

REPORT TO: FINANCE COMMITTEE - 12 MARCH 2007

REPORT ON: TREASURY MANAGEMENT STRATEGY 2007/2008

REPORT BY: HEAD OF FINANCE

REPORT NO: 168-2007

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy for 2007/2008, the preparation of which is a requirement of the Council's Treasury Policy Statement and the CIPFA Code of Practice on Treasury Management.

2 RECOMMENDATION

The Committee are asked to:

- 1 note that in terms of the Treasury Policy Statement, the Depute Chief Executive (Finance) is obliged to present the annual Treasury Management Strategy at the start of each financial year.
- 2 approve the strategy proposed by the Head of Finance for 2007/2008 as set out in the attached document "Treasury Management Strategy 2007/2008".

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 2007/2008 and future years. The 2007/2008 Revenue Budget has been set including a provision of £23.185m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 5.9% after taking into account borrowing for 2006/2007 at historically low rates.

4 SUSTAINABILITY POLICY IMPLICATIONS

None

5 EQUAL OPPORTUNITIES IMPLICATIONS

None

6 BACKGROUND

The Council's Treasury Policy Statement Report No 140-2005 requires that the Finance Committee will receive and consider the Treasury Management Strategy in advance of each new financial year.

The Local Government in Scotland Act 2003 requires the Council 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 also requires the Council to set out its treasury strategy for borrowing and investment.

7 TREASURY MANAGEMENT STRATEGY 2007/2008

The Council's Treasury Management Strategy for 2007/2008 is set out in detail in the attached document. The net new borrowing required for capital expenditure in 2007/2008 is relatively low. In light of this there is expected to be limited borrowing during the year. Rescheduling opportunities will continue to be monitored and lending will take place when necessary in line with guidance in Treasury Policy Statement.

8 BACKGROUND PAPERS

None

9 CONSULTATION

The Chief Executive and the Depute Chief Executive (Support Services) have been consulted.

MARJORY M STEWART
HEAD OF FINANCE

06 March 2007

DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2007/2008

Finance Department
Dundee

TREASURY MANAGEMENT STRATEGY 2007/2008

1 INTRODUCTION

The CIPFA Code of Practice on Treasury Management in the Public Services requires the Council to set out its treasury management strategy for borrowing and investment. This Treasury Management Strategy details the expected activities of the Treasury Management function in the financial year 2007/2008. Its production and submission to the Finance Committee is a requirement of the Council's approved Treasury Policy Statement. Its format and structure is in the format required by the approved Policy. The suggested strategy for 2007/2008 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 provided by the Council's treasury advisers. The strategy covers:

- The current treasury position;
- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- Capital borrowings required and the portfolio strategy;
- Temporary Lending strategy;
- Debt rescheduling.
- Prudential Indicators

2 PRUDENTIAL INDICATORS FOR 2005/2006-2009/2010

The Local Government in Scotland Act 2003 and supporting regulations require 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 indicators for 2005/2006 - 2009/2010 were reported to Committee on 20 February 2007. These are relevant to the integrated treasury management strategy. These are shown at Appendix A.

It is a statutory requirement under Section 93 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in revenue costs from:-

- 1 increases in interest charges caused by increased borrowing to finance the expenditure, and
- 2 any increases in running costs from new capital projects

are affordable for the foreseeable future.

3 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 January 2007 was as follows:

		<u>£m</u>	<u>£m</u>	<u>%</u>
Fixed Rate Funding	Public Works Loan Board	261.3		
	Market Loans	<u>36.2</u>	297.5	98.1
Variable Rate Funding	Market Loans	5.3	5.8	
	Temporary Loans	<u>0.5</u>	<u>0.0</u>	<u>1.9</u>
Total Loan Debt			<u>303.3</u>	<u>100.0</u>
<u>Investments</u>				
Short Term Lending			<u>17.2</u>	

