Chester-le-Street
District Council

Report to:	Council
Date of Meeting:	27 September 2007
Report from:	Accountancy Manager
Title of Report:	Treasury Management 2006/2007
Agenda Item Number:	**19**

1. PURPOSE AND SUMMARY

1.1 The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury activity for 2006/07. The report also covers the actual Prudential Indicators for 2006/07 in accordance with the requirements of the Prudential Code.

1.2 The report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through regulations issued under the Local Government Act 2003

1.3 During 2006/07 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	2005/06	2006/07
Actual Capital Expenditure	£9.154m	£11.467m
Capital Financing Requirement Non-HRA HRA Total	 -£0.45m £15.56m £15.11m	 £6.38m £13.58m £19.96m
Financing Costs as a proportion of net revenue stream	6.09%	5.03%

1.4 The Director of Resources also confirms that borrowing was only undertaken for a capital purpose and the Statutory borrowing limit, the Authorised Limit, was not breached.

1.5 At 31 March 2007, the Council's external debt was £18.77m (£17.63m at 31 March 2006) and its investments totalled £6.39m (£8.08m)

1.6 This report summarises:

- the capital activity for the year,
- how this activity was financed
- the impact on the Council's indebtedness for capital purposes,
- the Council's overall treasury position
- the reporting of the required prudential indicators
- a summary of interest rate movements in the year
- debt and investment activity

2. CONSULTATION

2.1 The Director of Resources has been consulted on the report.

3. CORPORATE PLAN AND PRIORITIES

3.1 The report is wholly concerned with the authority's treasury management activities, which impact on the resources available to the Council to achieve its corporate priorities.

4. IMPLICATIONS

4.1 Financial Implications and Value for Money Statement

Treasury Management is an important part of the overall financial management of the Council; the 2006/07 interest from investments resulted in income of £344,044 for the General Fund and £50,572 for the Housing Revenue Account.

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 has complied with all of 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 Data Quality

Every care has been taken in the development of this report to ensure that the information and data used in its preparation are accurate, timely, consistent and comprehensive. The Council's Data Quality Policy has been complied with in producing this report.

4.9 Other Implications

There are no other implications associated with this report.

5. THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2006/07

5.1 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through capital receipts, capital grants etc.; or
- If insufficient financing is available the expenditure will give rise to a borrowing need.

5.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. Wider information on the regulatory requirements is shown in Section 10.

5.3 The actual capital expenditure forms one of the required prudential indicators.

5.4 The table below also shows how this was financed.

	2005/06 Actual £000	2006/07 Estimate £000	2006/07 Actual £000
Non-HRA capital expenditure	4,687	7,424	5,419
HRA capital expenditure	4,467	4,766	5,286
Total capital expenditure	**9,154**	**12,190**	**11,467**
Resourced by:			
Major Repairs Allowance	2,217	2,376	2,376
Capital receipts	5,263	3,017	1,480
Other Grants & Contributions	1,232	1,890	2,087
Revenue	78	0	618
Unfinanced capital expenditure (additional need to borrow)	**364**	**4,907**	**4,906**

6. THE COUNCIL'S OVERALL BORROWING NEED

6.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. It represents 2006/07 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

6.2 The Non-HRA element of the CFR is reduced each year by a statutory revenue charge (called the Minimum Revenue Provision - MRP). The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charge more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP) or depreciation.

6.3 The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR (£m)	31 March 2006 Actual	31 March 2007 Original Indicator	31 March 2007 Actual
Opening balance	14.89	15.11	15.11
+ unfinanced capital expenditure	0.36	4.91	4.91
- MRP	0.14	0.13	.06
Closing balance	**15.11**	**19.89**	**19.96**

7. TREASURY POSITION AT 31 MARCH 2007

7.1 The treasury position at the 31 March 2007 compared with the previous year was:

Treasury position	31 March 2006		31 March 2007	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£14.67m	5.63%	£18.77m	4.93%
Variable Interest Rate Debt	£2.96m	4.80%	£0.00m	0.00%
Total Debt	**£17.63m**	**5.49%**	**£18.77m**	**4.93%**
Fixed Interest Investments	£8.08m	4.55%	£6.39m	5.01%
Variable Interest Investments	£0.00m	0.00%	£0.00m	0.00%
Total Investments	**£8.08m**	**4.55%**	**£6.39m**	**5.01%**
Net borrowing position	**£9.55m**		**£12.38m**	

8. PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

8.1 Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

8.2 **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2006/07 plus the expected changes to the CFR over 2007/08 and 2008/09. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2006 Actual	31 March 2007 Original Indicator	31 March 2007 Actual
Net borrowing position	**£9.55m**	**£12.31m**	**£12.38m**
CFR	**£15.11m**	**£19.89m**	**£19.96m**

8.3 **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2006/07 the Council has maintained gross borrowing within its Authorised Limit.

