Chester-le-Street
District Council

Report to:	Council
Date of Meeting:	1 March 2007
Report from:	Accountancy Manager
Title of Report:	Treasury Management Strategy 2007/2008 – 2009/2010
Agenda Item Number:	**18**

1. PURPOSE AND SUMMARY

1.1 The purpose of this report is to present for approval to Council a proposed Treasury Management Strategy for the period 2007/2008 to 2009/2010. The strategy has been drafted in conformity with the overall Treasury Management policy approved by Members on 27 March 2003. The main purpose of a Treasury Management Policy and its related Strategy is to identify risks and to set in place procedures which minimise the potential adverse effects of those risks. This Strategy refers to risks in relation to interest rate movements, borrowing, indebtedness, and investment.

1.2 Treasury management is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. Whilst the prudential indicators, considered in a separate report, deal with the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are also specific treasury prudential indicators which are covered from section 5.5 onwards in the Prudential Indicators report.

1.3 The Council's treasury management activities are strictly regulated by statutory requirements and by a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted that Code of Practice on 27 March 2003, and as a result adopted a Treasury Management Policy statement. This adoption complies with one of the requirements of the Code.

1.4 The Policy requires an annual strategy to be reported to the Council outlining the expected treasury management activity for the forthcoming 3 years. A further report is produced by the end of September after the year-end to account for treasury management actual activity during the previous financial year.

1.5 A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury management service covering the period 2007/2008 to 2009/2010.

1.6 This strategy covers:

- the current treasury position,
- the expected movement in interest rates,
- the Council's borrowing and debt strategy,
- the Council's investment strategy (in compliance with the DCLG guidance),
- treasury performance indicators,
- specific limits on treasury activities, and
- local treasury issues.

1.7 Members are recommended to:

(i) Approve the Treasury Management Strategy 2007/2008 – 2009/2010.

2. CONSULTATION

2.1 The Director of Resources has consulted with Corporate Management Team regarding the implications of the issues raised in the report. The Council's Treasury Management advisors have also been consulted.

3. CORPORATE PLAN AND PRIORITIES

3.1 The Council's Treasury Management Strategy contributes to the Council's budget which supports the Council's corporate plan.

4. IMPLICATIONS

4.1 Financial Implications and Value for Money Statement

The financial implications are detailed throughout the report. Treasury Management is an important part of the overall financial management of the Council; the 2007/2008 budget incorporates income from investments of £372,000 which results from our Treasury Management.

4.2 Legal

The Local Government Act of 2003 provides the powers to borrow and invest as well as providing controls and limits on these activities. Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act. The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities. The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

4.3 Personnel

There are no personnel implications.

4.4 Other Services

There is no direct impact on other services.

4.5 Diversity

There are no diversity implications.

4.6 Risk

The Council complies with all the relevant statutory and regulatory requirements which limit the levels of risk associated with treasury management activities.

The setting, monitoring and reporting of the Prudential Indicators ensure that the Council's capital expenditure is prudent, sustainable and affordable; and the treasury practices demonstrate a low risk approach.

4.7 Crime and Disorder

There are no Crime and Disorder implications.

4.8 Other Implications

There are no other implications associated with this report.

5. DEBT AND INVESTMENT PROJECTIONS 2007/08 – 2009/10

5.1 The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances.

	2006/07 Revised £	2007/08 Estimated £	2008/09 Estimated £	2009/10 Estimated £
External Debt				
Debt at 1 April	14,640,986	18,920,482	18,909,647	0
Additional borrowing	4,300,000	0	0	0
Principal repaid	20,504	10,835	18,909,647	0
Debt at 31 March	18,920,482	18,909,647	0	0
Investments				
Total Investments at 31 March	8,100,000	3,000,000	3,000,000	3,000,000
Investment change	4,600,000	-5,100,000	0	0

5.2 The related impact of the above movements on the revenue budget are:

	2006/07 Revised £	2007/08 Estimated £	2008/09 Estimated £	2009/10 Estimated £
Revenue Budgets				
Interest on Borrowing	899,954	1,006,248	0	0
Related HRA Charge	717,800	791,330	0	0
Net general Fund Borrowing Cost	182,154	214,918	0	0
Investment income	402,000	372,000	150,000	144,000

6. EXPECTED MOVEMENT IN INTEREST RATES

6.1 This section of the report has been prepared on the basis of advice received from the Council's treasury management advisers, Butlers.

6.2 Interest rate uncertainty is set to persist in the year ahead. The threat of higher inflation is considered a real danger for the UK economy in the near term, not least the possibility that an annual increase in RPI of close to 4.5% in January 2007 could translate to a buoyant pay round.

