REPORT TO: **FINANCE COMMITTEE – 12 MARCH 2001**

REPORT ON: **TREASURY MANAGEMENT STRATEGY 2001/2002**

REPORT BY: **DIRECTOR OF FINANCE**

REPORT NO: **152-2001**

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy for 2001/2002, the preparation of which is a requirement of the Council's Treasury Policy Statement.

2 RECOMMENDATION

The Committee are asked to:

1 note that in terms of the Treasury Policy Statement, the Director of Finance is obliged to present the annual Treasury Management Strategy at the start of each financial year.

2 approve the strategy proposed by the Director of Finance for 2001/2002 as set out in the attached document "Treasury Management Strategy 2001/2002".

3 FINANCIAL IMPLICATIONS

There are no direct financial implications arising from the recommendations in this report. However, decisions made within the Treasury Management function will affect the cost of the Council's long and short-term borrowing in 2001/2002 and future years.

4 LOCAL AGENDA 21 IMPLICATIONS

None.

5 EQUAL OPPORTUNITIES IMPLICATIONS

None.

6 BACKGROUND

The Code of Practice on Treasury Management in Local Authorities (the Code), requires the setting out of the responsibilities and duties of the members and officers, allowing a framework for reporting and decision-making on all aspects of treasury management. The primary requirement of the Code is the approval by the Council (to be monitored thereafter by the Finance Committee), of a policy statement setting out the Council's approach to all treasury operations.

At its meeting on 13 March 2000 the Finance Committee approved the Council's Treasury Policy Statement, setting out the policies which would govern all borrowing and lending transactions carried out by the Council. (Report No 516/2000).

The Treasury Policy Statement requires that the Finance Committee will receive and consider the Treasury Management Strategy before or around the commencement of each new financial year.

7 **TREASURY MANAGEMENT STRATEGY 2000/2001**

The Council's Treasury Management Strategy for 2001/2002 is set out in detail in the attached document. In summary, long-term borrowing rates are lower than short-term rates although this position is likely to close during 2001/2002. Short-term rates are expected to fall slightly during 2000/2001. Interest savings will be maximised by utilising long-term borrowing facilities, where appropriate, taking advantage of low long-term interest rates.

DAVID K DORWARD
DIRECTOR OF FINANCE

BACKGROUND PAPERS
No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above Report.

SM/HG
6-Jun-01
REPORTS/TMSTRAT00-01

DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2001/2002

21 February 2001
Finance Department
Dundee

TREASURY MANAGEMENT STRATEGY 2001/2002

1 INTRODUCTION

This Treasury Management Strategy details the expected activities of the Treasury Management function in the financial year 2001/2002. Its production and submission to the Finance Committee is a requirement of the Council's approved Treasury Management Policy. Its format and structure is in the format required by the approved Policy. The suggested strategy for 2001/2002 in respect of the following aspects of the treasury management function is based upon the officers views on interest rates, supplemented with leading market forecasts. The strategy covers:

- The current treasury position;
- Treasury limits in force which will limit the activity of the Council;
- Prospects for interest rates;
- Capital borrowings required and the portfolio strategy;
- Investments strategy;
- Debt rescheduling opportunities.

2 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 January 2001 was as follows:

		£m	£m	%
Fixed Rate Funding	Public Works Loan Board	234.7		
	Market Loans	7.3	242.0	93.9
Variable Rate Funding	Market Loans	12.6		
	Temporary Loans	3.0	15.6	6.1
Total Loan Debt			257.6	100.0

3 TREASURY LIMITS FOR 2001/2002

In accordance with Section 45 of the Local Government and Housing Act 1989, which whilst not applicable to Scotland is recommended good practice, the Treasury limits set by Council as part of its Treasury Management policy are:-

- the amount of the overall borrowing limit which may be outstanding by way of short term borrowing:
  - initial term under 3 months (15% of total debt) — Circa £39m
  - initial term under one year (20% of total debt) — Circa £52m

- the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt) — Circa £77m

4 PROSPECTS FOR INTEREST RATES

The Council appointed Prebon Financial Consultants as treasury advisers to the Council on 9 August 1999 and part of their service is to assist the Council to formulate a perpetual view on interest rates. Appendix A shows their forecasts for variable and longer fixed interest rates for 2001/2002.

The effect on interest rates for the UK is expected to be as follows:

Shorter term interest rates – The "average" City view now anticipates that the outlook for 2001 will mean that we will see a small decrease in base rates from the current 5.75% during 2001/2002.

