

REPORT TO: FINANCE COMMITTEE – 11 MARCH 2002
REPORT ON: TREASURY MANAGEMENT STRATEGY 2002/2003
REPORT BY: DIRECTOR OF FINANCE
REPORT NO: 142-2002

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy for 2002/2003, 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 2002/2003 as set out in the attached document "Treasury Management Strategy 2002/2003".

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 2002/2003 and future years.

4 LOCAL AGENDA 21 IMPLICATIONS

None.

5 EQUAL OPPORTUNITIES IMPLICATIONS

None.

6 BACKGROUND

At its meeting today the Finance Committee considered the Council's revised Treasury Policy Statement, setting out the policies which would govern all borrowing and lending transactions carried out by the Council.

The Treasury Policy Statement requires that the Finance Committee will receive and consider the Treasury Management Strategy in advance of each new financial year.

7 TREASURY MANAGEMENT STRATEGY 2002/2003

The Council's Treasury Management Strategy for 2002/2003 is set out in detail in the attached document. In summary, long-term borrowing rates are higher than short-term rates although this position may close during 2002/2003. Short-term rates are expected to rise during 2002/2003. Interest savings will be maximised by utilising long-term borrowing facilities, where appropriate, to take advantage of low long-term interest rates and using short-term borrowing, where appropriate, to take advantage of any differential from long-term 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.

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DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2002/2003

Finance Department
Dundee

TREASURY MANAGEMENT STRATEGY 2002/2003

1 INTRODUCTION

This Treasury Management Strategy details the expected activities of the Treasury Management function in the financial year 2002/2003. 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 2002/2003 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.

2 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 January 2002 was as follows:

		<u>£m</u>	<u>£m</u>	<u>%</u>
Fixed Rate Funding	Public Works Loan Board	239.0		
	Market Loans	<u>6.9</u>	245.9	87.7
Variable Rate Funding	Market Loans	12.7		
	Temporary Loans	<u>21.8</u>	<u>34.5</u>	<u>12.3</u>
Total Loan Debt			<u>280.4</u>	<u>100.0</u>

3 TREASURY LIMITS FOR 2002/2003

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 £42m
 - initial term under one year (20% of total debt) Circa £56m
- the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt) Circa £84m

4 PROSPECTS FOR INTEREST RATES

The Council appointed Prebon Financial Consultants (now Sector Treasury Services) as treasury advisers to the Council on 9 August 1999 and part of their service is to assist the Council to formulate a view on interest rates. Appendix A draws together a number of current City forecasts for short term or variable and longer fixed interest rates for 2002/2003.

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

Shorter term interest rates – The downturn in 2001 in the US economy, and also in world growth, is expected to only modestly turn round in 2002. Base rate is therefore expected to rise only gently in 2002 from a probable base of 4.00% in quarter to a broadly neutral level of 4.5% by the end of 2002. It is then expected to remain at this level in 2003.

Longer term interest rates – PWLB rates fell to remarkably low levels in the second half of 2001 due to the downturn in America, which was then compounded by the terrorist attacks. PWLB rates have recovered back up to neutral levels with 20-25 year lower quota rate at around 5.0 - 5.25%. These rates are expected to remain throughout 2002 (assuming there are no further huge terrorist attacks to shock the world). There could be technical factors which overlay from time to time above the general trend.

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 cheaper than long fixed rate borrowing for most of 2002/2003. However, with shorter term rates expected to rise to match longer term fixed rates, the differential will narrow over time. The interest rate market has been very volatile during 2001 and should be much less so during 2002 provided there are no further major terrorist attacks. This expectation provides a variety of options:-

- that the expectation for rising base rates in the future is so strong that the drawing of cheaper, fixed short term funding in the near term is essential to enable it to make short term savings required in order to meet budgetary constraints.
- that the risks intrinsic in the shorter term variable rates are such, when compared to relatively low long term funding which should be achievable early in 2002/03, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding.

Against this background caution will be adopted with the 2002/03 treasury operations. The Director of Finance will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

Sensitivity of the forecast – The main sensitivities of the forecast are likely to be the two scenarios below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- *an unexpected sharp rise in long and short term rates* – If growth accelerates above trend there would be a greater rise in all rates. In this event the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are relatively cheap.
- *an unexpected sharp fall in long and short term rates* – A slowdown in growth may see both short and long term rates fall. In this event long term borrowings will be postponed and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.

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.

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) provided they have maintained their credit rating.

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.

OUTLOOK FOR INTEREST RATES

The data below shows a variety of forecasts published by a number of institutions. The first represents the view of two City banks including UBS who provide Sector's economic forecasting; the second two represent summarised figures drawn from the population of all major City banks and academic institutions. The current data shows the rates at the time of issue, not necessarily current rates. The forecast within the strategy has been drawn from these diverse sources and officers own views.

Individual Banks Forecasts

UBS Warburg Economic Forecast - Interest Rates January 2002

(%)	Current	Q1 2002	Q2 2002	Q3 2002	Q4 2002	Q1 2003
Base Rate	4.00%	3.75%	3.75%	4.00%	4.50%	4.50%
10 Year Gilt	4.94%	5.20%	5.00%	5.00%	5.00%	5.00%
30 Year Gilt	4.65%	4.95%	4.75%	4.75%	4.75%	4.75%

HSBC - Economic and Financial Outlook - December 2001

(%)	Current	Q1 2002	Q2 2002	Q3 2002	Q4 2002
Base Rate	4.00%	4.00%	4.00%	4.25%	4.75%
10 Year Gilt	4.94%	4.70%	4.40%	4.50%	4.70%
30 Year Gilt (November 2001)	4.49%	4.60%	5.00%	5.50%	5.60%

Summary Bank Forecasts

HM Treasury - summary of 35 independent forecasters views of base rate - as at February 2002 (2003-2005 are also as at February 2002 but are based on 11 forecasts)

(%)	2002 Year End	2003 Average	2004 Average	2005 Average
Average	5.77%	5.31%	5.21%	5.09%
Highest	6.75%	5.80%	6.00%	6.00%
Lowest	5.00%	4.60%	4.50%	4.50%

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+	10
HBOS (formerly Bank of Scotland and Halifax)	F1+	10
Barclays Bank plc	F1+	10
* Clydesdale Bank plc (National Australia Bank)	F1+	10
Lloyds TSB Bank plc	F1+	10
HSBC Bank plc	F1+	10
Royal Bank of Scotland plc (inc National Westminster)	F1+	10
Alliance and Leicester plc	F1+	10
Bradford & Bingley plc	F1	5
<u>Building Societies</u>		
Nationwide Building Society	F1+	10
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
<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