AGENDA ITEM NO. 6

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 5 MARCH 2008

REPORT OF THE PRINCIPAL ACCOUNTANT

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

TREASURY MANAGEMENT & INVESTMENTS STRATEGY FOR 2008/2009

EXECUTIVE SUMMARY

- Council debt at time of issue of report £21m, outstanding investments £16.6m.
- Short-term interest rates look to fall to 4.75% by end of financial year but possibility of maintaining current levels or smaller decreases if inflation becomes problematic
- Long-term rates more stable at 4.45-4.50% (50yrs) for this financial year.
- 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 lower rates and match our debt to capital needs.

1. PURPOSE OF REPORT

1.1 The purpose of this report is to present the treasury management and investment strategies for the financial year 2008/09.

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 19 February 2008.

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 2008/09 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 2008/09 TO 2010/11

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 2008/09 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 2008/09 – 2010/11

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 2008/09 – 2010/11 have been incorporated into a table found in Appendix A and are for information only following Council approval on February 19th 2008.

5. CURRENT PORTFOLIO POSITION

5.1 The Council’s treasury portfolio position at 21/02/08 comprised:

		Principal £’m	£’m	Avg. rate %
Fixed Rate Funding	PWLB	18.008		5.55
	Other	3.079		4.25
TOTAL DEBT			21.087	5.36
TOTAL INVESTMENTS			16.571	5.61

6. BORROWING REQUIREMENT

	2007/08 £’000 probable	2008/09 £’000 estimate	2009/10 £’000 estimate	2010/11 £’000 estimate
New Borrowing	210	2,821	821	821
Replacement Borrowing	6	6	0	0
TOTAL	216	2,827	821	821

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.

6.2 However, for 2008/09 some £2m of borrowing is intended to finance transformation projects associated with Southwest One. The latter borrowing is only temporary and will be repaid on receipt of released cash savings arising out of the Southwest One contract. 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.

	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011
Bank Rate	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.55%	4.55%	4.50%	4.50%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.85%	4.85%
10yr PWLB rate	4.60%	4.55%	4.50%	4.50%	4.55%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.80%
25yr PWLB rate	4.55%	4.50%	4.50%	4.50%	4.50%	4.55%	4.60%	4.65%	4.70%	4.70%	4.75%	4.75%	4.75%	4.75%
50yr PWLB rate	4.50%	4.45%	4.45%	4.45%	4.45%	4.50%	4.55%	4.60%	4.60%	4.65%	4.65%	4.65%	4.65%	4.60%

7.2 As ever the the forecast above has been developed over time as the economic data across the world arises and consequential opinion and sentiment on impact is voiced, usually first of all coming from the US. Indeed the latest 'crisis' in sub prime lending there and significant downturn in the housing market has lead to 'a sharp downturn in economic sentiment' which lead to the US Federal Bank making drastic rate cuts in response.

7.3 Due to the ever increasing mutual dependency of world markets, the negative sentiment in the US, and actual downturn in economic growth, is eventually felt across the world, which has lead to similar pressures on the Bank of England to reduce interest rates. However, there has been no clamour to make such drastic a reduction in rates and in the UK the expectation is of a much softer fall.

7.4 In addition, despite economic downturn, inflation would seem to persist and in the UK there will be a reluctance to reduce rates further if inflation remains relevant in the background. Indeed our advisers warn that the risk to the forecast above is that rates will rise, should inflation worsen and this should be borne in mind setting any strategies.

8. BORROWING STRATEGY

8.1 The chart presented in 7.1 above, incorporated the rates for borrowing from 5-50 years and therefore is central to the Councils strategy for borrowing to finance its capital programme.

8.2 Although the least expensive borrowing is in the 50 yr bracket, officers will seek to establish a maturity profile that best matches out capital needs, cash flows and with an eye on the consequences of PWLB new borrowing terms and conditions (see 9.1 below). In addition, given the forecast of increasing rates, officers are engaged in establishing future borrowing requirements to consider bringing forward any borrowing at a time of lower rates. This is consistent with prudential treasury management and a permitted strategy from a regulatory point of view.

8.3 As an alternative to PWLB borrowing the Council has and will continue to consider other lenders and types of debt structure. The approach was demonstrated during 2007 when the Council externalised £3m of its debt with Barclays bank at a cost of 4.25% per annum, a rate at the time well below that of the PWLB.

9. DEBT RESTRUCTURING

9.1 The Council will always seek to restructure its debt when advantageous to do so and undertook such and exercise in December of 2006. However, since November 8th 2007, the PWLB changed their lending arrangements, which had the impact of significantly increasing the penalties this Council would have to pay on early redemption of debt. The result means that significant savings would have to be evident before restructure takes place but officers and advisors will continue to seek out those opportunities.

10. ANNUAL INVESTMENT STRATEGY

10.1 **Investment Policy**

10.1.1 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**

10.4.1 The Councils cash funds are managed internally and derive entirely from the flux in cash coming in an 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 2008/09 is 4.81%; 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.

10.7 In 2008/09 we have budgeted to receive £750k in investment income within the General Fund, Members may be interested to note that this is the equivalent of a 14.2% increase in Council Tax.

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 a 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 be 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 20/06/07 – Treasury Management Outturn 2006/07 & 2007/08 Update.
Executive 06/02/08 – General Fund Revenue Estimates 2008/09

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Appendix A

PRUDENTIAL INDICATOR	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000	2010/11 £'000
	Outturn	**estimate**	**estimate**	**estimate**	**estimate**
Capital Expenditure					
General Fund	£3,279,910	£4,655,110	£3,946,000	£1,566,520	£3,176,740
HRA	£4,115,000	£5,655,700	£5,082,390	£5,265400	£5,450,030
TOTAL	£7,394,910	£10,310,810	£9,028,390	£6,831,920	£8,626,770
Ratio of financing costs to net revenue stream					
General Fund	-1.91%	-5.48%	0%	0.5%	0.5%
HRA	4.00%	3.93%	3.35%	3.19%	3.05%
Net borrowing requirement					
brought forward 1 April	£5,897,121	£6,633,630	£10,000,000	£12,000,000	£12,000,000
Carried forward 31 March	£6,633,630	£10,000,000	£12,000,000	£12,000,000	£12,000,000
in year borrowing requirement	£736,509	£3,310,623	£2,000,000	£0	£0
Capital Financing Requirement as at 31 March					
General Fund	£7,137,288	£9,394,827	£10,014,827	£10,634,827	£11,254,827
HRA	£14,451,342	£14,451,342	£14,451,342	£14,451,342	£14,451,342
TOTAL	£21,588,630	£23,846,169	£24,466,169	£25,086,169	£25,706,169
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D)	0.50	0.65	0.65	0.65	0.65
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

	Credit Criteria	Maximum Maturity
Specified Investments		
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.
Non-Specified Investments		
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.