Longer term PWLB interest rates – The longer term fixed interest rates are expected to increase during 2001/2002. However, the expectation is that fixed interest rates will remain cheaper than short-dated and variable rates although the margin should have closed by the year-end.

5 CAPITAL BORROWINGS REQUIRED AND THE PORTFOLIO STRATEGY

Based upon the prospects for interest rates outlined above, there are a number of strategy options available. The anticipation is that short term rates will continue to be more expensive than longer term fixed borrowing throughout 2001/2002, albeit with base rates likely to fall during the year. This expectation provides a variety of options:-

- that the expectation for falling base rates in the future is so strong that the drawing of cheaper, longer term funding in the near term could eventually entail longer term costs and the Council's view is that maintaining a short term position will lead to a cheaper, low risk long term portfolio;

- that the risks intrinsic in the shorter term variable rates are such, when compared to historically low long term funding, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding.

In previous years the Council has had an option to borrow long-term over as long a period as 60 years. However, the Public Works Loans Board (PWLB) from whom the Council borrows most of its long-term monies has changed its rules on borrowing to Local Authorities. The PWLB has decided that it will no longer lend for periods of more than 25 years. The reason for this change is due to the fact that the 30 year gilt yield on which the interest rates for borrowings of 25 years plus were based has been artificially depressed. This is because Private Sector Pension funds have been buying gilts to meet the requirement by the Pensions Act 1995 to hold a proportion of their Funds in long-term gilts and the lack of gilt issues by the Government at this longer end.

The implication of this is that to borrow for periods greater than 25 years the Council would have to go out to the money market. This is generally a more expensive method of funding and would only be considered if money market rates at the longer end were cheaper than the PWLB.

Sensitivity of the forecast – The main sensitivities of the forecast are likely to be the two scenarios below:-

- *A projected sharp rise in long and short term rates* – In the event of a sharp rise in interest rates the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are relatively cheap.

- *A projected sharp fall in long and short term rates* – In the event of falling interest rates the borrowings will be postponed (waiting for borrowings to get cheaper) and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.

The Director of Finance will monitor the interest rate movements on a daily basis, taking regular advice from the Council's Treasury Adviser, and thereafter take decisions on the borrowing and lending strategy that is in the best interests of the Council.

6 TEMPORARY LENDING STRATEGY

It is not the Council's policy to be in a lending position although there are occasions when due to timing of cashflows the Council is lending funds for short periods of time.

The money market yield curve is currently anticipating decreases in the base rate in 2001. Where the Council finds itself lending funds it will maximise its return taking into account the availability of interest rates and its own cashflow requirement.

Short term lending will be restricted to only those institutions identified in the Council's investment list approved as part of the Treasury Policy Statement. (Shown at Appendix B.)

7 DEBT RESCHEDULING

Any debt rescheduling is likely to take place when long-term fixed interest rates are anticipated to be at their lowest, although the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve.

APPENDIX A

APPENDIX A

INTEREST RATE FORECAST 2001/2002

Date	Base Rate	1 Year LIBOR	5 Year Gilt Yield	10 Year Gilt Yield
Feb-01	5.75	5.62	5.25	4.90
Mar-01	5.75	5.62	5.25	5.10
Jun-01	5.75	5.37	5.25	5.15
Dec-01	5.50	5.25	5.10	5.20
Jun-02	5.25	5.00	5.00	5.25

APPENDIX B

APPROVED COUNTERPARTIES FOR LENDING TRANSACTIONS

Approved Lending Bodies	**Short Term Credit Rating**	**Maximum Deposits £m**
Banks		
Abbey National plc	A1+	7
Bank of Scotland	A1+	7
Barclays Bank plc	A1+	7
* Clydesdale Bank plc (National Australia Bank)	A1+	7
Lloyds TSB Bank plc	A1+	7
Midland Bank plc	A1+	7
National Westminster Bank plc	A1+	7
Royal Bank of Scotland plc	A1+	7
Alliance and Leicester plc	A1+	7
Halifax plc	A1+	7
Building Societies		
Nationwide Building Society	A1+	7
Other		
Scottish Local Authorities	N/A	5
English and Welsh Local Authorities	N/A	5

* This bank is a wholly owned subsidiary of the bank in brackets and the rating quoted refers to the parent bank.

SM/HG
06 June 2001
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