

**TREASURY MANAGEMENT STRATEGY  
AND ANNUAL INVESTMENT STRATEGY 2006/07**

## **TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY 2006/07**

### **1. Introduction**

The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (included as paragraph 9); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2006/07 in respect of the following aspects of the treasury management function is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators
- the current treasury position;
- the borrowing requirement
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy;
- any extraordinary treasury issues (such as the implications of a LSVT or ALMO).

### **2. Treasury Limits for 2006/07 to 2008/09**

It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the authorised limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

### 3. Prudential Indicators for 2006/07 – 2008/09

The following prudential indicators (in table 2 below) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted on 16<sup>th</sup> March 2005 by the full Council.

PRUDENTIAL INDICATOR	2004/05	2005/06	2006/07	2007/08	2008/09
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£ p	£ p	£ p	£ p	£ p
	actual	probable out-turn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
<b>Capital Expenditure</b>					
Non - HRA	2,811	5,549	5,847	5,242	5,392
HRA (applies only to housing authorities)	4,260				
<b>TOTAL</b>	<b>7,071</b>	<b>5,549</b>	<b>5,847</b>	<b>5,242</b>	<b>5,392</b>
<b>Ratio of financing costs to net revenue stream</b>					
Non - HRA	3.25	%	0	0	0
HRA (applies only to housing authorities)	10.91	%	0	0	0
<b>Net borrowing requirement</b>					
brought forward 1 April	24,765	22,856	0	0	0
carried forward 31 March	22,856	0	0	0	0
in year borrowing requirement (see assumptions below)	-1,909	22,856	0	0	0
<b>In year Capital Financing Requirement</b>					
Non - HRA	-301	-4,532	-157	-151	-145
HRA (applies only to housing authorities)	778	-19,042	0	0	0
<b>TOTAL</b>	<b>477</b>	<b>-23,574</b>	<b>-157</b>	<b>-151</b>	<b>-145</b>
<b>Capital Financing Requirement as at 31 March</b>					
Non - HRA	8,466	3,934	3,777	3,626	3,481
HRA (applies only to housing authorities)	19,042	0	0	0	0
<b>TOTAL</b>	<b>27,508</b>	<b>3,934</b>	<b>3,777</b>	<b>3,626</b>	<b>3,481</b>

*The assumption has been made that as the capital programme indicates a surplus of receipts compared to expenditure, in 2006/07, therefore no new borrowing will be required. In other circumstances borrowing of £1.5M would be required..*

PRUDENTIAL INDICATOR	2004/05	2005/06	2006/07	2007/08	2008/089
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
<b>actual</b>					
<b>Authorised limit for external debt -</b>					
borrowing	27,420	38,700	4,000	4,000	4,000
other long term liabilities	0	0	0	0	0
TOTAL	27,420	38,700	4,000	4,000	4,000
<b>Operational boundary for external debt -</b>					
borrowing	25,200	36,500	2,500	2,500	2,500
other long term liabilities	0	0	0	0	0
TOTAL	25,200	36,500	2,500	2,500	2,500
<b>Upper limit for fixed interest rate exposure</b> expressed as either:- Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
<b>Upper limit for variable rate exposure</b> expressed as either:- Net principal re variable rate borrowing / investments	30%	30%	30%	30%	30%
<b>Upper limit for total principal sums invested for over 364 days</b> (per maturity date)	£ 2000	£ 2000	£ 500	£ 500	£ 500

<b>Maturity structure of new fixed rate borrowing during 2005/06</b>	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	25%

#### 4. Current Portfolio Position

The Council's treasury portfolio position at 6<sup>th</sup> March 2006 comprised:

		Principal		Ave. rate
		£m		%
Fixed rate funding	PWLB	11,862		
	Market	<u>10,000</u>	21,862	6.19
Variable rate funding	PWLB	1,000		
	Market	<u>0</u>	1,000	5.04
Other long term liabilities				
<b>TOTAL DEBT</b>			<u><b>22,862</b></u>	<b>6.14</b>
<b>TOTAL INVESTMENTS</b>			<b>5,533</b>	<b>4.50</b>

The Council anticipates a £Nil borrowing position as at 1<sup>st</sup> April 2006 due to Housing Stock Transfer and the repayment of outstanding debt by the Office of the Deputy Prime Minister following a debt rescheduling exercise converting Market debt into PWLB debt.

#### 5. Borrowing Requirement

	2004/05	2005/06	2006/07	2007/08	2008/09
	£'000	£'000	£'000	£'000	£'000
	actual	probable	estimate	estimate	estimate
New borrowing	0	0	0	0	0
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	10,000	0	0	0
<b>TOTAL</b>	<b>0</b>	<b>10,000</b>	<b>0</b>	<b>0</b>	<b>0</b>

## 6. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix A draws together a number of current City forecasts for short term or variable (the base rate or repo rate) and longer fixed interest rates. The following table gives the Sector central view.

