

**REPORT TO: POLICY AND RESOURCES COMMITTEE - 23 MARCH 2009**

**REPORT ON: TREASURY MANAGEMENT STRATEGY 2009/2010**

**REPORT BY: HEAD OF FINANCE**

**REPORT NO: 160-2009**

## **1 PURPOSE OF REPORT**

This report introduces the Dundee City Council Treasury Management Strategy for 2009/2010, 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 Head 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 Head of Finance for 2009/2010 as set out in the attached document "Treasury Management Strategy 2009/2010".

## **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 2009/2010 and future years. The 2009/2010 Revenue Budget has been set including a provision of £23.451m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 5.6%.

## **4 BACKGROUND**

The Council's Treasury Policy Statement Report No 172-2008 requires that the Policy and Resources 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 CIPFA Code of Practice on Treasury Management in the Public Services also requires that the Council sets out its treasury management strategy for borrowing and investment.

Specific guidance on investments is expected to be issued by the Scottish Ministers in the new financial year.

## **5 TREASURY MANAGEMENT STRATEGY 2009/2010**

The Council's Treasury Management Strategy for 2009/2010 is set out in detail in the attached document. The net new borrowing required in 2009/2010 is £31m. In light of this there is expected to be phased borrowing during the year. This will be based on cash flow and interest rate monitoring to determine the term and value of each loan taken.

In light of the current uncertainties in the finance market, lending transactions will be closely monitored to achieve maximum security of capital. This will involve using all available sources of information to assess the financial strength of any counter-parties.

**6 POLICY IMPLICATIONS**

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

**7 CONSULTATION**

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

**8 BACKGROUND PAPERS**

None

**MARJORY M STEWART  
HEAD OF FINANCE**

**19 MARCH 2009**

**DUNDEE CITY COUNCIL**

**TREASURY MANAGEMENT STRATEGY 2009/2010**

**Finance Department  
Dundee**

## TREASURY MANAGEMENT STRATEGY 2009/2010

### 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 2009/2010. Its production and submission to the Policy and Resources 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 2009/2010 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 Investment strategy;
- Debt rescheduling.
- Prudential Indicators

### 2 PRUDENTIAL INDICATORS FOR 2007/2008-2011/2012

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 2007/2008 - 2011/2012 were reported to Committee on 12 February 2009. 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 2009 was as follows:

		<u>£m</u>	<u>£m</u>	<u>%</u>
Fixed Rate Funding	Public Works Loan Board	262.8		
	Market Loans	<u>35.3</u>	298.1	98.2
Variable Rate Funding	Market Loans	5.2		
	Temporary Loans	<u>0.4</u>	<u>5.6</u>	<u>1.8</u>
Total Loan Debt			<u>303.7</u>	<u>100.0</u>
<u>Investments</u>				
Short Term Lending			<u>46.0</u>	

### 4 TREASURY LIMITS FOR 2009/2010

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 £35m
- the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt based on operational boundary)
 Circa £106m
- the maximum proportion of interest on borrowing which is subject to fixed rate interest - (100% of total debt based on operational boundary)
 Circa £353m
- authorised limit for external borrowing
 £378m

### 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 2009/2010.

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

**Shorter term interest rates** - Base rate is expected to stabilise at 0.5% throughout the year.

**Longer term interest rates 50 years** - PWLB rates are expected to reach a low of 3.90% in mid 2009.

## 6 CAPITAL BORROWINGS REQUIRED AND THE PORTFOLIO STRATEGY

The net borrowing requirement for capital expenditure is shown in Appendix A. In 2009/10 it is £31m. Cash flows and PWLB rates will be monitored to determine the appropriate time to borrow and term of the loans. Estimates of the likely rates for different terms are shown at Appendix B. Short-term rates are expected to be lower but this must be balanced against the risk of having to re-finance at an earlier date.

## 7 TEMPORARY INVESTMENT STRATEGY

The Council will have regard to CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities are a) security of capital and b) liquidity of investments. The Council will aim to achieve the optimum return in light of these.

The borrowing of monies purely to invest or on-lend is unlawful and the Council will not engage in such activity.

Balances on reserves and variations in cash flow requirements means that there will be surplus funds which will be invested for short periods (maximum of 364 days).

Short term investment 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 remove some parties who now fail to meet the Fitch Credit Rating Agency criteria and to add the Government Debt Management Office.

This list reflects the full range of counterparties to be used in the normal course of events. In light of the continuing uncertainty in financial markets each lending decision is being reviewed individually and more restrictive criteria will be applied, where considered appropriate.

The return from investments is expected to be very low over the next year and security of capital will be the Council's prime objective.

## 8 DEBT RESCHEDULING

The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt and the setting of a spread between the two rates has meant that PWLB to PWLB restructuring is now much less attractive.