4 TREASURY LIMITS FOR 2007/2008

In accordance with the Council's Prudential Indicators for Treasury Management, the Treasury limits set by the Council as part of its Treasury Management policy are:-

- the amount of the overall borrowing limit which may be fixed rate maturing
 - under one year (10% of total debt based on operational boundary)
 Circa £32m
- the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt based on operational boundary)
 Circa £96m
- the maximum proportion of interest on borrowing which is subject to fixed rate interest - (100% of total debt based on operational boundary)
 Circa £323m
- authorised limit for external borrowing
 £348m

5 PROSPECTS FOR INTEREST RATES

The Council appointed Sector Treasury Services, as treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix B draws together a number of current City forecasts for short term or variable and longer fixed interest rates for 2007/2008.

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

Shorter term interest rates - Base rate is expected to peak at 5.5% in early 2007 then fall back to 5.0% by the end of the year.

Longer term interest rates 50 years - PWLB rates are expected to remain at around 4.25% throughout the year.

6 **CAPITAL BORROWINGS REQUIRED AND THE PORTFOLIO STRATEGY**

The net borrowing requirement for capital expenditure is shown in Appendix A. In 2007/08 it is £3.907m. This will require limited borrowing decisions and PWLB rates will be monitored to determine the appropriate time to borrow and term of the loan.

7 **TEMPORARY LENDING STRATEGY**

It is not the Council's policy to be in a lending position although balances on reserves and variations in cash flow requirements means that there will be times of surplus funds which will be lent for short periods.

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 Approved Counterparties list (shown at Appendix C) provided they have maintained their credit rating. This list has been updated to add Bank of Ireland.

8 **DEBT RESCHEDULING**

The Council will continue to monitor opportunities for rescheduling debt based on interest rate differentials. Possible reasons for rescheduling would include:

- cash savings at minimal risk
- help fulfil portfolio strategy
- enhance balance of the long term profile with respect to maturity and volatility

CIPFA have issued a draft accounting standards document (SORP 2007) which includes major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premia and discounts arising from debt rescheduling. The strategy will be reviewed once the final decisions in this area are known to see whether any changes in strategy are required.

DUNDEE CITY COUNCIL

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09	2009/10
1 CAPITAL PLAN PRUDENTIAL INDICATORS	£ p	£ p	£ p	£ p	£ p
	actual	estimate	estimate	estimate	estimate
Capital Expenditure	£'000	£'000	£'000	£'000	£'000
General Services	40,620	51,573	41,047	32,452	29,600
Ratio of financing costs to net revenue stream					
General Services	7.7%	8.0%	8.1%	7.9%	7.9%
Net borrowing requirement					
brought forward 1 April	292,714	319,671	319,712	322,805	330,079
carried forward 31 March	319,671	319,712	322,805	330,079	331,777
in year borrowing requirement	26,957	41	3,093	7,274	1,698
In year Capital Financing Requirement					
General Services	9,212	9,598	4,361	6,586	3,699
HRA	1,282	4,932	454	1,810	1,497
TOTAL	10,494	14,530	3,907	8,396	2,202
Capital Financing Requirement as at 31 March					
General Services	200,474	210,072	214,433	221,019	224,718
HRA	119,968	124,900	124,446	126,256	124,759
TOTAL	320,442	334,972	338,879	347,275	349,477
Difference between Net Borrowing and Capital Financing Requirement					
	319	13,972	14,879	15,275	16,477
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase/(Decrease) in Council Tax (band D per annum)	0.83	-2.24	-2.85	-0.46	1.96

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09	2009/10
2 TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised limit for external debt -					
borrowing	329,000	345,000	348,000	356,000	357,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	334,000	350,000	353,000	361,000	362,000
Operational boundary for external debt -					
borrowing	319,671	320,000	323,000	331,000	332,000
other long term liabilities	452	1,000	1,000	1,000	1,000
TOTAL	320,123	321,000	324,000	332,000	333,000
Upper limit for fixed interest rate exposure					
expressed as					
Net principal re fixed rate borrowing/investments	100	100	100	100	100
Upper limit for variable rate exposure					
expressed as					
Net principal re variable rate borrowing/investments	30	30	30	30	30
Upper limit for total principal sums invested for over 364 days	N/A	N/A	N/A	N/A	N/A

