

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 10TH MARCH 2004

REPORT OF THE FINANCIAL SERVICES MANAGER

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

TREASURY MANAGEMENT STRATEGY FOR 2004/2005

EXECUTIVE SUMMARY

The Council is required to consider an annual Treasury Management Strategy, the key points of the 2004/04 Strategy are as follows,

- Current portfolio (30/1/04) consists of £20m debt (6.18% avg) and £16.5m investments (3.85% avg).
- Short-term interest rates are forecast to reach 4.5% by March 2005, Long-term rates are forecast to peak at 5%.
- Debt redemption is highly unlikely in the short term, but rescheduling opportunities will be continually sought.
- Where short-term cash flows permit advantage will be taken of the higher rates currently available from the market for longer-term investments. The Treasury Management Team will constantly revise this strategy as conditions in the money markets change.

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the strategy for treasury management activity for the financial year 2004/05.

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 24th February 2004 as part of the budget setting process.

- 2.3 The suggested strategy for 2004/05 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;
 - treasury limits in force which will limit the treasury risk and activities of the Council;
 - the borrowing strategy;
 - the investment strategy;
- 2.4 In future years a combined strategy encompassing Treasury Management, Investments, Borrowing and the Prudential Indicators will be presented to Members as part of the annual budget approval process.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position at 30/01/04 comprised:

		Principal £m	Principal £m	Average Rate
Fixed rate funding	PWLB	19		
	Market	1	20	6.18%
TOTAL DEBT			20	6.18%
TOTAL INVESTMENTS			16.5	3.85%

4. PROSPECTS FOR INTEREST RATES

- 4.1 Short-term rates are expected to rise to 4.5% at the end of financial year 2004/05 having reached a 48 year low in 2003/04 of 3.5%. However there is the risk that this may falter if economic data proves to be less indicative of a general sustained recovery. Beyond the 2004/05 horizon rates are harder to predict, but 4.5% is the taken view of our treasury advisors. Further details of estimates provided by our Treasury Management Advisors can be found in Appendix A.
- 4.2 Longer-term rates also were at relatively low levels over 2003 (4.4% in June) followed by a sharp upturn in October (5%). The current expectation is that these will hover around the 5% mark over 2004/5 and not yet return to what is considered to be the normal level of about 5.40%. Having just repaid some

debt there is little likelihood of the authority being affected by this movement on new borrowings, however refinancing opportunities may be limited.

5. BORROWING STRATEGY

- 5.1 Based upon the prospects for interest rates outlined above, there is an opportunity that whilst short-term variable rates remain lower than longer term fixed debt, officers could take advantage, and redeem longer higher rated debt for short variable and consequently reduce the debt interest burden. However officers remain cautious of the potential risk associated with sudden upswings in variable rated debt, which would negate any reduced cost benefit.
- 5.2 Against this background caution will be adopted with the 2004/05 treasury operations. The Head of Finance and other officers will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to Council at the next available opportunity.

6. TEMPORARY INVESTMENTS STRATEGY

- 6.1 It is the treasury management team view that the markets' expectation for base rates as being too high and so investments will be kept long, as much as possible, with a view to locking in higher rates of return than may be available at a later stage when market expectations are corrected. This decision will constantly be reviewed in light of emerging patterns of cash liquidity, which takes precedent over final yield or return achieved.

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 11/02/04 – Annual Investments Strategy 2004/5

Executive 11/02/04 – Borrowing Limit 2004/5

Executive 11/2/04 – Prudential Indicators (part of General Fund revenue estimates Report)

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TABLES OF INTEREST RATE EXPECTATION

Sector Interest rate forecast – December 2003

(%)	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	3.75%	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.50%	4.50%
5yr Gilt Yield	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
10yr PWLB	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
25yr PWLB	5.00%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%

UBS Economic interest rate forecast (for quarter ends) - December 2003

(%)	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	3.75%	4.00%	4.00%	4.25%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
10yr PWLB	5.15%	5.15%	5.15%	5.25%	5.25%	5.40%	5.40%	5.40%	5.40%	5.40%
25yr PWLB	5.20%	5.25%	5.35%	5.45%	5.45%	5.65%	5.65%	5.65%	5.65%	5.65%

Capital Economics interest rate forecast – December 2003

(%)	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	3.75%	4.00%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.50%
5yr Gilt Yield	4.90%	5.10%	5.00%	4.80%	4.50%	4.40%	4.40%	4.50%	4.50%	4.80%
10yr PWLB	5.25%	5.35%	5.25%	5.15%	4.85%	4.75%	4.75%	4.85%	4.85%	5.05%
25yr PWLB	5.05%	5.05%	5.05%	5.05%	4.95%	4.85%	4.95%	4.95%	4.95%	4.95%

HM Treasury - summary of 35 independent forecasters views of base rate – as at November 2003

(2004 – 2007 are as at Aug 2003 but are based on 11 forecasts)

(%)	2003	2004	2005	2006	2007
	Year end	Year end	Average	Average	Average
Average	3.67%	4.27%	4.78%	5.05%	4.93%
Highest	3.90%	5.00%	5.72%	5.60%	5.60%
Lowest	3.48%	3.14%	4.00%	3.81%	3.84%

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

(%)		Nov- 03	Feb - 04	Nov - 04
3 month interbank –	Aver	3.88%	3.70%	4.10%
	High	3.88%	4.00%	4.70%
	Low	3.88%	3.50%	3.30%
10yr PWLB Rate –	Aver	5.20%	4.85%	4.95%
	High	5.20%	5.15%	5.55%
	Low	5.20%	4.45%	4.25%