Opportunities will continue to be monitored and possible reasons would be:

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

**DUNDEE CITY COUNCIL**

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
1 CAPITAL PLAN PRUDENTIAL INDICATORS	£ p	£ p	£ p	£ p	£ p
	estimate	estimate	estimate	estimate	actual
<b>Capital Expenditure</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
General Services	36,915	31,494	54,120	100,172	47,030
<b>Ratio of financing costs to net revenue stream</b>					
General Services	7.9%	7.3%	7.0%	6.7%	6.8%
<b>Net borrowing requirement</b>					
brought forward 1 April	314,075	313,779	322,000	353,000	407,000
carried forward 31 March	313,779	322,000	353,000	407,000	429,000
in year borrowing requirement	(296)	8,221	31,000	54,000	22,000
<b>In year Capital Financing Requirement</b>					
General Services	(3,277)	3,841	21,263	47,487	15,473
HRA	(281)	5,583	10,780	7,337	7,322
TOTAL	(3,558)	9,424	32,043	54,824	22,795
<b>Capital Financing Requirement as at 31 March</b>					
General Services	204,065	225,000	230,000	277,000	293,000
HRA	124,318	127,000	141,000	148,000	155,000
TOTAL	328,383	352,000	371,000	425,000	448,000
<b>Difference between Net Borrowing and Capital Financing Requirement</b>					
	14,604	30,000	18,000	18,000	19,000
<b>Incremental impact of capital investment decisions</b>	£ p	£ p	£ p	£ p	£ p
Increase/(Decrease) in Council Tax (band D per annum)	-	-	0.07	0.12	8.58

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
2 TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
<b>Authorised limit for external debt - borrowing</b>	340,000	347,000	378,000	432,000	454,000
other long term liabilities	4,500	4,000	4,000	4,000	4,000
TOTAL	344,500	351,000	382,000	436,000	458,000
<b>Operational boundary for external debt - borrowing</b>	313,730	322,000	353,000	407,000	429,000
other long term liabilities	49	-	-	-	-
TOTAL	313,779	322,000	353,000	407,000	429,000
<b>Upper limit for fixed interest rate exposure</b> expressed as Net principal re fixed rate borrowing/investments	100	100	100	100	100
<b>Upper limit for variable rate exposure</b> expressed as Net principal re variable rate borrowing/investments	30	30	30	30	30
<b>Upper limit for total principal sums invested for over 364 days</b>	N/A	N/A	N/A	N/A	N/A

Maturity structure of fixed rate borrowing during 2009/10	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 by Sector, UBS and Capital Economics (an independent forecasting consultancy). 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) - February 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Bank Rate	0.5%	0.5%	0.5%	0.5%	0.5%
5 Year PWLB	2.6%	2.45%	2.3%	2.3%	2.3%
10 Year PWLB	3.6%	3.35%	3.2%	3.2%	3.25%
25 Year PWLB	4.15%	4.05%	4.0%	4.0%	4.1%
50 Year PWLB	4.1%	3.95%	3.9%	3.9%	3.95%

**Capital Economics** interest rate forecast - January 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Bank Rate	0.5%	0.0%	0.0%	0.0%	0.0%
5 Year PWLB	1.65%	1.45%	1.45%	1.45%	1.45%
10 Year PWLB	2.65%	2.15%	2.15%	2.15%	2.15%
25 Year PWLB	4.15%	4.0%	3.8%	3.65%	3.65%
50 Year PWLB	4.05%	3.95%	3.85%	3.75%	3.75%

**UBS** interest rate forecast - January 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Bank Rate	0.5%	0.5%	0.5%	0.5%	0.5%
10 Year PWLB	3.75%	4.15%	4.35%	4.65%	-
25 Year PWLB	4.25%	4.55%	4.85%	5.05%	-
50 Year PWLB	4.3%	4.65%	5.0%	5.25%	-

**Summary Economic Forecasts**

HM Treasury - summary of 35 independent forecasters views of bank rate - as at January 2009 (2010-2012 are based on 21 forecasts)

(%)	2009 Year End	2010 Average	2011 Average	2012 Average
Medium	0.5%	3.11%	3.97%	4.49%
Highest	2.5%	4.7%	5.0%	5.25
Lowest	0.0%	1.0%	2.25%	3.0%



**APPROVED COUNTERPARTIES FOR INVESTMENT TRANSACTIONS**

<b><u>Approved Lending Bodies</u></b>	<b><u>Short Term Credit Rating</u></b>	<b><u>Maximum Deposits £m</u></b>
<b><u>Banks</u></b>		
Abbey National plc, Alliance & Leicester	F1+	12
Barclays Bank plc	F1+	12
* Clydesdale Bank plc (National Australia Bank)	F1+	12
Lloyds TSB Bank plc (inc HBOS)	F1+	12
HSBC Bank plc	F1+	12
Royal Bank of Scotland plc (inc National Westminster)	F1+	12
Northern Rock	F1+	12
Bank of Ireland	F1+	12
Dexia Bank	F1+	12
Anglo Irish Bank Corporation	F1+	12
<b><u>Building Societies</u></b>		
Nationwide Building Society	F1+	12
Coventry Building Society	F1	8
Skipton Building Society	F1	8
Yorkshire Building Society	F1	8
Chelsea Building Society	F1	8
Leeds Building society	F1	8
<b><u>Other</u></b>		
Debt Management Office	N/A	12
Scottish Local Authorities	N/A	8
English and Welsh Local Authorities	N/A	8

\* 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