Maturity structure of fixed rate borrowing during 2006/07	lower limit	upper limit
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under 12 months	-	10%
12 months and within 24 months	-	15%
24 months and within 5 years	-	25%
5 years and within 10 years	-	25%
10 years and above	50%	95%

Adoption of CIPFA Code of Practice for Treasury Management	YES
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OUTLOOK FOR INTEREST RATES

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), who both provide economic forecasting for Sector. The final one represent summarised figures drawn from the population of all major City banks and academic institutions. The forecast within the strategy statement has been drawn from these diverse sources and officers own views.

Individual Banks Forecasts

Sector Economic interest rate forecast (for quarter ends) - January 2007

(%)	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Base Rate	5.50%	5.50%	5.25%	5.00%	5.00%
10 Year PWLB	5.00%	5.00%	4.75%	4.75%	4.50%
25 Year PWLB	4.50%	4.50%	4.50%	4.50%	4.50%
50 Year PWLB	4.25%	4.25%	4.25%	4.25%	4.25%

Capital Economics interest rate forecast - January 2007

(%)	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Base Rate	5.25%	5.50%	5.50%	5.25%	4.75%
10 Year PWLB	4.95%	4.75%	4.45%	4.45%	4.55%
25 Year PWLB	4.45%	4.35%	4.25%	4.25%	4.25%
50 Year PWLB	4.05%	3.95%	3.95%	4.05%	4.05%

UBS interest rate forecast - January 2007

(%)	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Base Rate	5.25%	5.25%	5.25%	5.25%	5.25%
10 Year PWLB	4.85%	4.80%	4.80%	4.80%	4.80%
25 Year PWLB	4.25%	4.25%	4.25%	4.30%	4.35%
50 Year PWLB	4.15%	4.15%	4.25%	4.35%	4.40%

Summary Bank Forecasts

HM Treasury - summary of 40 independent forecasters views of base rate - as at January 2007 (2008-2010 are as at November 2006 and based on 18 forecasts)

(%)	2007 Year End	2008 Average	2009 Average	2010 Average
Average	4.97%	4.86%	4.88%	4.85%
Highest	5.80%	5.90%	5.60%	6.10%
Lowest	4.50%	3.75%	4.00%	4.00%

APPROVED COUNTERPARTIES FOR LENDING TRANSACTIONS

<u>Approved Lending Bodies</u>	<u>Short Term Credit Rating</u>	<u>Maximum Deposits £m</u>
<u>Banks</u>		
Abbey National plc	F1+	12
HBOS (formerly Bank of Scotland and Halifax)	F1+	12
Barclays Bank plc	F1+	12
* Clydesdale Bank plc (National Australia Bank)	F1+	12
Lloyds TSB Bank plc	F1+	12
HSBC Bank plc	F1+	12
Royal Bank of Scotland plc (inc National Westminster)	F1+	12
Alliance and Leicester plc	F1+	12
Bank of Ireland	F1+	12
Bradford & Bingley plc	F1	5
Anglo Irish Bank Corporation	F1	5
<u>Building Societies</u>		
Nationwide Building Society	F1+	12
Britannia Building Society	F1	5
Coventry Building Society	F1	5
Skipton Building Society	F1	5
Principality Building Society	F1	5
Yorkshire Building Society	F1	5
Chelsea Building Society	F1	5
<u>Other</u>		
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.

NB Credit ratings indicate the capacity for timely repayments as follows:

F1+	strongest
F1	strong
F2	satisfactory
F3	adequate
B	uncertain
C	highly uncertain
D	actual or imminent default