AGENDA ITEM No. 5 NORTH LANARKSHIRE COUNCIL

REPORT

To: POLICY & RESOURCES (FINANCE) SUB-COMMITTEE	Subject: ANNUAL TREASURY STRATEGY 2005/2006
From: DIRECTOR OF FINANCE	
Date: 1 March, 2005 — Ref: JV/KH	

1. Introduction

1.1. The Policy and Resources (Finance) Sub-Committee agreed the Council's revised Treasury Management Policy on 1 June 2004. The Policy requires an annual strategic plan for Treasury Management arrangements to be approved by Council prior to the commencement of each financial year. This report sets out the strategy to be adopted for 2005/2006.

1.2. In addition, the report makes reference to the Prudential Treasury Indicators that were approved by this Committee on the 25th January 2005 and which will be closely monitored during the course of the incoming year.

2. Background

2.1 Treasury Management deals with the borrowing and investment activity of the Council, and an integral part of the financial management of the Council's affairs. It seeks to ensure that both capital borrowing requirements and day to day revenue cash transactions are fully funded. Its importance has increased as a result of the additional freedoms provided by the Prudential Code.

2.2 The Council's long-term loans portfolio amount to £461m, the majority of which has been accumulated to source capital investment programmes inherited at local government reorganisation. Conversely, the Council has short- term cash investments of approximately £67m, which has been generated by surplus cash inflows.

2.3 In determining Treasury strategy, due recognition has been taken of the requirements of both the CIPFA Code of Practice on Treasury Management, and the Prudential Code for Capital Finance in Local Authorities.

3. The Prudential Code

3.1.1 The Prudential Code for Capital Finance in Local Authorities was introduced in April 2004 and brought about a change to capital spending controls from 1 April 2004. From that date, councils had freedom to invest in capital projects without the limitation of Section 94 controls, provided their programmes can be shown to be affordable, prudent and sustainable.

3.1.2 The Policy & Resources (Finance) Sub-Committee, at their meeting on 25 January 2005, approved a report titled, *"Prudential Code On Capital Finance – Prudential Indicators 2005/06 to 2007/08"*. This report detailed a variety of mandatory and local indicators aimed at assisting members' in determining that proposed capital investment levels and treasury management decisions satisfied the key requirements of affordability, prudence and sustainability.

3.1.3 Appendix 1 summarises the key indicators presented to Committee on 25 January 2005. When taken together, these indicators illustrate that the increase in capital investment from 2005/06 onwards is both prudent and affordable. Additionally, healthy prudential margins from 2004/05 onwards justify the increased investment, the cost or affordability of which is contained within the existing financial strategies. As highlighted, there will be no impact on council tax and housing rent levels.

3.1.4 These key indicators will be monitored consistently and presented quarterly to the Policy & Resources (Finance) Sub-Committee to assist members in ensuring that Treasury Management decisions remain in line with the requirements of the Code

4. Borrowing Requirement 2004/2005

4.1 Members have approved a Capital Programme of £103.2 million for 2005/06, of which approximately £37 million has still to be funded from external borrowing. The remaining £66.2 million will be funded from revenue contributions to capital, cash grants and housing and general services capital receipts.

4.2 Loans amounting to £2.365 million are due to be repaid and replaced during the year giving a potential long term borrowing requirement for 2005/2006 of approximately £39.4 million. However, given the existing short-term investment levels of approximately £67 million, it is anticipated that this remaining capital financing requirement will primarily be funded using ongoing investment balances rather than seeking new funds from sources such as the PWLB.

5. Sources of Borrowing

5.1 Where required, the primary sources of long-term borrowing will be the Public Works Loan Board (PWLB), other approved financial institutions through the London Sterling Money Market and, when available, internally accumulated cash funds. In addition, other institutional sources will be utilized as approved through the issue of Mortgage Bonds.

5.2 Where temporary borrowing is required to finance, for example, short term cash flows or other temporary and long-term loans, the London Sterling Money Market will be used to acquire term or notice deposits.

5.3 On occasions, leasing will be used if advantageous to the Council.

5.4 No more than 25% or £15m, whichever is the greater, shall be taken from any one lender at any one time, except for borrowing from Public Works Loan Board, unless expressly approved by the Director of Finance.

6. Outlook for Interest Rates

6.1 Having reached historically low levels during 2003/2004, short-term interest rates gradually increased during 2004/05, reaching a peak of 4.75% in August 2004. Whilst there is still a risk of modest increases to the base rate in the early part of 2005, the majority of economic forecasters anticipate that there is a very low probability of this occurring, hence base rates are forecast to remain generally steady until 2007.

6.2 Forecasting medium to long-term interest rates is a very imprecise exercise. Unexpected world events can dramatically alter interest rates, whilst inflation, growth of the economy, and the performance of sterling on foreign exchanges are examples of the types of domestic activity that can also influence longer term rates.

6.3 Having examined the major influencing factors, economists predict that medium to long-term interest rates will move marginally, possibly increasing slightly towards the end of 2006.

7. Treasury Management Strategy

7.1 The introduction of the Prudential Code allows the Council to determine the level of capital investment appropriate to its needs. Additionally, by placing heavier reliance on balance sheet information, the Code assists the Council to effectively monitor its treasury management activities and informs the strategic decision making process.

7.2 Based on a review of information available in the Annual Accounts 2003/04, plus economic and interest rate forecasts, borrowing during 2005/06 will be considered on the basis of:

7.2.1 PWLB rates are expected to rise in the early part of 2005, hence the majority of long-term borrowing will be delayed until the later part of 2005/06 with a view to locking in lower long-term rates. However, this strategy will be monitored continually and may be altered if market developments present good borrowing opportunities ahead of expectations.