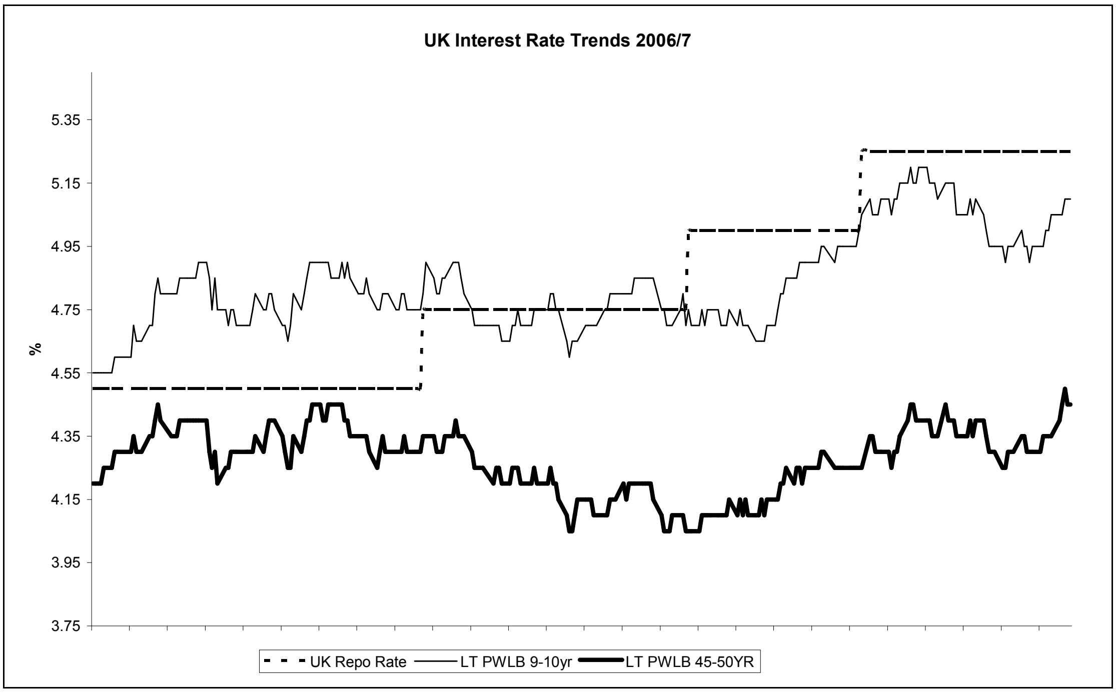
8.4 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

8.5 **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2006/07
Original Indicator - Authorised Limit	**£22.05m**
Maximum gross borrowing position	**£21.77m**
Original Indicator - Operational Boundary	**£20.04m**
Average gross borrowing position	**£16.37m**
Minimum gross borrowing position	**£14.63m**
Financing costs as a proportion of net revenue stream	**5.03%**

9. ECONOMIC BACKGROUND FOR 2006/07

9.1 All treasury activity is directed by both the current market interest rates and expectations of future movements, for instance longer term investment rates for one and two years will reflect anticipated movements in the MPC Bank Rate (UK Repo Rate). Longer term borrowing rates are influenced by inflation and demand and supply considerations.



9.2 The 2006/07 financial year featured a rising trend in short term interest rates as policy makers and financial markets responded to the twin effects of strengthening economic activity and rising inflation.

9.3 The optimism that prevailed in the first few months of 2006 had evaporated by the beginning of the new financial year. The rebound in economic activity since 2005 proved more robust that consensus expectations. In addition, external pressures on consumer price inflation had continued to escalate. While short-term interest rates remained steady in the first few months of the year, there were growing expectations that a rise in official interest rates would eventually materialise.

9.4 The first hike in the Bank Rate from 4.5% to 4.75% was announced in August 2006 as the Bank of England responded to the deteriorating inflation outlook. The economy's slow response to monetary policy tightening, a less than favourable international backdrop and concerns that deteriorating inflation expectations at home would drive prices higher prompted additional rate hikes. Two quarter point increases in Bank Rate were announced in November 2006 to 5% and January 2007 to 5.25%. Further tightening measures were anticipated by the market, and attractive investment opportunities prevailed to year end.

