AGENDA ITEM No..2..... **NORTH LANARKSHIRE COUNCIL**

REPORT

To: POLICY & RESOURCES (FINANCE) SUB-COMMITTEE	Subject: ANNUAL TREASURY STRATEGY 2006/07
From: DIRECTOR OF FINANCE	
Date: 2 March, 2006 — Ref: JV/KH	

1. Introduction

1.1 The Council has adopted the CIPFA Code of Practice in Treasury Management and operates its treasury services to mitigate the effect of possible risk in this function, while undertaking borrowing and investment activities that are prudent, affordable and sustainable.

1.2 The Code of Practice requires the Council to produce reports on its Treasury Management policies, practices and activities on a regular and ongoing basis. This encompasses the preparation and approval of an Annual Strategic Plan, which defines the arrangements for managing the Treasury function in the incoming year. This report details the proposed strategy for 2006/07.

1.3 In addition, the report makes reference to the Prudential Treasury Indicators that were approved by this Committee on the 24th January 2006 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 is 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 amounts to £458 million, the majority of which has been accumulated to source capital investment programmes inherited at local government reorganisation. Conversely, the Council has external 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 The Prudential Code for Capital Finance in Local Authorities introduced in April 2004 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.

3.2 The Policy & Resources (Finance) Sub-Committee, at their meeting on 24 January 2006, approved a report titled, *"Prudential Code On Capital Finance – Prudential Indicators 2006/07 to 2008/09"*. 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.

3.3 Appendix 1 summarises the key indicators presented to Committee on 24 January 2006, and illustrates that the substantial levels of capital investment planned from 2006/07 onwards are both prudent and affordable.

3.4 Healthy prudential margins in each year justify the high levels of investment, without having any impact on Council Tax or Housing Rents. In line with the requirements of the Prudential Code, indicative impacts to Council Tax and House Rents have been illustrated, however, the cost (affordability) of additional capital investment has been contained within the Council's existing financial strategies

3.5 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 2006/2007

4.1 Members have approved a Capital Programme of £104.8 million for 2006/07, of which approximately £33.8 million has still to be funded from external borrowing. The remaining £71 million will be funded from revenue contributions to capital, cash grants and housing and general services capital receipts.

4.2 Loans amounting to £13.306 million are due to be repaid and replaced during the year giving a potential long term borrowing requirement for 2006/2007 of approximately £47.1 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 available, the primary source of long-term borrowing will be internally accumulated cash funds. Where additional sums are deemed to be required, long-term borrowing will then be sourced from the Public Works Loan Board (PWLB), Mortgage Bonds, and other approved financial institutions through the London Sterling Money Market.

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 an option appraisal review identifies this as being 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 The Monetary Policy Committee (MPC) has held base rates at 4.50% since August 2005, primarily due to being cautiously upbeat about inflation prospects while anticipating modest recovery in economic activity. With growth in government spending and investment likely to be fairly benign, the key factor affecting the economy during 2006/07 is likely to be consumer behaviour.

6.2 There is evidence to suggest that consumer spending will strengthen throughout 2006 but this may prove to be more modest than the Bank of England is anticipating. Slower than forecast growth may leave scope for short-term rates to fall, but stable inflation around the 2% target rate combined with a moderate rebound in house price inflation may limit the scope for interest rate cuts. Base rates are expected to return to the 4.5% level in the closing stages of 2006/07 as activity and inflation strengthen. On balance, therefore, little movement in rates is expected during the financial year.

6.3 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.

6.4 The investment of excess global savings in bond markets and the strong pension fund demands for government bonds have placed considerable downward pressure upon medium to long-term rates in the past year. These influences are likely to persist throughout the balance of 2006 therefore interest rate rises are likely to be modest.

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, and by placing heavier reliance on balance sheet information, the Code assists the Council to effectively monitor its treasury management activities and inform the strategic decision making process.

7.2 Based on a review of information available in the Annual Accounts 2004/05, available economic and interest rate forecasts, and previous borrowing decisions, borrowing during 2006/07 will be considered on the basis of:

7.2.1 The opportunity to obtain loans with attractive interest rates. As is normal practice, the majority of any additional long-term borrowing requirement will be sourced from the PWLB. However, PWLB rates were erratic during 2005/06, reaching an all time low of 3.70% (for loans due to mature between 45 and 50 years) in January 2006, but gradually rising thereafter. This trend towards higher levels is forecast to continue in the early part of the 2006/07 financial year, reducing scope for borrowing in the early part of the year.

