

REPORT TO: FINANCE COMMITTEE – 13 MARCH 2006

REPORT ON: TREASURY MANAGEMENT STRATEGY 2006/2007

REPORT BY: DEPUTE CHIEF EXECUTIVE (FINANCE)

REPORT NO: 178-2006

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy for 2006/2007, 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 Depute Chief Executive (Finance) is obliged to present the annual Treasury Management Strategy at the start of each financial year.
- 2 approve the strategy proposed by the Depute Chief Executive (Finance) for 2006/2007 as set out in the attached document "Treasury Management Strategy 2006/2007".

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 2006/2007 and future years. The 2006/07 Revenue Budget has been set including a provision of £22.011m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 5.9% after taking into account borrowing for 2006/07 at historically low rates. This borrowing generated savings of £260,000 which have been included in the provision of £22.011m.

4 LOCAL AGENDA 21 IMPLICATIONS

None.

5 EQUAL OPPORTUNITIES IMPLICATIONS

None.

6 BACKGROUND

The Council's Treasury Policy Statement Report No 140-2005 requires that the Finance 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 Act also requires the Council to set out its treasury strategy for borrowing and investment.

7 TREASURY MANAGEMENT STRATEGY 2006/2007

The Council's Treasury Management Strategy for 2006/2007 is set out in detail in the attached document. The opportunity arose in 2005/06 to take advantage of historically low interest rates to borrow for the majority of the Council's 2006/07 capital expenditure requirements. In light of this there is expected to be limited borrowing during the year. Rescheduling opportunities will continue to be monitored and lending will take place when necessary in line with guidance in Treasury Policy Statement.

8 CONSULTATION

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

9 BACKGROUND PAPERS

None

DAVID K DORWARD
DEPUTE CHIEF EXECUTIVE (FINANCE)

3 MARCH 2006

DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2006/2007

Finance Department
Dundee

TREASURY MANAGEMENT STRATEGY 2006/2007

1 INTRODUCTION

This Treasury Management Strategy details the expected activities of the Treasury Management function in the financial year 2006/2007. 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 2006/2007 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.
- Prudential Indicators

2 PRUDENTIAL INDICATORS FOR 2004/05-2008/09

The indicators for 2004/05 - 2008/09 were reported to Committee on 9 January 2006. These are relevant to the integrated treasury management strategy. These have been updated and are shown at Appendix C.

3 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 January 2006 was as follows:

		<u>£m</u>	<u>£m</u>	<u>%</u>
Fixed Rate Funding	Public Works Loan Board	266.7		
	Market Loans	<u>1.6</u>	268.3	86.1
Variable Rate Funding	Market Loans	42.7		
	Temporary Loans	<u>0.5</u>	<u>43.2</u>	<u>13.9</u>
Total Loan Debt			<u>311.5</u>	<u>100.0</u>
<u>Investments</u>				
Short Term Lending			<u>27.8</u>	

4 **TREASURY LIMITS FOR 2006/2007**

In accordance with the Council's Prudential Indicators for Treasury Management, the Treasury limits set by 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) Circa £31m
- the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt) Circa £93m
- the maximum proportion of interest on borrowing which is subject to fixed rate interest - (100% of total debt) Circa £311m
- authorised limit for external borrowing £352m

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 A draws together a number of current City forecasts for short term or variable and longer fixed interest rates for 2006/2007.

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

Shorter term interest rates – Base rate is expected to fall from 4.5% to 4% by the end of 2006 and then edge up by 0.25%.

Longer term interest rates 50 years – PWLB rates are expected to remain at around 4% for first half of financial year then rise to 4.5% by the end.

6 **CAPITAL BORROWINGS REQUIRED AND THE PORTFOLIO STRATEGY**

The borrowing required for 2006/07 has been taken in 2005/06 to take advantage of historically low rates. The need for additional borrowing is expected to be very limited.

7 **TEMPORARY LENDING STRATEGY**

It is not the Council's policy to be in a lending position although the borrowing taken for 2006/07 and variations in cash flow requirements means that there will be times of surplus funds which will be lent for short periods.

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 Approved Counterparties list (shown at Appendix B) provided they have maintained their credit rating. This list reflects that agreed by the Committee on 14 November 2005 (Report No 663-2005).

8 **DEBT RESCHEDULING**

The Council will continue to monitor opportunities for rescheduling based on interest rate differentials. Possible reasons for rescheduling would include:

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

OUTLOOK FOR INTEREST RATES

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy), who both provide economic forecasting for Sector. The final one 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 statement has been drawn from these diverse sources and officers own views.