7.2.2 Any new borrowing will take account of the debt maturity profile to ensure that an acceptable amount matures in any one year and is also undertaken at the most advantageous rate in the yield curve.

7.2.3 Whilst the largest proportion of the portfolio will remain as fixed rate debt to reduce uncertainty and risk, variable rate loans may be used in order to capture potential falls in money market rates, so maximising the performance of the loan portfolio.

7.2.4 A proportion of funding will be held back to insure against unexpected economic/political events that could potentially drive yields down to unexpectedly low levels.

7.3 In determining the lending and investment strategy for 2005/06, the following factors will be taken into consideration: -

7.3.1 Investment opportunities are likely to be poorer than in recent years, given that base rates are forecast to gradually decline until 2007. Given these estimates, longer term lending (currently up to 1 year) may be considered for part of the portfolio to ensure security of return.

7.3.2 The balance of the portfolio will be held shorter-term to protect against the possibility of an unexpected rise in interest rates.

7.3.3 All investments will be made in accordance with Council policies and prevailing legislation and regulations, following consideration of prevailing interest rates and all known risk factors. It is anticipated that new investment guidance will shortly be introduced for Scottish authorities, which may enhance the Council's investment opportunities. As yet, there is no implementation date regarding this, so further details will be reported to members through the committee cycles as they become available.

7.4 Based on the Council's expected borrowing position, and using delegated powers, the Finance Department will look to undertake debt rescheduling exercises during 2005/06 providing interest rates are beneficial, and can assist in maximizing the Council's financial position.

8. Recommendations

8.1 The Committee is requested to approve the Treasury Management Strategy for 2005/2006, and to note the Prudential Indicators and limits detailed within the appendix to this report.

Director of Finance

Prudential Indicators 2005/06 to 2007/08
Approved by Policy & Resources (Finance) sub-committee meeting of 25th January 2005

Appendix 1

At their meeting of 25th January, members approved a report titled, *"Prudential Code On Capital Finance – Prudential Indicators 2005/06 to 2007/08"*. This report detailed a variety of mandatory and local indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities, of which summary details are listed below.

Mandatory prudential indicators are:

	2004/05 Revised	**2005/06 Estimated**	**2006/07 Estimated**	**2007/08 Estimated**
Capital Expenditure (£000s)	101,814	103,170	93,739	93,355
Capital financing requirement (£000s)	431,514	444,876	460,368	475,064
Prudential Margin (£000s)	8,244	7,554	6,864	6,173
Authorised limit for external debt (£000s)	600,000	520,000	520,000	520,000
Operational boundary for external debt (£000s)	570,000	485,000	485,000	485,000
Ratio of financing costs to net revenue stream – Non HRA	5.30%	5.38%	5.49%	5.82%
Ratio of financing costs to net revenue stream –HRA	22.01%	21.64%	22.15%	22.86%
Indicative Incremental impact of capital investment decisions on the Band D Council Tax	N/A	£12 (1.15%)	£14 (1.30%)	£14 (1.26%)
Indicative Incremental impact of capital investment decisions on housing rents levels per annum	N/A	-£36 (1.55%)	-£29 (1.21%)	- £27 (1.09%)

Limits on interest rates	**2004/05 Upper**	**2005/06 Upper**	**2006/07 Upper**
Fixed interest rates	110%	105%	105%
Variable interest rates	25%	25%	25%
Maturity Structure of fixed interest rate borrowing			
	Upper	**Upper**	**Upper**
Under 12 months	5%	5%	5%
12 months to 2 years	5%	5%	5%
2 years to 5 years	10%	10%	10%
5 years to 10 years	25%	25%	25%
10 years and above	90%	90%	90%
Maximum principal sums invested > 364 days	N/A	N/A	N/A

Prudential Indicators 2005/06 to 2007/08
Approved by Policy & Resources (Finance) sub-committee meeting of 25th January 2005

Appendix 1

Local Indicators aimed at enhancing decision making are:

Content of loan portfolio	**2005/06**		**2006/07**		**2007/08**	
	Value	**%**	**Value**	**%**	**Value**	**%**
	£000s		£000s		£000s	
Interest Council is due to pay on loans outstanding:						
Loans with Fixed rate debt	30,352	**97.37%**	30,246	**97.47%**	30,528	**97.71%**
Loans with Variable rate debt	820	**2.63%**	784	**2.53%**	717	**2.29%**
	31,172	**100%**	31,030	**100%**	31,245	**100%**
Interest Council is due to receive from investments:						
Variable rate investments	- 2,479	**100%**	- 1,868	**100%**	- 1,087	**100%**
Net Loan Interest Payments Due (£000s)	**£28,693**		**£29,162**		**£30,158**	

Maturity Structure of borrowing	**< 12 months**	**12 months to 2 years**	**2 to 5 years**	**5 to 10 years**	**10 years + above**
Upper limit maturing on fixed rate debt as per mandatory indicator above	**5%**	**5%**	**10%**	**25%**	**90%**
Maturity profile; fixed debt 1/4/05	0.35%	2.92%	5.22%	13.95%	77.57%
Maturity profile; fixed debt 1/4/06	2.65%	1.59%	3.99%	17.37%	74.40%
Maturity profile; fixed debt 1/4/07	0.28%	2.72%	7.10%	18.61%	71.29%