Agenda No 3

AGENDA MANAGEMENT SHEET

Name of Committee	**Council**
Date of Committee	**6 February 2007**
Report Title	**Treasury Management Strategy 2007/08**
Summary	This report sets out the proposed Treasury Management Strategy for 2007/08 as required by the CIPFA Code of Practice on Treasury Management.
For further information please contact:	Phil Triggs Group Manager (Treasury and Pensions) Tel: 01926 412227 philtriggs@warwickshire.gov.uk
Would the recommended decision be contrary to the Budget and Policy Framework? [please identify relevant plan/budget provision]	No.
Background papers	• CIPFA publication "Treasury Management in the Public Services: Code of Practice and Guidance notes for Local Authorities" • CIPFA publication "The Prudential Code for Capital Finance in Local Authorities" • Treasury Management Practices (TMPs)

CONSULTATION ALREADY UNDERTAKEN prior to consideration by Cabinet:

Details to be specified

Other Committees	☒	Cabinet 1 February 2007..............................
Local Member(s)	☐	
Other Elected Members	☒	Cllrs Atkinson, Booth, Hicks – for information
Cabinet Members	☒	Cllr Cockburn – Portfolio Holder
Chief Executive	☐	....
Legal	☒	Tony Maione
Finance	☒	David Clarke – reporting officer

Other Chief Officers	☐	....
District Councils	☐	....
Health Authority	☐	....
Police	☐	....
Other Bodies/Individuals	☐	

FINAL DECISION: Yes

SUGGESTED NEXT STEPS:		Details to be specified
Further consideration by this Committee	☐	....
To Council		
To Cabinet	☐	
To an O & S Committee	☐	....
To an Area Committee	☐	....
Further Consultation	☐	....

Agenda No 3

Council – 6 February 2007

Treasury Management Strategy 2007/08

Report of the Strategic Director of Resources

Recommendations (being considered by Cabinet on 1 February)

(1) That the Treasury Management Strategy and Investment Strategy for 2007/08 be approved.

(2) That the Council delegates authority to the County Treasurer to undertake the activities listed in paragraph 10 of the report.

(3) That the Prudential Indicators (see **Appendix A**) are approved, subject to any changes as a result of the setting of the 2007/08 budget.

1 Introduction

1.1 The Local Government Act 2003 and supporting regulations 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.

1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (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.

1.3 The suggested strategy for 2007/08 in respect of the following aspects of the treasury management function is based upon the Director of Resource's 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.

1.4 It is a statutory requirement, under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to 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 charges to revenue from:

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

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2 Treasury Limits for 2007/08 to 2009/10

2.1 It is a statutory duty, under section 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 Borrowing Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Borrowing 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’.

2.3 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 Borrowing Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

3 Prudential Indicators for 2007/08 to 2009/10

3.1 The Prudential Indicators, as set out in **Appendix A** to this report, are relevant for the purposes of setting an integrated Treasury Management Strategy. The indicators are provisional and based on the currently agreed capital programme. The Prudential figures will be revised when the 2007/08 revenue and capital budgets are agreed by the County Council in February 2007.

4 Projected Portfolio Position

4.1 The Council’s projected treasury portfolio position at 31 March 2007 comprises:

	Principal £m	Average Rate %
Fixed Rate Funding		
PWLB	**249.0**	**6.04**
EIB	**0.0**	**-**
Total Debt	**249.0**	**6.04**
Total Investment	**82.0**	**4.90**

PWLB = Public Works Loans Board
EIB = European Investment Bank

5 Borrowing Requirement

5.1 The Council's anticipated borrowing requirement, based upon the 2007/08 to 2009/10 Capital Programme report (being considered by Cabinet on 1 February 2007) comprises:

	05/06 Actual £000	06/07 Probable £000	07/08 Estimate £000	08/09 Estimate £000	09/10 Estimate £000
New borrowing	31,700	16,258	40,390	19,280	20,319
Replacement borrowing	-	2,500	3,750	2,500	-
Total	**31,700**	**18,758**	**44,140**	**21,780**	**20,319**

6 Prospects for Interest Rates

6.1 The County Council has appointed Sector Treasury Services as its treasury advisor and part of Sector's service is to assist the County Council to formulate a view on interest rates. The following table gives Sector's central view on interest rates.

