Chester-le-Street
District Council

Report to:	Council
Date of Meeting:	28 February 2008
Report from:	Head of Corporate Finance
Title of Report:	Treasury Management Strategy 2008/2009
Agenda Item Number:	14

1. PURPOSE AND SUMMARY

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

2. CONSULTATION

2.1 The Head of Corporate Finance 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 2008/2009 budget incorporates income from investments of £513,080 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 Data Quality

Every care has been taken in the development of this report to ensure that the information and data used in its preparation and the appendices attached 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. DEBT AND INVESTMENT PROJECTIONS 2007/08 – 2008/09

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. It also highlights the expected change in investment balances.

	2007/08 Revised £	**2008/09 Estimated £**
Debt at 1 April	18,770,482	0
Additional borrowing	1.099,000	0
Principal repaid	19,869,482	0
Debt at 31 March	0	0
Total Investments at 31 March	7,000,000	6,000,000
Investment change	4,000,000	-1,000,000

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

	2007/08 Revised £	2008/09 Estimated £
Revenue Budgets		
Interest on Borrowing	817,280	0
Related HRA Charge	579,780	0
Net general Fund Borrowing Cost	237,500	0
Investment income	372,000	513,080

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 **Short Term Interest Rates** - While the December cut in Bank Rate ultimately came as no great surprise to the financial markets it did reflect the Monetary Policy Committee's growing unease about the state of the domestic economy.

6.3 The November Inflation Report did highlight the threat of a comparatively steep decline in economic activity in 2008. However, until then there had been few decisive signals that this process had commenced in earnest. More recently, the economic data has been transmitting an increasing amount of evidence that this may indeed be the case.

6.4 The cooling in the housing market has been noted for some time although it is only in the past few months that the two key indicators on this front (the Nationwide & Halifax Indices) have moved down in unison. The deciding factors behind the MPC's decision were probably the November CIPS surveys of the manufacturing and service sectors.

6.5 Both these indicators pointed towards a marked deceleration in activity on a broad front and may well have been interpreted by the policy doves as a sure sign that the effects of the summer's credit squeeze are beginning to spread beyond the confines of the financial markets.

6.6 The squeeze on credit represents a sharp and involuntary tightening of domestic monetary policy. The fact that it is likely to take some time to evaporate suggests that consumers' expenditure (which has still to see the full effects of the adjustment of discounted, fixed-rate mortgages) will eventually respond through a marked contraction.

6.7 This, along with an easing of capacity constraints as the economy slows down, is expected to reduce inflation pressures and ensure CPI growth reverts to the 2% central target rate over the medium term.

6.8 Nevertheless, the Bank of England does note that the upside risks to inflation remain. Many of the current pressures are externally generated (oil, food, commodity prices etc) and will not respond to UK interest rate policy.

6.9 Hopes rest upon the anticipated deceleration in international activity reversing at least some of these trends. In the mean time, the MPC is hoping that domestic inflation expectations do not deteriorate and that weakening household consumption prevents companies passing cost increases on to the retail level. The outcome of this “central case” scenario will not be known for some time.

6.10 **Longer Term Interest Rates** - Bond markets (which underpin the Council borrowing rates) will remain aware of the risks policy makers are taking with inflation for the sake of engineering a gradual and moderate dip in economic activity. Concerns about the health of the financial sector will persist for some time and these will maintain the downward bias to bond yields in the near term.

6.11 However, investors may be unsettled by the risks central banks are taking with long-term inflation control in their attempts to shore up faltering activity. Worries about inflation prospects in the medium to long term are expected drive yields higher through 2008/09 and beyond.

6.12 Medium-Term Rate Forecasts (averages)

	Bank Rate	1-year LIBOR	5-year Gilt	20-yr Gilt	50-yr Gilt
2006/07	4.8	5.3	4.9	4.4	4.0
2007/08	5.6	6.0	5.3	4.9	4.5
2008/09	4.8	4.7	4.7	4.8	4.6
2009/10	4.8	4.8	4.8	4.7	4.6
2010/11	5.0	5.3	4.9	4.8	4.8
2011/12	5.2	5.5	5.3	5.2	5.1

7. BORROWING STRATEGY 2008/09

7.1 The 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 The risks associated with long-term fixed interest rates are expected to be for higher rates over the medium term. The Head of Corporate Finance, 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 earlier if borrowing rates deteriorate.

7.3 From the table shown in 5.1 above the authority became debt free as a result of transferring the Housing Stock to Cestria Community Housing. It is not expected that the authority will undertake any new borrowing. However, as noted in the 2008/2009 General Fund Capital Programme report some prudential borrowing may be considered during the year.

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 Head of Corporate Finance 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 2008/09

9.1 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 5.25% Bank Rate being the peak with the next fall in early 2008. 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, subject to over riding credit counterparty security. The Head of Corporate Finance, 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 2008/09.

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 2008/2009.

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.

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