9.5 Long-term interest (PWLB) rates charted an erratic course but the overall trend was towards higher levels. Deteriorating inflation expectations on the domestic and international fronts, in reaction to strong growth on a global basis, was the principal force driving yields higher. Strong technical demand for bonds, courtesy of the rebalancing of pension fund portfolios in favour of fixed income assets, was insufficiently strong to counter the rise in yields. Occasional rallies in the gilt-edged market caused dips in rates and presented favourable borrowing opportunities. But these were short-lived and by the close of the year, yields were trading close to the highest levels seen since early 2005.

10. THE STRATEGY AGREED FOR 2006/07

10.1 The revised prudential indicators for 2006/07 expected a net financing need for the year to be £4.91m, and that investments would be made only with a counterparty that is on the Council's approved list and no more than £2,000,000 is to be invested with any one counterparty at any time.

11. ACTUAL DEBT MANAGEMENT ACTIVITY DURING 2006/07

11.1 **Borrowing** - Loans were drawn to finance the net capital spend and naturally maturing debt. The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity	Average for 2006/07
PWLB	£2.00m	Fixed interest rate	4.10%	45.5 Years	4.27%
PWLB	£2.30m	Fixed interest rate	4.35%	45.5 Years	4.27%
PWLB	£3.35m	Fixed interest rate	4.35%	46 Years	4.27%

11.2 **Rescheduling** – On 28/03/07 the Council repaid £3m at a rate of 6.66% with breakage costs of £0.338m. These loans were replaced with £3.35m at 4.35%.

11.3 **Repayment** – No repayment of maturing debt took place in 2006/2007.

11.4 **Summary of Debt Transactions** – The overall position of the debt activity resulted in a fall in the average interest rate by 0.56%.

12. INVESTMENT POSITION

12.1 **Investment Policy –** The Council's investment policy is governed by ODPM (now DCLG) Guidance, which has been implemented in the annual investment strategy approved by Council on 24 February 2005. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

12.2 **Investments Held by the Council** - The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds (whose performance may fluctuate more). The Council maintained an average balance of £8.167m and received an average return of 4.83%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.84%.

13. PERFORMANCE INDICATORS SET FOR 2006/07

13.1 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. The latest CIPFA Treasury Management Statistics, which are for the year 2005/2006, show:

Debt – Borrowing – Gross average external rate of interest on all external debt for this Council was 5.57% as compared to all English non-metropolitan Districts' rate of 6.19%

Investments – this Council's average rate of interest on all external investments was 4.61% compared to all English non-metropolitan Districts' rate of 5.02%.

14. REGULATORY FRAMEWORK, RISK AND PERFORMANCE

14.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2006/07);

- 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;

- Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.

14.2 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

14.3 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

14.4 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Average Rates for the Comparison Borrowing Table

Average Fixed Maturity Interest Rates for the PWLB over 2006/07 (%)

	1	1 1/2	2	2 1/2	3	3 1/2	4	4 1/2	5	5 to 6
Average	5.13433	5.14365	5.12897	5.11468	5.09702	5.07679	5.05536	5.03010	5.01032	4.98452
High	5.70000	5.70000	5.70000	5.65000	5.60000	5.60000	5.55000	5.50000	5.50000	5.45000
Low	4.55000	4.55000	4.55000	4.55000	4.55000	4.55000	4.55000	4.35000	4.55000	4.55000
	6 to 7	**7 to 8**	**8 to 9**	**9 to 10**	**10 to 15**	**15 to 20**	**20 to 25**	**25 to 30**	**30 to 35**	**35 to 40**
Average	4.94405	4.90179	4.86448	4.83333	4.80694	0.00000	4.69524	4.56230	4.43770	4.37659
High	5.35000	5.30000	5.25000	5.20000	5.15000	0.00000	4.95000	4.80000	4.65000	4.60000
Low	4.55000	4.55000	4.55000	4.55000	4.55000	0.00000	4.45000	4.35000	4.20000	4.15000

	40 to 45	45 to 50
Average	4.46349	4.27302
High	43.35000	4.50000
Low	4.10000	4.05000

Average Variable Rates for the PWLB over 2006/07

1-M Rate	3-M Rate	6-M Rate
4.99052	5.08956	5.18658

15. RECOMMENDATIONS

Members are recommended to:

(i) Approve the actual 2006/2007 prudential indicators within this report.

(iI) Note the treasury management stewardship report for 2006/2007.

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