Sector View: Interest rate forecast – December 2006

	Q/E1 2007	Q/E 2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008
Base rate	5.00%	5.00%	5.00%	5.00%	4.75%	4.75%	4.75%	4.50%
25 yr PWLB Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
50 yr PWLB Rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

Q/E = calendar quarter end

Sector's current interest rate view is that Bank Rate will peak at 5.0% from November 2006 and then fall to 4.75% in Q1 2008 and then to 4.5% in Q4 2008 before rising back to 4.75% in Q3 2009.

6.2 The US, UK and EU economies have all been on the upswing of the economic cycle in 2005 and 2006. During this period, we have seen rising interest rates in order to cool their economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices which could feed through into increases in wage inflation, producer prices, etc.

6.3 The US is ahead of the UK and EU in the business cycle and it looks as if the Federal Reserve rate has probably already peaked at 5.25% whereas there is some expectation in the financial markets of a possible increase in the EU and UK (our consultant does not expect a further increase). The major feature of the US economy is a still steepening downturn in the housing market, which is likely to drag down consumer spending and the wider economy with it. Falling house prices will undermine household wealth and so lead to an increase in savings, leading to a fall in consumer expenditure.

6.4 The Federal Reserve may be reluctant to respond to the downturn in the economy if inflationary pressures remain stubbornly high. This could exacerbate the downturn in the US and the world economies. EU growth picked up strongly in the first half of 2006 and remained healthy in the second half. Growth is anticipated to slow moderately in 2007 due to weaker US and global demand.

6.5 Despite sharply increased energy prices, deflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3% and will fall as the energy effects go into reverse.

6.6 The UK is on the upswing of the economic cycle from the low point reached in June 2005. Robust growth is expected to continue for a little longer but a modest cooling is expected in 2007. The recovery in consumer spending and retail sales has underpinned this upswing in GDP. The housing market has proved more robust than expected with house price inflation at an annual 10%.

6.7 Higher than expected immigration from Eastern Europe has strengthened growth and dampened wage inflation. The Monetary Policy Committee (MPC) raised the Bank Rate in November 2006 to bring CPI inflation down to the 2% target level two years ahead. The MPC has been concerned that short term price increases (CPI has been significantly above target since June 2006) could feed through into wage settlements in the next pay round.

6.8 Household income growth is expected to recover in 2007 as inflation falls and pay rises but extra income is likely to result in a recovery of the savings rate and the servicing of debt rather than consumer expenditure. The increases in the Bank Rate in August and November 2006 are likely to dampen the housing market and unsecured borrowing.

6.9 When inflation is considered to be back under control, the Bank Rate will start to fall in 2008 to counter the negative effects on the economy and growth.

7 Borrowing Strategy

7.1 The 50-year PWLB rate is expected to remain flat at 4.25%. With the Sector forecast is in 25 basis point segments (0.25%), there is obviously scope for the rate to move around the central forecast by +/- 25bp without affecting this overall forecast. The 25-30 year PWLB rate is expected to rise to 4.5% in Q1 2007 and then remaining at that rate for the foreseeable future.

7.2 This forecast indicates, therefore, that the borrowing strategy for 2007/08 should be set to take very long dated borrowing at any time in the financial year. Variable rate borrowing is expected to be more expensive than long-term borrowing and will therefore be unattractive throughout the financial year compared with long-term borrowing.

7.3 With 50-year PWLB rate at 4.25%, borrowing should be made in this area of the market at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4.25%.

7.4 Against this background, caution will be adopted with the 2007/08 treasury operations. The Strategic Director of Resources will monitor the interest rate market and adopt a pragmatic approach to changing circumstances. If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or in increases in inflation, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

7.5 If it were felt that there was a significant risk of a sharp fall in long and short term rates, perhaps due to growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

8 Debt Rescheduling

8.1 As the first fall in the Bank Rate is expected in Q1 2008, it is therefore expected that there will be a sharp difference between higher short-term rates and cheaper long-term rates in quarters 2 to 4 of 2007. Later on in 2007/08, this advantage will diminish once the Bank Rate and short term rates generally start falling. There will therefore be opportunity during quarters 2 to 4 of 2007 to restructure shorter term debt into long term in order to optimise the potential savings achievable in the financial year 2007/08. Any positions taken via rescheduling will be in accordance with the strategy position outlined above.

