DERBY CITY COUNCIL

COUNCIL CABINET
31 OCTOBER 2006

ITEM 11

Cabinet Member for Corporate Policy

Treasury Management Progress Report

SUMMARY

1.1 Treasury Management activity during the year has resulted in further savings for the Council, as a result of increasing interest rates for investment and lower borrowing rates, as well as a restructuring of existing debts.

1.2 The prudential indicators need further updating commensurate with the latest changes to the capital programme.

1.3 A minor update to the Treasury Strategy is required to make the formal documentation more consistent.

1.4 Subject to any issues raised at the meeting, I support the following recommendations:

RECOMMENDATIONS

2.1 To note the progress report on Treasury Management during 2006/07.

2.2 To clarify that the Treasury Management Strategy allows all top twenty building societies to have a counterparty limit for investments of at least £6m.

2.3 That the Cabinet recommend to the Council the adoption of updated Prudential Indicators at Appendix 2.

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31 OCTOBER 2006

Report of the Corporate Director – Resources and Housing

Treasury Management Progress Report

SUPPORTING INFORMATION

1. This report updates the Cabinet on progress in Treasury Management so far this financial year. There has been substantial activity since the strategy was set at the Council Cabinet on 21 February and subsequently approved by Council on 1 March 2006.

2 Borrowing

2.1 The existing strategy for borrowing takes account of the latest regulatory framework, the existing borrowing structure, the potential borrowing requirement for the year, sources of new borrowing and external factors influencing borrowing decisions.

2.2 The original strategy for 2006/07 identified an increase in the Council's net borrowing requirement of £23m, £15m of which had been borrowed during 2005/06 as approved by Cabinet, resulting in a maximum borrowing requirement for the year of £8m.

2.3 As a result of the advice received from our Treasury advisers, reported as part of the Treasury outturn report on 1 August 2006, and changes to the capital programme reported on 5 September 2006, and again on 3 October 2006 the required level of borrowing has increased to £20.2m.

2.4 This change will require the prudential indicators to be updated and approved by Council. These are set out at Appendix 2 to this report.

3 Factors influencing borrowing decisions

3.1 In early 2006, Butlers, the Council's treasury management advisers, produced their economic outlook and interest rate forecasts for 2006/07. Their advice at that time was that long-dated PWLB debt offered the best value for borrowing, and that commitment to medium-dated debt should be avoided. PWLB rates were expected to rise slightly during 2006/07, but to drop back to current levels towards the end of the financial year.

3.2 The Strategy for 2006/07 considered that variable debt would be avoided even though rates are currently low. A substantive reliance on variable debt would leave the Council exposed to market fluctuations, and therefore does not minimise risk. Increases in rates during this year demonstrate the risks that are faced when taking variable rate debt.

4 Debt Maturity profile

4.1 There is also a need to achieve a debt maturity profile that reduces exposure to market changes in any one year. No more than 15% of the debt portfolio should mature in any one year.

4.2 The Strategy determined that the Council should continue with its approach of taking mostly long-dated fixed rate debt, where borrowing is necessary, with the current preference for long- over medium- and short-dated loans being subject to review if market conditions change. This approach was seen to be more attractive, given the availability of newly introduced 50-year PWLB loans, on which the rates of interest have been generally even lower than for the previous maximum length of PWLB loan of 30 years.

5 Sources of Borrowing

5.1 The authority can meet its financing requirement by a combination of borrowing from external sources and the use of funds generated internally. If the authority chooses to borrow externally, it can use either the money market or the Public Works Loans Board, PWLB. Funds created internally have only one primary source. This is the amount the authority must set aside from the revenue account to meet debt repayments, known as the minimum revenue provision, MRP. This minimum amount can be topped up by a voluntary revenue provision, VRP, in order to make the charge to revenue better reflect the actual use of the acquired capital item.

6 Debt Rescheduling

6.1 Debt rescheduling needs to be considered in the context that the value of debt on the Council's balance sheet is forecast to be at least stable and is currently rising. There may be an opportunity when market conditions are right to cease new borrowing and to use internal reserves as cover, but current interest rates do not make this sensible at this stage.

