Chester-le-Street
District Council

Report to:	Special Council
Date of Meeting:	2 March 2006
Report from:	Finance and Accountancy Manager
Title of Report:	Treasury Management Strategy 2006/2007 - 2008/2009
Agenda Item Number:	

1 INTRODUCTION

1.1 The purpose of this report is to present for the approval of Council a proposed Treasury Management Strategy for the period 2006/2007 to 2008/2009. 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 8 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 2006/2007 to 2008/2009.

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 ODPM guidance),
- treasury performance indicators,
- specific limits on treasury activities, and
- local treasury issues.

2 CURRENT TREASURY POSITION

2.1 The current treasury position and the expected movement in debt and investment levels over the next three years are shown below. This table assumes that the Council takes up all likely supported borrowing approvals. It has the option of disinvesting rather than borrowing if it appears advantageous to do so.

	2004/05 Actual	**2005/06 Revised**	**2006/07 Estimated**	**2007/08 Estimated**	**2008/09 Estimated**
External Debt					
Total Debt at 31 March	£13,960,045	£14,640,986	£14,620,482	£14,609,647	£14,609,647
Investments					
Total Investments at 31 March	£5,475,000	£9,075,000	£3,500,000	£3,500,000	£3,500,000

3 EXPECTED MOVEMENT IN INTEREST RATES

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

3.2 The Monetary Policy Committee announced the long-awaited cut in base rates following its August 2005 meeting. However, the downturn in the UK interest rates cycle is expected to be prolonged and shallow with the low point not being too wide of the 4.25% level (currently 4.5%). GDP growth had been substantially weaker than anticipated as the slowdown in house price inflation and higher debt servicing costs combined to undermine consumer spending growth.

3.3 The Bank of England believes that the rebound in consumer activity, together with continued strength in public sector spending and a rise in corporate investment, will encourage higher growth in the future. This is open to debate and it is clear that the forecasting of interest rates in the current climate is difficult and a cautious approach is needed in treasury activity.

3.4 The international economic situation creates further uncertainty in the forecast. UK longer term interest rates have been influenced by US interest rates, which currently appear unrealistically low, and there continues to be risk of an upward shift in rates. The exact timing of this is however difficult to predict.

3.5 Medium-Term Rate Forecasts* - Annual Averages %

Percent	**Base Rate**	**5-year Gilt**	**20-year Gilt**
2005/06	4.6	4.2	4.3
2006/07	4.3	4.4	4.5
2007/08	4.5	4.5	4.5
2008/09	4.8	4.8	4.7

* Butlers' forecasts (January 2006)

There are significant risks to the forecast, which expects positive but low world and UK economic growth. Further weaknesses in growth could see short and longer term rates return to historic lows, although there is a higher probability within the forecast that rates will return to historic norms and shift to a higher level.

4. BORROWING AND DEBT STRATEGY 2006/07 – 2008/09

4.1 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.

4.2 Long-term fixed interest rates are expected to rise modestly and base rates are expected to fall initially by ¼% before rising again in 2007/08. 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.

4.3 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.

4.4 The expected borrowing requirement is:

	2005/06 Revised £m	2006/07 Estimated £m	2007/08 Estimated £m	2008/09 Estimated £m
Movement in CFR	0.66	0.06	0.06	0.17
Maturing Debt	0.00	0.00	0.00	0.00
Total borrowing need	0.66	0.06	0.06	0.17

4.5 The Council's capital budget for 2006/2007 totals £9.70m. The total of supported borrowing presently assured for 2006/2007 is £190,000, for 2007/2008, £190,000, and for 2008/2009, £190,000. More may become available through further central government approvals for 2007/2008 and 2008/2009. New loans may be raised up to the supported borrowing limits from external sources, most probably the PWLB. Capital receipts from Right to Buy sales, other land sales, capital grants and developer's contributions 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.

5. INVESTMENT STRATEGY 2005/2006 – 2007/2008

5.1 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.

5.2 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.

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

5.4 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.

5.5 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).

5.6 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of remaining stable during the first half of 2005/06, with a risk of falling after this. 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. The Director of Resources, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, and taking into account the risks shown in the forecast above.

6 PERFORMANCE INDICATORS

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

- Debt – Borrowing – Gross average rate of interest on all external debt as compared to all English non-metropolitan Districts (Source CIPFA Capital Expenditure and Treasury Management Statistics).
- Investments – Average rate of interest on all external investments (Source CIPFA Capital Expenditure and Treasury Management Statistics)

The results of these indicators will be reported in the Treasury Annual Report for 2005/06.

7 LOCAL ISSUES

7.1 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 2006/2007.

8 RECOMMENDATIONS

8.1 It is recommended that Members approve:

The Treasury Management Strategy contained in this report.

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

The schedule of counter parties attached at Appendix 2.

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2 March 2006
Version 1.0

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