REPORT TO: FINANCE COMMITTEE – 18 APRIL 2005

REPORT ON: TREASURY MANAGEMENT STRATEGY 2005/2006

REPORT BY: DEPUTE CHIEF EXECUTIVE (FINANCE)

REPORT NO: 141-2005

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy for 2005/2006, 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 2005/2006 as set out in the attached document "Treasury Management Strategy 2005/2006".

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 2005/2006 and future years. The 2005/06 Revenue Budget has been set including a provision of £21.294m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 6.05%.

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 2005/2006

The Council's Treasury Management Strategy for 2005/2006 is set out in detail in the attached document. In summary, long-term borrowing and short-term borrowing rates are similar. Short-term rates are expected to fall by early 2006. 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.

8 BACKGROUND PAPERS

None

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DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2005/2006

Finance Department
Dundee

TREASURY MANAGEMENT STRATEGY 2005/2006

1 INTRODUCTION

This Treasury Management Strategy details the expected activities of the Treasury Management function in the financial year 2005/2006. 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 2005/2006 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 2005/06-2007/08

The indicators for 2004/05 - 2006/07 were reported to Committee on 13 December 2004. These are relevant to the integrated treasury management strategy. These are shown at Appendix C together with estimates for 2007/08.

3 CURRENT TREASURY PORTFOLIO POSITION

The Council’s loan debt position at 31 January 2005 was as follows:

		£m	£m	%
Fixed Rate Funding	Public Works Loan Board	251.6		
	Market Loans	2.0	253.6	91.6
Variable Rate Funding	Market Loans	22.7		
	Temporary Loans	0.5	23.2	8.4
Total Loan Debt			276.8	100.0

4 TREASURY LIMITS FOR 2005/2006

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 £28m
• the maximum proportion of interest on borrowing which is subject to variable rate interest. (30% of total debt)	Circa £83m
• the maximum proportion of interest on borrowing which is subject to fixed rate interest - (100% of total debt)	Circa £280m
• authorised limit for external borrowing	£335m

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 2005/2006.

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

Shorter term interest rates – Base rate is expected to peak at 5% during the year and fall back thereafter.

Longer term interest rates 25 years – PWLB rates are expected to drift at around 4.75% during the year.

6 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 there will not be much difference between short term variable PWLB rates and medium and long-term fixed rate borrowing during 2005/2006. Short term rates are expected to rise in line with base rates. Variable rates are expected to become cheaper during 2006. These expectations provide a variety of options.

- that short term rates will be good value compared to long term rates, and are expected to remain so for the next two years, so that best value will be achieved by borrowing short term at variable rates, in order to minimise borrowing costs in the short term or to make short term.

- that the risks intrinsic in the shorter term variable rates are such, when compared to relatively low long term fixed funding, which may be achievable in 2005/06, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding at a marginally higher rate.

Against this background caution will be adopted with the 2005/06 treasury operations. The Depute Chief Executive (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:

- *a significant risk of sharp rise in long and short term rates*, perhaps arising from an increase in world economic activity. 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 still relatively cheap.

- *a significant risk of sharp fall in long and short term rates*, due to e.g. growth rates remaining low or weakening. In this event long term borrowings will be postponed, and any rescheduling from fixed rate funding into variable or short rate funding will be considered.

7 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 Approved Counterparties list. (Shown at Appendix B) provided they have maintained their credit rating. This list reflects that contained in the Council's Treasury Policy Statement.

8 DEBT RESCHEDULING

The expected differential between short term and long term rates later in the year is sufficient to provide some potential for debt restructuring. 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) - January 2005

(%)	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	5.00%	5.00%	4.75%	4.75%	4.50%
10 Year PWLB	5.00%	4.75%	4.75%	4.75%	4.75%
25 Year PWLB	4.75%	4.75%	4.75%	4.75%	4.75%

Capital Economics interest rate forecast - January 2005

(%)	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	4.75%	4.50%	4.25%	4.00%	3.75%
10 Year PWLB	4.55%	4.45%	4.45%	4.35%	4.25%
25 Year PWLB	4.50%	4.40%	4.50%	4.45%	4.50%

UBS interest rate forecast - January 2005

(%)	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
Base Rate	4.75%	5.00%	5.00%	5.00%	5.00%
10 Year PWLB	4.70%	4.60%	4.65%	4.70%	4.70%
25 Year PWLB	4.55%	4.55%	4.60%	4.65%	4.65%

Summary Bank Forecasts

HM Treasury - summary of 39 independent forecasters views of base rate - as at January 2005 (2006-2008 are as at November 2004 and based on 11 forecasts)

(%)	**2005** Year End	**2006** Average	**2007** Average	**2008** Average
Average	4.71%	4.81%	4.82%	4.76%
Highest	5.25%	5.50%	5.25%	5.25%
Lowest	3.90%	4.10%	4.10%	3.80%

APPENDIX B

APPROVED COUNTERPARTIES FOR LENDING TRANSACTIONS

Approved Lending Bodies	Short Term Credit Rating	Maximum Deposits £m
Banks		
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
Anglo Irish Bank Corporation	F1	5
Building Societies		
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
Chelsea Building Society	F1	5
Other		
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

PRUDENTIAL INDICATORS - TREASURY MANAGEMENT

Adoption of CIPFA Code of Practice for Treasury Management		YES
Upper Limit for borrowing that is at variable rates less investments that are variable rate investments		%
	2004/05	30
	2005/06	30
	2006/07	30
	2007/08	30
Upper Limit for borrowing that is at fixed rates less investments that are fixed rate investments		
	2004/05	100
	2005/06	100
	2006/07	100
	2007/08	100

Limit for 2004/05 for amount of projected borrowing that is fixed rate maturing in each period as percentage of total projected borrowing that is fixed at the start of the period

Where the periods are:		Lower %	Upper %
	Under 12 months	0	10
	12 months & within 24 months	0	15
	24 months & within 5 years	0	25
	5 years & within 10 years	0	25
	10 years +	50	95

Upper limit for sums invested for periods longer than 364 N/A

Authorised Limit for external debt with limit for borrowing and other long term liabilities separately identified

	Borrowing £000	Other £000	Total £000
2004/05	330,000	5,000	335,000
2005/06	350,000	5,000	355,000
2006/07	367,000	5,000	372,000
2007/08	367,000	5,000	372,000

Operational Boundary for external debt with limit for borrowing and other long term liabilities separately identified

	Borrowing £000	Other £000	Total £000
2004/05	305,000	1,000	306,000
2005/06	325,000	1,000	326,000
2006/07	342,000	1,000	343,000
2007/08	342,000	1,000	343,000

Estimates of Capital Financing Requirements

	non HRA £000	HRA £000	Total £000
2004/05	197,000	123,000	320,000
2005/06	205,000	130,000	335,000
2006/07	212,000	135,000	347,000
2007/08	216,000	135,000	351,000