6.2 In that context, the Strategy endorsed the potential rescheduling of further long-term loans in 2006/07, which may be running at disadvantageous interest rates, or where savings can be made to reduce the debt charge costs to the authority. Consideration of options to reschedule debt has been undertaken in conjunction with our Treasury advisers, and consequently the Council has repaid £59.174m of debt and replaced this with £58.75m of new long-term debt. The overall impact of these changes have been to save the Council's general fund approximately £1.5m over the life of the existing loans.

7 Long term borrowing activity to date

7.1 So far in 2006/07, a total of £15m PWLB money has been borrowed to finance current year capital expenditure and PWLB principal repayments of £8.123m. This contained no variable rate debt. Market conditions and the careful planning of loans have enabled the authority to borrow at an average of 4.16%, against a budgeted rate of 4.75%, for an average period of 43.4 years. The situation is continually being monitored to assess the possibility of further borrowing for 2006/07 within the limits set by the prudential framework.

7.2 Effectively a balance of £5.2m remains to be borrowed this year. It is intended at this point to undertake this borrowing around December or January if rates continue to prove attractive. Should PWLB rates fall, consideration will be given to borrowing in advance for the next financial year, as was successfully achieved last year.

7.3 The current debt outstanding with the PWLB is £312.289m at a weighted average rate of 4.966% and is spread as follows:

Period remaining	Debt Outstanding £m	Average Rate %
Under 1 year	0.001	2.500
1 – 2 years	0.016	2.877
2 – 3 years	3.033	9.442
3 – 4 years	10.046	9.599
4 – 5 years	3.279	8.540
6 – 10 years	3.643	8.936
10 – 20 years	29.505	5.271
20 – 30 years	149.016	4.764
Over 30 years	113.750	4.400

In addition, the Council has Lenders Option, Borrowers Option – LOBO – market loans of £22.7m at 4.45%, which are repayable on demand at certain call points.

7.4 New borrowing this year has been undertaken as follows:

Date	**Amount (£m)**	**Period (years)**	**Interest Rate %**
25 August 2006 (A)	4.0	42.5	4.25
25 August 2006 (B)	4.0	42.5	4.25
28 September 2006	4.0	46.5	4.05
28 September 2006	3.0	46.0	4.05

In addition there has been borrowing of £58.75m as part of the restructuring during the year. Details of this borrowing are as follows:

Date	**Amount (£m)**	**Period (years)**	**Interest Rate %**
19 June 2006	3.0	20.5	4.50
19 June 2006	7.5	45.5	4.25
19 June 2006	4.0	35.5	4.30
19 June 2006	5.0	46.5	4.25
19 June 2006	6.0	35.5	4.30
19 June 2006	2.5	46.5	4.25
16 August 2006	7.0	31.5	4.45
16 August 2006	6.5	32.5	4.45
16 August 2006	7.0	31.5	4.45
25 August 2006	5.25	31.5	4.30
25 August 2006	5.0	31.5	4.30

The repaid loans as part of the restructure are as follows:

Date	Amount (£m)	Period to Maturity(years)	Interest Rate %
09 June 2006	5.000	19.8	4.75
09 June 2006	1.848	18.71	4.75
09 June 2006	0.652	18.71	4.75
09 June 2006	8.000	19.23	4.75
15 June 2006	4.435	18.74	4.50
15 June 2006	2.000	18.74	4.50
15 June 2006	4.000	19.74	4.50
15 June 2006	2.500	19.74	4.50
17 August 2006	5.000	8.80	4.30
17 August 2006	2.500	12.55	4.875
17 August 2006	5.000	14.55	4.875
17 August 2006	5.000	13.56	4.875
17 August 2006	3.000	14.55	4.75
17 August 2006	2.239	16.55	4.50
17 August 2006	8.000	17.56	4.50

