,291,342	£14,291,342	£14,291,342
TOTAL	£20,099,696	£21,051,944	£21,824,568	£22,567,239	£23,309,239
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D)	1.04	1.18	1.37	1.80	2.70
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 20%	£2m or 20%	£2m or 20%	£2m or 20%	£2m or 20%

Appendix B

Interest Rate Forecasts

The tables below shows various forecasts published by some institutions. The first three are individual forecasts including those of Sector Treasury Services (the Councils' advisers) 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 – January 2006

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	Q /E1 2007	Q /E2 2007	Q /E3 2007	Q /E4 2007	Q /E1 2008	Q /E2 2008	Q /E3 2008	Q /E4 2008	Q /E1 2009	Q /E2 2009
Base rate	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
5yr Gilt Yield	4.00%	4.00%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
10yr PW LB Rate	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	4.75%	4.50%
25yr PW LB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	4.75%	4.50%
50yr PW LB Rate	4.00%	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.50%	4.25%

UBS Economic interest rate forecast (for quarter ends) - January 2006

	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	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
10 yr PWLB rate	4.25%	4.35%	4.45%	4.55%	4.60%	4.60%	4.65%	4.65%
25 yr PWLB rate	4.15%	4.45%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%
50 yr PWLB rate	4.05%	4.45%	4.61%	4.74%	4.80%	4.86%	4.91%	4.97%

Capital Economics interest rate forecast – January 2006

	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	4.25%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
5yr gilt yield	4.10%	4.00%	3.90%	3.80%	4.00%	4.10%	4.30%	4.40%
10 yr PW LB rate	4.25%	4.15%	4.25%	4.35%	4.55%	4.75%	4.85%	4.75%
25 yr PW LB rate	4.25%	4.25%	4.35%	4.45%	4.45%	4.55%	4.65%	4.65%
50 yr PW LB rate	3.95%	3.95%	4.05%	4.15%	4.15%	4.25%	4.35%	4.35%

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

	Repo	Q uarter ended		annual average repo rate		
		Q 4 2005	Q 4 2006	ave.2007	ave.2008	ave.2009
Indep. forecasters BoE Base Rate	4.50%	4.49%	4.29%	4.39%	4.54%	4.60%
H ighest base rate	4.50%	4.55%	5.00%	5.40%	5.90%	6.20%
Low est base rate	4.50%	4.20%	3.50%	3.75%	3.75%	3.75%

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: -
 - 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)