

**TAUNTON DEANE BOROUGH COUNCIL**

**EXECUTIVE**

**WEDNESDAY 12TH MARCH 2003**

**REPORT OF THE FINANCIAL SERVICES MANAGER**

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

**TREASURY MANAGEMENT STRATEGY STATEMENT FOR 2003/2004**

**1. PURPOSE OF REPORT**

- 1.1** The purpose of this report is to present the strategy for treasury management activity for the financial year 2003/04.

**2. INTRODUCTION**

- 2.1** This Treasury Management Strategy details the expected activities of the Treasury management function in 2003/04, and outlines the objectives to be adopted. The Executive must approve the Strategy prior to the start of the financial year to which it applies. The strategy for 2003/04 is based upon the Financial Services Manager's views on interest rates, supplemented with forecasts provided by the Council's treasury advisors. The strategy covers:

- the current treasury position;
- treasury limits in force which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;
- minimum revenue position;
- the extent of debt rescheduling opportunities

- 2.2** Sector Treasury Services Ltd are the Council's current treasury advisors, and part of their service is to assist the Council formulate a view on interest rates, as stated in 2.1. Appendix A draws together a number of current City forecasts for short term and longer fixed interest rates.

### 3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position at 27/02/03 comprised:

	<b>Principal</b>	<b>Av'gRate</b>
<b>Borrowing:</b>		
Fixed Rate Funding PWLB	£22,047,265	
Local Market Bond	£ 200	
Other Miscellaneous Loans	£ 90,512	
<b>Total Debt</b>	<b>£22,137,977</b>	<b>6.80%</b>
<b>Investments:</b> <small>*(see Appendix B)</small>		
Money Market Investments	£15,850,000	
Abbey National Business Reserve Acc't	£ 1,000,000	
Royal Bank of Scotland Bus. Res. Acc't	£ 1,400,000	
<b>Total Investments</b>	<b>£18,250,000</b>	<b>3.96%</b>

### 4. TREASURY LIMITS FOR 2003/2004

4.1 In accordance with Section 45 of the Local Government and Housing Act, 1989, the Treasury limits set by Council on 25<sup>th</sup> February 2003 are:

Overall Borrowing Limit £44,000,000

The maximum proportion of the borrowing limit that may be outstanding by way of short-term borrowing. 25%

The maximum proportion of total borrowing that is subject to variable rate interest. 50%

### 5. PROSPECTS FOR INTEREST RATES

5.1 Until very recently, the basic rate was anticipated to remain stable at 4% throughout 2003. Whilst downward pressure arose from weak manufacturing output, deflated equity markets and uncertainty surrounding Iraq, this was compensated for by the risks to inflation arising from the prospect of still further house price increases.

5.2 The reduction of base rate to 3.75% is primarily the result of the Bank of England taking the view that household consumption growth will ease following a reduction in consumer confidence, and that house price inflation will fall to zero over the next two years.

5.3 Interest rate levels are now considered by the Bank to be at the right level to enable their 2.5% inflation target, in association with which they have revised their growth forecast down from 3.1% to 2.5%.

However, the consensus market view is that growth could be lower, which could result in a further 0.25% fall in the Base rate, within an environment that could cause it to go lower still.

- 5.4 As a consequence of the above, short term interest rates will broadly match the base rate, whilst long-term rates (which have implications only for any new borrowing carried out by the Council) can be expected to fluctuate within a band broadly 1% above this level.

## **6. EXTERNAL BORROWING STRATEGY**

- 6.1 The Council's external borrowing arises from the long term financing of its capital programme. The level of borrowing at 31<sup>st</sup> March 2003 will be some £22 million and will remain at this level throughout 2003/04. The aggregate of external borrowing comprises mainly 16 loans with the Public Works Loans Board, none of which fall due for repayment within the next financial year.

- 6.2 Until recently, the Council has used some of its own fund balances to finance temporarily what would otherwise be an external borrowing liability. However, continuing levels of Council house sales have resulted in releasing cash used to repay our debt and reduce the need to use these funds. This has freed these funds for use in temporary investments and brought our actual debt back inline with the external borrowing liability. Approximately 80% of the Council's external borrowing liability represents housing debt, for which an annual subsidy is received by the Housing Revenue Account to cover the revenue costs of interest and repayment provision.

- 6.3 The Council's external borrowing strategy for 2003/04 is, as a consequence of the above, to simply maintain the existing debt portfolio, and to consider rescheduling opportunities should it be considered opportune to do so.

## **7. SHORT-TERM INVESTMENTS STRATEGY**

- 7.1 The Council's short-term investments comprise of revenue balances, reserves and provisions (some £10 million at 31<sup>st</sup> March 2002) together with any other cash flow surpluses that arise on a relatively consistent, whilst varying basis.

- 7.2 The downward movement of base rate referred to above means that the short terms deposits that are provided for under regulation as "approved investments" will similarly be lower.

- 7.3 Although it is possible to invest for varying periods within the 12 month time band allowed by the Approved Investment Regulations for most forms of investment, differentials have become much more narrow. Consequently it is proposed that for the time being, opportunities should be taken to optimise returns within these parameters.

One example is the use of a Business Reserve Account, which secures rates for at least monthly periods, whilst also offering instant access.