7.5 Interest rates have developed as follows:

Rates	1 Apr 06	1 May 06	1 Jun 06	1 Jul 06	1 Aug 06	1 Sep 06	1 Oct 06
	%	%	%	%	%	%	%
Base rate	4.50	4.50	4.50	4.50	4.50	4.75	4.75
PWLB 3 years	4.60	4.80	4.85	5.00	4.85	4.95	4.95
PWLB 7 - 8 years	4.55	4.80	4.80	4.90	4.80	4.75	4.70
PWLB 20 - 25 years	4.35	4.60	4.55	4.65	4.55	4.45	4.40
PWLB 25 – 30 years	4.25	4.50	4.40	4.55	4.45	4.35	4.30
PWLB 30 – 35 years	4.25	4.50	4.40	4.50	4.40	4.25	4.25
PWLB 35 – 40 years	4.20	4.45	4.35	4.50	4.35	4.25	4.20
PWLB 40 – 45 years	4.20	4.45	4.35	4.45	4.30	4.25	4.15
PWLB 45 – 50 years	4.20	4.40	4.30	4.45	4.30	4.20	4.15

7.6 New borrowing has been taken at rates lower than those indicated above, as opportunities are constantly monitored to pick up what appears at the time to be a likely low point in interest rates. These are identified with the help of advice from our Treasury advisers. For example, the latest borrowing was undertaken at the end of September at a rate of 4.05% - lower than either the 4.20% at the start of September or the 4.15% at the start of October.

8 Investments

8.1 The increase in short term interest rates as a result of the bank base rate increase this year and anticipated further increase in November has resulted in greater returns than those originally budgeted. The cash balance held by the Council has also continued to outperform the budgeted position in the short term. It is not anticipated that the current level of cash balances of over £120m can be sustained as there are a number of significant pressures on the Council, which are likely to lead to a significant reduction in the cash balance available for investment over the next couple of years.

8.2 The Council's ability to secure a good rate of return has depended on its ability to act flexibly when market conditions suggest a particular investment is good value. The general strategy is therefore to take either short or long dated investments that outperform market expectations, informed by the view of our treasury advisers.

The following investment activity had taken place as at 1 October 2006.

Total number of investments	166
Value of investment held at:	
1 April 2006	£104.230m
1 October 2006	£130.935m
Average value of investments April – Sep 2006	£129.355m
Total interest earned on investments	£3.126m
Average return on portfolio	**4.833%**
Average LIBID 7 day rate	4.575%
Average LIBID 3 month rate	4.684%
Average LIBID 12 month rate	4.936%
Weighted average Base Rate (2006/07 to date)	4.587%

The interest earned to 1 October 2006 represents a return of 4.833%, which is 0.246% more than the weighted average base rate, which since April has increased from 4.50% to 4.75%. The portfolio has therefore continued to outperform all but the 12 month rate, yet remained flexible enough to be able to deal with any short term cash pressures.

8.3 Short-term cash available for investment has fluctuated between £104m and £154m so far during 2006/07 and has averaged £129m. The high point was only due to having borrowed funds for restructuring purposes, and while we awaited a short term change in interest rates to obtain an increased level of discount from the PWLB. Cash has been invested only with institutions on the Council's approved list, with restrictions on overall amounts for particular institutions and sectors. All activity has been conducted within the current limits for investment set as part of the Prudential Code indicators.

9 Treasury Management Strategy

9.1 Currently there is a slight inconsistency between annexes 1 and 2 of the Treasury Management Strategy for 2006/07. Annex 1 indicates that all top twenty building societies should be able to be used as counterparties for investments, with a limit of at least £6m each. Annex 2 states that those building societies between 11 and 20 on the list are limited to £3m each. Our Treasury advisers believe that to extend the limit to £6m each for the latter group would not involve too great an increase in risk for the Council.

9.2 As current balances are higher than expected, the Council is to some extent restrained from obtaining even greater value on its investments, and it is recommended that to clarify the inconsistency in favour of the larger figure would help to increase investment returns at negligible increased risk.