8.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings at minimum risk;
- helping to fulfil the strategy outlined above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.3 CIPFA issued a draft accounting standards document (SORP 2007) on 18 October 2006, which includes major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premiums and discounts arising from debt rescheduling. There will be a three-month consultation period before proposals are finalised. It is also expected that these proposals, once finalised, may make necessary the issue of legislation by the Government to take effect from 1 April 2007. The Authority's treasury management strategy will be reviewed once the final decisions in this area are known to see whether any changes will be required in borrowing, investment or debt rescheduling strategies.

9 Annual Investment Strategy

9.1 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:

- the security of capital and
- the liquidity of its investments.

9.2 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 and make a return is unlawful and this Council will not engage in such activity.

9.3 Investment instruments identified for use in the financial year are listed below under the 'Specified' (12 months or less) and 'Non-Specified' (longer than 12 months) Investments categories. Counterparty limits will be as set through the Council's Treasury Management Procedures.

<u>Specified Investments</u>

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

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – Local Authorities	--	In-house
Term deposits – Banks and Building Societies	Short-term F1, Long-term A, Individual B, Support 3	In-house and External Manager
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A, Individual B, Support 3	External Manager
Money Market Funds	AAA	In-house and External Manager
UK Government Gilts	AAA	External Manager
Gilt Funds and Bond Funds	Long-term A	External Manager
Treasury Bills	--	External Manager

Non-Specified Investments

	*** Minimum Credit Criteria**	**Use**
Term deposits – banks and building societies (with maturities in excess of 1 year)	Short-term F1, Long-term A, Individual B, Support 3	External Manager
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A, Individual B, Support 3	External Manager
UK Government Gilts with maturities in excess of 1 year	AAA	External Manager

9.4 The Council's external fund manager(s) will comply with the Annual Investment Strategy. The agreement(s) between the Council and the fund manager(s) additionally stipulate guidelines and duration and other limits in order to contain and control risk. (It should be noted that the Council is currently out to tender for a replacement external manager.

9.5 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 consistently monitored. 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.

9.6 Investments will made according to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

9.7 Sector is forecasting the Bank Rate to remain at 5.0% from November 2006 until falling to 4.75% in Q1 2008 and then again to 4.5% in Q4 2008. The Bank Rate is then expected to remain unchanged until rising to 4.75% in Q3 2009 and remaining at that level for the foreseeable future. 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. For 2007/8, clients should budget for a cautious investment return of 4.75%

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

9.9 At the end of the financial year, the Council will report on its investment activity to the Cabinet.

10 Delegated Authority

10.1 It is recommended that Cabinet, subject to County Council approval, delegates authority to the Strategic Director of Resources to undertake the activities listed below. These activities will be carried out in accordance with the Treasury Management Practice Documents. Decisions will be made depending on the actual market conditions during the year.

10.2 Borrowing/Funding

- Raising debt finance from the most appropriate of these sources:
  - Government's Public Works Loans Board
  - European Investment Bank
  - Overdraft
  - Banks and building societies
  - Local Authorities
  - Lease finance providers

- Repayment of debt
- Managing the cost of debt
- Delegate authority to treasury management staff to undertake borrowing activities
- Delegated power to include vehicles in the 2007/08 capital programme if borrowing is the preferred financing option, following evaluation of all funding options. Evaluation with regard to the options concerning PWLB borrowing or operating leases will be based on the advice of the Council's leasing consultant.
- Delegated power to approve budget adjustments between departments and the capital financing budget in 'Other Services' to cover borrowing costs.

10.3 CIPFA's *Prudential Code for Capital Finance in Local Authorities* includes the following as a key indicator of prudence:

> "In order to ensure that over the medium term **net borrowing** will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

10.4 Net borrowing refers to the Authority's total external borrowing. The Authority had no difficulty meeting this requirement in 2006/07. Cabinet is being asked to approve and recommend to County Council that they request the Strategic Director of Resources to ensure that this requirement is not breached in future years, taking into account current commitments, existing plans, and the proposals in this budget report.

10.5 Investing

- Arranging investments using these instruments:

    - o Fixed term deposits with banks and building societies
    - o Money Market Funds
    - o Local Authorities
    - o Government's Debt Management Agency Deposits
    - o Bonds & gilts *
    - o Certificates of deposit *
    - o Treasury Bills*

    *Used by the external cash manager

- Compiling and updating the Lending List, utilising the criteria for counterparties, in consultation with the treasury management consultants. The criteria are fully detailed in the Treasury Management Practice Document, Risk Management.
- Consideration and use of new financial instruments and treasury management techniques
- Managing surplus funds and revenue from investments
- Appointment and performance management of external cash managers
- Delegate authority to invest to designated treasury management staff.