Individual Banks Forecasts

Sector Economic interest rate forecast (for quarter ends) - February 2006

(%)	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007
Base Rate	4.50%	4.25%	4.25%	4.00%	4.25%
10 Year PWLB	4.25%	4.25%	4.25%	4.50%	4.50%
25 Year PWLB	4.25%	4.25%	4.25%	4.50%	4.50%
50 Year PWLB	4.00%	4.00%	4.25%	4.25%	4.50%

Capital Economics interest rate forecast - January 2006

(%)	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007
Base Rate	4.25%	4.00%	4.00%	4.00%	4.00%
10 Year PWLB	4.25%	4.15%	4.25%	4.35%	4.55%
25 Year PWLB	4.25%	4.25%	4.35%	4.45%	4.45%
50 Year PWLB	3.95%	3.95%	4.05%	4.15%	4.15%

UBS interest rate forecast - January 2006

(%)	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007
Base Rate	4.50%	4.50%	4.50%	4.50%	4.50%
10 Year PWLB	4.25%	4.35%	4.45%	4.55%	4.60%
25 Year PWLB	4.15%	4.45%	4.55%	4.65%	4.70%
50 Year PWLB	4.05%	4.45%	4.61%	4.74%	4.80%

Summary Bank Forecasts

HM Treasury - summary of 40 independent forecasters views of base rate - as at December 2005 (2007-2009 are as at November 2005 and based on 18 forecasts)

(%)	2006 Year End	2007 Average	2008 Average	2009 Average
Average	4.29%	4.39%	4.54%	4.60%
Highest	5.00%	5.40%	5.90%	6.20%
Lowest	3.50%	3.75%	3.75%	3.75%

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+	12
HBOS (formerly Bank of Scotland and Halifax)	F1+	12
Barclays Bank plc	F1+	12
* Clydesdale Bank plc (National Australia Bank)	F1+	12
Lloyds TSB Bank plc	F1+	12
HSBC Bank plc	F1+	12
Royal Bank of Scotland plc (inc National Westminster)	F1+	12
Alliance and Leicester plc	F1+	12
Bradford & Bingley plc	F1	5
Anglo Irish Bank Corporation	F1	5
<u>Building Societies</u>		
Nationwide Building Society	F1+	12
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
Chelsea 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

APPENDIX C**DUNDEE CITY COUNCIL**

PRUDENTIAL INDICATOR	2004/05	2005/06	2006/07	2007/08	2008/09
1 CAPITAL PLAN PRUDENTIAL INDICATORS	£ p	£ p	£ p	£ p	£ p
	actual	estimate	estimate	estimate	estimate
Capital Expenditure	£'000	£'000	£'000	£'000	£'000
General Services	46,546	42,016	51,404	39,042	25,694
Ratio of financing costs to net revenue stream					
General Services	7.4%	7.8%	7.9%	7.9%	7.8%
Net borrowing requirement					
brought forward 1 April	281,233	292,714	316,946	326,518	336,764
carried forward 31 March	292,714	316,946	326,518	336,764	342,401
in year borrowing requirement	11,481	24,232	9,572	10,246	5,637
In year Capital Financing Requirement					
General Services	7,525	10,387	14,197	5,381	759
HRA	3,874	1,151	7,139	5,679	6,000
TOTAL	11,399	11,538	21,336	11,060	6,759
Capital Financing Requirement as at 31 March					
General Services	191,262	201,649	215,846	221,227	221,986
HRA	118,686	119,837	126,976	132,655	138,655
TOTAL	309,948	321,486	342,822	353,882	360,641
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D per annum)	-5.54	-1.16	-3.93	-9.41	Nil

PRUDENTIAL INDICATOR	2004/05	2005/06	2006/07	2007/08	2008/09
2 TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised limit for external debt -					
borrowing	318,000	329,000	352,000	362,000	368,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	323,000	334,000	357,000	367,000	373,000
Operational boundary for external debt -					
borrowing	293,000	304,000	327,000	337,000	343,000
other long term liabilities	1,000	1,000	1,000	1,000	1,000
TOTAL	294,000	305,000	328,000	338,000	344,000
Upper limit for fixed interest rate exposure					
expressed as					
Net principal re fixed rate borrowing/investments	100	100	100	100	100
Upper limit for variable rate exposure					
expressed as					
Net principal re variable rate borrowing/investments	30	30	30	30	30
Upper limit for total principal sums invested for over 364 days	N/A	N/A	N/A	N/A	N/A

Maturity structure of new fixed rate borrowing during 2005/06	lower limit	upper limit
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	-	95%

Adoption of CIPFA Code of Practice for Treasury Management	YES
--	-----