6.3 The Bank of England remains concerned that domestically generated inflation could strengthen in the months ahead increase to unacceptably high levels. The key in this respect lies in a number of relationships within the economy:

- The buoyancy of the international economy and the effect upon UK growth.
- The strength of domestic activity and the extent of spare capacity.
- The state of the labour market and the outcome of the forthcoming pay round.
- The strength of domestic demand and the pricing power of companies.

6.4 UK growth has been stronger than expected. This has been driven mainly by domestic factors, in particular the buoyancy of consumer spending. While the recent rise in official interest rates may lead to some deceleration, the extent of this is expected to be comparatively modest.

6.5 Long-term interest rates have been underpinned by the twin effects of concerns about domestic inflation prospects and the unexpected buoyancy of the US and German economies. Uncertainties generated by these developments are likely to underpin yields in the months ahead, although market conditions will remain erratic and occasional phases of downbeat economic data should generate declines in interest rates.

6.6 However, these phases will prove temporary until the markets are convinced the US economy has unquestionably entered a weaker activity phase and a return to lower dollar interest rates is a near certainty. This, coupled with evidence of decelerating activity and moderating inflation on the domestic front should create conditions for a sustainable, yet moderate, decline in long-term yields.

6.7 Expected Movement in Interest Rate

	Base Rate	5-year Gilt	20-year Gilt	50-year Gilt
2006/07	4.8	4.9	4.4	4.0
2007/08	5.3	5.1	4.6	4.0
2008/09	5.0	4.8	4.5	3.9
2009/10	4.8	4.5	4.3	3.9

7. BORROWING STRATEGY 2007/08 – 2009/10

7.1 The growing uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

7.2 Long-term fixed interest rates are expected to rise modestly and base rates are expected to peak at 5¼%. The Director of Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that longer term fixed rates will be considered if borrowing levels remain relatively low. With the possibility of increasing long term interest rates debt restructuring is likely to take place later in the financial year or in future years, although the Director of Resources and treasury consultants will monitor prevailing rates for any opportunities during the year.

7.3 The Council's capital programme for 2007/2008 totals £7.75m. The total of supported borrowing presently assured for 2007/2008 is £190,000. New loans may be raised up to the supported borrowing limits from external sources, most probably the PWLB. Capital receipts from land sales, capital grants and developer's contributions as well as the Major Repairs Allowance will be the main sources of funding for the capital programme. Any new borrowing will be raised in line with the Council's debt maturity profile to ensure that the value of repayments in any one year will not present a risk to the Council.

8. INVESTMENT COUNTERPARTY AND LIQUIDITY FRAMEWORK

8.1 The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield. Although the yield or return on the investment will be a consideration, it will always be subject to the main requirement for adequate security and liquidity of public money. After this main principle the Council will ensure that:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also will apply to the Council's prudential indicators covering the maximum principal sums invested.

- It maintains a policy covering the categories of investment types it will invest in, the criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

8.2 The Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit it to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counterparties the Council will choose rather than defining what the nature of its investments will be.

- Banks – the Council will use banks which have at least the following Fitch ratings (or equivalent) – Fitch ratings measure the financial strength and overall integrity of financial institutions.

-	Short Term	F1
-	Long Term	A
-	Individual / Financial Strength	C
-	Support	3

- Bank Subsidiary and Treasury Operations – the Council will use these where the parent bank has the necessary ratings outlined above.
- Building Societies – the Council will use Building Societies that have total assets in excess of £500m.
- Money Market Funds – AAA rated.
- UK Government (including gilts and the Debt Management Office).
- Other Local Authorities.

8.3 The proposed criteria for specified and non-specified investments are shown in Appendix 1 for approval.

8.4 In the normal course of the Council's cash flow operations it is expected that both specified and non specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

8.5 The use of longer term instruments (greater than one year from inception to repayment) would fall into the non-specified investment category. These instruments would only be used where the council's liquidity requirements are safeguarded. Investments of over one year duration may be made and this is reflected in the investment prudential indicator included in the relevant report (see Appendix 1).

9. INVESTMENT STRATEGY 2006/2007 – 2009/2010

9.1 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of peaking at 5¼% in early 2007. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise. The Director of Resources, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

10. PERFORMANCE INDICATORS

10.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Management Annual Report for 2006/07.

11. LOCAL ISSUES

11.1 Attached at Appendix 2 is a list of counterparties for lending which have been drawn up by Butlers, and it is recommended that Members approve this list as part of the Treasury Management Strategy for 2007/2008.

12. RECOMMENDATIONS

12.1 It is recommended that the Council approves:

(i) The Treasury Management Strategy contained in this report.

(ii) The Treasury Management Practice – Credit and Counterparty Risk Management provisions contained in Appendix 1.

(iii) The schedule of counter parties attached at Appendix 2.

Ian Herberson
Accountancy Manager
13 February 2007
Version 1.0

Contact Details:
Ian Herberson Tel: 0191 3872343
E-mail: ianherberson@chester-le-street.gov.uk