10.6 Use of the Provision for Credit Liabilities (amounts set aside as a provision to meet credit liabilities)

- Use of the PCL balance as the Strategic Director of Resources sees as appropriate

10.7 Loan rescheduling

- Any rescheduling will be done in consultation with the treasury management consultants

10.8 Leasing

- Take out finance leases (recorded on the balance sheet)
- Take out operating leases (revenue expenditure)

Leasing activities are undertaken in consultation with the leasing adviser.

10.9 Policy Documentation

- The formulation and review of the Treasury Management Policy Statement
- The formulation and review of the Treasury Management Practice Documents as follows:

- o risk management (includes credit criteria for the Authority’s lending list)
- o best value and performance measurement
- o decision making and analysis
- o approved instruments, methods and techniques
- o organisation, clarity and segregation of responsibilities, and dealing arrangements
- o reporting requirements and management information arrangements
- o budgeting, accounting and audit arrangements
- o cash and cash flow management
- o money laundering
- o staff training and qualifications
- o use of external service providers
- o corporate governance

Neither of the above documents requires Council approval but they are available for viewing.

10.10 Strategy Implementation

- Implementing the Strategy ensuring no breaches of regulations
- Reporting to Cabinet any material divergence from the Strategy
- Making requests to Council to approve amendments to the Strategy as required
- Ensuring that treasury management activities are carried out in accordance with CIPFA Codes of Practice.

DAVID CLARKE
Strategic Director, Resources
Shire Hall,
Warwick

January 2007

Council – 6 February 2007 – Item 3 - Appendix A

Warwickshire County Council Prudential Indicators 2006/2007

PRUDENTIAL INDICATOR (1). AFFORDABILITY PRUDENTIAL INDICATORS	2004/05 actual	2005/06 actual	2006/07 estimate	2007/08 estimate	2008/09 estimate	2009/10 estimate
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure	75,887	64,059	58,933	33,273	18,609	70,000
	%	**%**	**%**	**%**	**%**	**%**
Ratio of financing costs to net revenue stream	3.62	7.23	6.77	6.77	6.73	
Net borrowing requirement	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
brought forward 1 April	178,210	207,881	239,428	252,733	289,334	306,071
carried forward 31 March	207,881	239,428	252,733	289,334	306,071	318,322
in year borrowing requirement	29,671	31,547	13,305	36,601	16,736	12,251
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
In year Capital Financing Requirement	23,848	19,051	(14,372)	12,605	21,996	79,218
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Capital Financing Requirement as at 31 March	195,022	214,073	199,701	212,307	234,303	313,520
Affordable Borrowing Limit						
Position as agreed at Feburary 2004 Council	**£**	**£**	**£**	**£**	**£**	**£**
Increase per council tax payer	11.07	14.56	10.91			
Position as agreed at February 2005 Council	10.15	11.81	12.26	8.03		
Increase per council tax payer						
Updated position of Current Capital Programme						
Increase per council tax payer	12.72	7.58	-1.68	4.91	4.54	

PRUDENTIAL INDICATOR (2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2004/05 actual	2005/06 actual	2006/07 estimate	2007/08 estimate	2008/09 estimate	2009/10 estimate
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	244,573	267,326	306,822	351,750	370,337	403,046
other long term liabilities	18,000	18,000	600	600	600	600
TOTAL	**262,573**	**285,326**	**307,422**	**352,350**	**370,937**	**403,646**
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	203,811	222,771	255,685	293,125	308,614	335,872
other long term liabilities	15,000	15,000	500	500	500	500
TOTAL	**218,811**	**237,771**	**256,185**	**293,625**	**309,114**	**336,372**
Upper limit for fixed interest rate exposure						
Net principal re fixed rate borrowing / investments OR:-	100%	100%	100%	100%	100%	100%
Actual						
Upper limit for variable rate exposure						
Net principal re variable rate borrowing / investments OR:-	25%	25%	25%	25%	25%	25%
Actual						
Upper limit for total principal sums invested for over 364 days	£	£	£	£	£	
(per maturity date)	£0	£0	£0	£0	£0	£0

Maturity structure of new fixed rate borrowing during 2005/06	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%