### Sector View: Interest rate forecast – 21.2.06

	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009
Base rate	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
5yr Gilt Yield	4.25%	4.00%	4.00%	4.25%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%
10yr PWLB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%
25yr PWLB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.50%	4.50%	4.50%
50yr PWLB Rate	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.50%	4.50%

**Sector's current interest rate view is that the repo (base) rate will: -**

- remain on hold at 4.5% until the end of Q1 2006
- fall to 4% by the end of Q4 2006
- edge up by 0.25% in Q1, Q2 and Q4 of 2007 to end the year at 4.75%

### Economic background

#### UK

- GDP growth weakened from 3.2% in 2004 to 1.7% in 2005 under the impact of monetary and fiscal tightening and the oil price shock depressing household spending. Growth expected to recover weakly to about 2.0% in 2006 and then return to the long term trend rate of 2.5% in 2007.
- House price inflation has fallen to low levels and may now stabilise
- Inflation forecast to stay around target despite hike in oil prices. MPC on alert for pipeline cost pressures, primarily from oil price increases, feeding through into output prices and then into retail prices.
- Public sector deficit to decline steadily over next few years as the Government cuts back on the rate of growth of its expenditure.

## **International**

- Boom in world commodity prices driven by strong growth in China and India; potential for further increases in prices but supply side increases and improvements in technology are likely to reduce prices in the medium term
- Inability of oil producers to spend their huge cash surpluses and reluctance of Asian economies to run current account deficits will suppress world demand and dampen world growth
- US – Fed nearing the end of its phase of measured rate raising. Fed rate may now peak at 4.5%.
- US GDP growth expected to weaken from 4.2% 2004 to 3.5% 2005 and 3.0% 2006
- ECB had held repo rate at 2.00% since June 2003; increase in December to 2.25% and further increases expected as the economic outlook has improved.
- Eurozone GDP growth expected to rise weakly and to continue to under perform the UK and US economies.

## **7. Borrowing Strategy**

It is anticipated that there will be no capital borrowings required during 2006/07

## **8. Debt Rescheduling**

It is anticipated that the Council will be debt free as a result of the Housing Stock Transfer, therefore there will be no rescheduling requirements.

## **9. ANNUAL INVESTMENT STRATEGY**

### **9.1 Investment Policy**

The Council will have regard to the ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

- (a) the security of capital and
- (b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

**Specified Investments :**

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	<b>* Minimum 'High' Credit Criteria</b>	<b>Use</b>
Term deposits – UK government	--	In-house
Term deposits – other LAs	--	In-house
Term deposits – banks and building societies **	* Short-term __, Long-term __, Individual __, Support __	In-house and fund managers
Certificates of deposits issued by banks and building societies	* Short-term __, Long-term __, Individual __, Support __	In-house buy and hold and fund managers
UK Government Gilts	AAA	In-house buy and hold and Fund Managers
Treasury Bills		Fund Managers

The Council uses Fitch ratings to derive its counterparty criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's (or other rating agency if applicable) rating will be used. All credit ratings will be monitored monthly. The Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

**9.2 Investment Strategy**

**In-house funds :** the Council's in-house managed funds are mainly cash-flow derived and will accordingly be made with reference to the cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

**Interest Rate Outlook:** Sector is forecasting base rates to be on a falling trend from 4.50% to reach 4.00% in Q4 2006 but to rise again to end Q1 2007 at 4.25%. Councils should therefore seek to lock in longer period investments at higher rates before this fall starts for some element of their investment portfolio which represents their core balances. Some investments should be aimed to mature during Q1 2007 when the interest rate cycle turns up and the market yield curve should have turned positive. This will enable councils to lock into higher yielding investments with their maturing deposits. For 2006/7 clients should budget for a cautious investment return of 4.0%.



For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest.

#### **10. Large Scale Voluntary Transfer (LSVT)**

The anticipated completion of the Councils LSVT is 27<sup>th</sup> March 2006 and the effects of this are reflected throughout this strategy.

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## Appendix A

### INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

### 1. INDIVIDUAL FORECASTS

#### Sector View interest rate forecast – 21.2.06

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	Q /E1 2007	Q /E2 2007	Q /E3 2007	Q /E4 2007	Q /E1 2008	Q /E2 2008	Q /E3 2008	Q /E4 2008	Q /E1 2009	Q /E2 2009
Base rate	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
5yr Gilt Yield	4.00%	4.00%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
10yr PW LB Rate	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	4.75%	4.50%
25yr PW LB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	4.75%	4.50%
50yr PW LB Rate	4.00%	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.50%	4.25%