7.2.2 Rate forecasts combined with the availability of internally accumulated cash funds indicate that the need to undertake additional borrowing is not urgent, hence there is scope for the Council to wait for potential opportunities of locking in lower long-term rates later in the year. This strategy will be monitored continually and may be altered if market developments or unexpected economic/political events present good borrowing opportunities ahead of expectations.

7.2.3 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.

7.2.4 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.

7.3 In determining the lending and investment strategy for 2006/07, the following factors will be taken into consideration: -

7.3.1 Investment opportunities are likely to be poorer than in recent years, given the scope for base rates to decline marginally during 2006/2007. However, given the uncertainty in the market regarding rate projections, it is proposed that the majority of the investment profile be held short-term. However, longer term lending (currently up to 364 days) and forward deals may be considered for part of the portfolio with a view to obtaining satisfactory security of return.

7.3.2 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 disappointing that Scottish authorities do not yet have enhanced investment opportunities, however, there is scope for the Scottish Executive to introduce new investment guidance during 2006/07. Further details will be reported to members through the committee cycles as and when they become available.

7.4 Based on the Council's expected borrowing position and delegated powers, the Finance Department will look to undertake debt rescheduling exercises during 2006/07 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 2006/2007, and to note the Prudential Indicators and limits detailed within the appendix to this report.

Director of Finance

Members wishing further information should contact Mrs K Hassell, Treasury Manager, Tel No 01698 302235

Prudential Indicators 2006/07 to 2008/09
Approved by Policy & Resources (Finance) sub-committee meeting of 24th January 2006

Appendix 1

At their meeting of 24th January, members approved a report titled, *"Prudential Code On Capital Finance – Prudential Indicators 2006/07 to 2008/09"*. 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:

	2005/06 Revised	**2006/07 Estimated**	**2007/08 Estimated**	**2008/09 Estimated**
Capital Expenditure (£000s)	115,423	104,798	100,924	73,821
Capital financing requirement (£000s)	435,079	442,738	451,216	441,929
Prudential Margin (£000s)	8,684	9,749	10,814	11,879
Authorised limit for external debt (£000s)	520,000	520,000	520,000	520,000
Operational boundary for external debt (£000s)	485,000	485,000	485,000	485,000
Ratio of financing costs to net revenue stream – Non HRA	5.88%	6.02%	6.16%	TBC
Ratio of financing costs to net revenue stream –HRA	21.64%	19.13%	19.10%	19.36%
Indicative Incremental impact of capital investment decisions on the Band D Council Tax	£12 (1.15%)	£12 (1.11%)	£12 (1.07%)	£0 (0%)
Indicative Incremental impact of capital investment decisions on housing rents levels per annum	-£36 (1.55%)	-£25 (1.06%)	-£22 (0.88%)	- £25 (0.98%)

Limits on Interest rates	**2006/07 Upper**	**2007/08 Upper**	**2008/09 Upper**
Fixed interest rates	110%	110%	110%
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 2006/07 to 2008/09
Approved by Policy & Resources (Finance) sub-committee meeting of 24th January 2006

Appendix 1

Local Indicators aimed at enhancing decision making are:

Content of loan portfolio	**2006/07**		**2007/08**		**2008/09**	
	Value	**%**	**Value**	**%**	**Value**	**%**
	£000s		£000s		£000s	
Interest Council is due to pay on loans outstanding:						
Loans with Fixed rate debt	30,565	**97.35%**	30,967	**97.69%**	30,682	**97.84%**
Loans with Variable rate debt	831	**2.65%**	731	**2.31%**	678	**2.16%**
	31,396	**100%**	31,698	**100%**	31,360	**100%**
Interest Council is due to receive from investments:						
Variable rate investments	- 2,916	**100%**	- 2,479	**100%**	- 2,191	**100%**
Net Loan Interest Payments Due (£000s)	**£28,480**		**£29,219**		**£29,169**	

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 1/4/06	2.62%	0.30%	5.16%	12.55%	79.37%
Maturity profile; fixed debt 1/4/07	0.31%	1.34%	4.02%	16.27%	78.06%
Maturity profile; fixed debt 1/4/08	1.35%	1.43%	4.81%	17.50%	74.91%