## **8. MINIMUM REVENUE PROVISION**

- 8.1 Repayment of both HRA and General Fund debt will be accounted for at 2% (HRA) and 4% (Gen Fund), the minimum permissible under the regulations.

## **9. DEBT RESCHEDULING**

- 9.1 Debt rescheduling if appropriate will be carried out to lengthen the debt portfolio maturity in line with the interest rate scenario and strategy outline in section 6 above. This will be done in consultation with our advisers, Sector, who will monitor the situation closely in order to ensure the best interests of the Council are maintained.

- 9.2 The purpose of any rescheduling will be to:

- generate cash savings at minimum risk;
- help fulfil the strategy outlined in Section 6 above; and
- enhance the balance of the long-term portfolio (amend the maturity profile and/or the balance of volatility).

- 9.3 Any rescheduling will be reported to the Executive in the next treasury management activity report in six months time.

## **10. RECOMMENDATION**

- 10.1 Members of the Executive are requested to approve the proposed Treasury Management Strategy outlined in this report.

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## APPENDIX A

### INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy), who both provide our economic forecasting. The final two represent summarised figures drawn from the population of all major City banks and academic institutions. The current data shows the rates at the time of issue, not necessarily current rates. The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

#### INDIVIDUAL FORECASTS

##### UBS Warburg Economic interest rate forecast (for quarter ends) - February 2003

(%)	Current	Q1 2003	Q2 2003	Q3 2003	Q4 2003
Base Rate	3.75%	3.75%	3.75%	3.75%	3.75%
10 year gilt	4.23%	4.50%	4.50%	4.50%	4.50%
30 year gilt	4.28%	4.25%	4.25%	4.25%	4.25%

##### Capital Economics interest rate forecast – February 2003

(%)	Current	Q1 2003	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Q2 2004
Base Rate	3.75%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%
10 year gilt	4.23%	4.60%	4.50%	4.40%	4.20%	4.20%	
20 year gilt	4.28%	4.60%	4.50%	4.50%	4.40%	4.40%	

##### HSBC interest rate forecast – December 2002

(%)	Current	Q1 2003	Q2 2003	Q3 2003	Q4 2003
Base Rate	4.00%	4.00%	4.00%	4.00%	4.00%
10 year gilt	4.23%	4.50%	4.30%	4.20%	4.20%
30 year gilt	4.28%	4.40%	4.40%	4.40%	4.30%

#### SURVEYS OF ECONOMIC FORECASTS

**HM Treasury** - summary of 35 independent forecasters views of base rate – as at January 2003 (2004 - 2006 are as at November 2002 but are based on 11 forecasts)

(%)	2003	2004	2004	2005	2006
	Year end	Year end	Average	Average	Average
Average	4.27%	4.59%	5.14%	5.12%	4.81%
Highest	5.00%	6.40%	6.10%	5.60%	5.00%
Lowest	3.01%	3.00%	4.60%	4.90%	4.50%

**Consensus Forecasts** - summary view of 25 city houses on the likely change in short term and 10 year fixed interest rates (February 2003)

(%)	Feb – 03	May – 03	Feb - 04
3 month interbank - average	3.60%	3.80%	4.20%
High	3.60%	4.70%	5.20%
Low	3.60%	3.50%	3.00%
10 year gilt yield – average	4.20%	4.40%	4.70%
High	4.20%	4.90%	5.30%
Low	4.20%	4.10%	3.90%

## APPENDIX B

### ANALYSIS OF INVESTMENTS

Investments represent the temporary flux of cash balances of the Council that may be used to invest until such time as they are required to meet our revenue and capital expenditure. Currently there are three main options available when investing temporary surplus cash, general money market deposits, treasury deposits with TDBC bankers, Nat West and deposits in TDBC's Business Reserve Accounts held by Abbey National plc and Bank of Scotland plc. Details of these can be found below:

#### Money Market Investments:

<u>Investment with:</u>	<u>Amount (£)</u>	<u>Maturity Date</u>
Chelsea Building Society	1,000,000	13/05/2003
Cheshire Building Society	1,000,000	28/02/2003
Coventry Building Society	1,000,000	16/04/2003
Dexia Banque Int'l a Luxembourg	1,500,000	21/03/2003
Hamburgische L B, Germany	1,500,000	03/03/2003
Leeds & Holbeck Building Society	1,000,000	21/05/2003
National Australia Bank	1,500,000	15/08/2003
Nationwide Building Society	1,500,000	17/04/2003
Newcastle Building Society	1,000,000	03/04/2003
Portman Building Society	1,500,000	18/03/2003
Scarborough building Society	1,500,000	18/03/2003
Stroud & Swindon Building Society	500,000	20/03/2003
West Bromwich Building Society	1,350,000	06/05/2003
<b>Total</b>	<b>15,850,000</b>	

#### National Westminster Treasury Deposits:

No deposits were held with Nat West at the time of this report.

#### Abbey National Business Reserve Account:

As at 27/02/2003 there is **£1,000,000** on deposit in the Abbey National Business Reserve Account. This is available for immediate use.

#### Bank of Scotland Business Reserve Account:

As at 27/02/2003 there is **£1,400,000** on deposit in the Bank of Scotland Business Reserve Account. This is available for use following a thirty-day notice period.