#### Capital Economics interest rate forecast - 13.1.06

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	Q /E1 2007	Q /E2 2007	Q /E3 2007	Q /E4 2007
Base Rate	4.25%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
5yr gilt yield	4.10%	4.00%	3.90%	3.80%	4.00%	4.10%	4.30%	4.40%
10 yr PW LB rate	4.25%	4.15%	4.25%	4.35%	4.55%	4.75%	4.85%	4.75%
25 yr PW LB rate	4.25%	4.25%	4.35%	4.45%	4.45%	4.55%	4.65%	4.65%
50 yr PW LB rate	3.95%	3.95%	4.05%	4.15%	4.15%	4.25%	4.35%	4.35%

**UBS Economic interest rate forecast (for quarter ends) – 13.1.06**

	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007
<b>Base Rate</b>	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
<b>10 yr PWLB rate</b>	4.25%	4.35%	4.45%	4.55%	4.60%	4.60%	4.65%	4.65%
<b>25 yr PWLB rate</b>	4.15%	4.45%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%
<b>50 yr PWLB rate</b>	4.05%	4.45%	4.61%	4.74%	4.80%	4.86%	4.91%	4.97%

**2. SURVEY OF ECONOMIC FORECASTS**

**HM Treasury** – December 2005 summary of forecasts of 26 City and 14 academic analysts for Q4 2005 and 2006. (2007 – 2009 are as at November 2005 but are based on 18 forecasts)

	Repo	Q uarter ended		annual average repo rate		
		Q 4 2005	Q 4 2006	ave.2007	ave.2008	ave.2009
<b>Indep. forecasters BoE Base Rate</b>	4.50%	4.49%	4.29%	4.39%	4.54%	4.60%
<b>H ighest base rate</b>	4.50%	4.55%	5.00%	5.40%	5.90%	6.20%
<b>Low est base rate</b>	4.50%	4.20%	3.50%	3.75%	3.75%	3.75%

## **Glossary of Terms and Examples**

### **Authorised Limit for External Debt**

The Authorised Limit, like all other prudential indicators, has to be set and revised by elected members. It should not be set so high that it would never in any possible circumstances be breached but rather reflect a level of borrowing which while not desired, could be afforded but may not be sustainable

### **Capital Expenditure**

Expenditure on the acquisition of a fixed asset or expenditure which adds to and not merely maintains the value of an existing fixed asset.

### **Capital Financing Requirement**

This important component of an authority's capital strategy is the amount of capital spending that has not been financed by capital receipts, capital grants, and contributions from revenue. It is a measure of the underlying need to borrow for capital purposes

### **Debt Rescheduling**

Similar to re-mortgaging a house, in so far as, loans are repaid before maturity, and replaced with new loans, usually at a more advantageous rate of interest

### **Liquidity**

Access to cash deposits at very short notice

### **Market Loans**

Loans borrowed from financial institutions such as banks and building societies

### **Maturity**

The date at which loans are due for repayment. See table below for Rossendale's profile

An Analysis of Maturity Dates	£000
Maturing within one year	3,000
Maturing in 1- 2 years	0
Maturing in 2-5 years	1,000
Maturing in 5-10 years	5,000
Maturing in more than 10 years	18,355
<b>Total Outstanding</b>	<b>22,862</b>

### Net Borrowing Requirement

The Council's borrowings less cash and short term investments

### Public Works Loan Board

A Government agency that provides longer term loans to local authorities

### Operational Boundary for External Debt

This indicator is, as its name suggest, the focus of day to day treasury management activity within the authority. It is a means by which the authority manages its external debt to ensure that it remains within the self imposed Authorised limit. However it differs from the Authorised limit in being based on expectations of the maximum external debt of the authority according to probable- not simply possible- events and being consistent with the maximum level of external debt projected by the estimates.

### Prudential Borrowing

This is borrowing wholly supported by the Council and would include 'invest to save projects'. Market conditions permitting it may well be cheaper to borrow rather than lease vehicles and or plant.

### Ratio of Financing costs to Net Revenue Stream

This is the proportion of interest payments plus debt repaid less interest receipts expressed as a proportion of the revenue stream. In the case of General Fund the revenue stream equates to the budget requirement of £10.8 (funded by Rate Support Grant,

Business Rates and Council Tax). In relation to Housing Revenue the revenue stream is made up of rent income, service charges and interest.

### **Repurchase Rate (Repo)**

This is equivalent to the Bank of England base rate

### **Supported Borrowing**

This is borrowing that is supported by the government through the revenue support grant and housing subsidy grant.

### **Term Deposit**

Investments for a pre-defined period of time at a fixed interest rate

### **Upper Limit for fixed/variable interest rate exposure**

This relates to the limit in loans which can be held in either fixed interest rates or variable interest rates. Whilst fixed interest-rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance may justify, or even demand, retaining a degree of flexibility through the use of variable interest rates

### **Volatility**

Sudden upward or downward movements in interest rates in reaction to economic, market and political events