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Background papers:	Cabinet reports 21 Feb 2006, 1 Aug 2006, 5 Sep 2006
List of appendices:	Appendix 1 – Implications Appendix 2 – Updated Prudential Indicators

IMPLICATIONS

Financial

1. As detailed in the report.

Legal

2. As detailed in the report

Personnel

3. None.

Equalities impact

4. None.

Corporate priorities

5. The objectives and outcomes of the Council's Treasury Management Strategy contribute to minimising Council Tax and providing Value for Money.

APPENDIX 2

Prudential Code Indicators Summary 2005/06 - 2008/09

Prudential Code Reference	Indicator	Actual 2003/04	Actual 2004/05	Estimated: 2005/06	Actual 2005/06	Estimated: 2006/07	Estimated: 2007/08	Estimated: 2008/09
Affordability								
	Forecast Financing cost to Net Revenue Stream Ratio							
35	- General Fund %			4.78%		**8.40%**	9.32%	9.50%
36	- HRA %			22.35%		**23.46%**	23.43%	23.36%
	Actual Financing cost to Net Revenue Stream Ratio							
37	- General Fund %	4.21%	3.82%		4.03%			
38	- HRA %	23.60%	21.49%		24.76%			
39	**Incremental Impact on Council Tax: Band D £/year year's programme**		11.43		20.31	**64.85**	30.79	14.34
Local	**Impact on Council Tax of new borrowing: £1m a year band D / yr years programme**				1.27	**1.24**	1.22	1.24
40-41	**Incremental Impact on Housing Rents £/week - year's programme = cumulative**		0.28		0.41	**1.70**	2.99	3.14
Prudence								
45	**Actual / Forecast Borrowing compared to CFR**							
	-Net External Debt £m	216.7	201.8	231.2	220.2	**240.3**	262.4	271.6
	- CFR £m	272.7	326.6	366.5	364.7	**383.0**	390.1	393.0
Local	- Gross External Debt £m		332.7	362.4	371.0	**381.3**	387.1	388.5
	- CFR £m	272.7	326.6	366.5	364.7	**383.0**	390.1	393.0
Capital Expenditure								
51-52	**Total Capital Expenditure**							
	- General Fund £m			37.6	45.3	**80.7**	69.9	54.3
	- HRA £m			32.3	31.1	**10.1**	10.7	10.7
	- Total £m			69.8	76.4	**90.8**	80.6	65.1
53-54	**Estimated Capital Financing Requirement**							
	- General Fund £m		157.5	172.8	176.1	**193.5**	199.6	201.5
	- HRA £m		169.1	193.7	188.5	**189.5**	190.5	191.5
	- Total £m		326.6	366.5	364.7	**383.0**	390.1	393.0
57-58	**Actual Total CFR £m**	272.7	326.6		364.7			
External Debt								
59	Authorised Limit for borrowing £m			421	419	**440**	449	452
	Authorised Limit for other long term liabilities £m			1	1	**1**	1	1
	Authorised Limit £m			422	420	**441**	450	453
60	Operational Boundary for borrowing £m			385	383	**402**	410	413
	Operational Boundary for other long term liabilities £m			1	1	**1**	1	1
	Operational Boundary £m			386	384	**403**	411	414
Treasury Management								
66	**Adopted CIPFA Treasury Management Code of Practice**	Yes	Yes	Yes	Yes	**Yes**	Yes	Yes
67-70	**Interest Rate Exposure - Fixed**							
	Upper limit %			120	101.92	**120**	120	120
	Lower limit %			80		**80**	80	80
67-70	**Interest Rate Exposure - Variable**							
	Upper limit %			20	-1.92	**20**	20	20
	Lower limit %			-20		**-20**	-20	-20
Local	**Long term Borrowing - Fixed rate**							
	Upper limit %			100	93.09	**100**	100	100
	Lower limit %			80		**80**	80	80
Local	**Long term Borrowing - Variable rate**							
	Upper limit %			20	6.01	**20**	20	20
	Lower limit %			0		**0**	0	0
Local	**Investments - Fixed rate**							
	Upper limit %			100	73.18	**100**	100	100
	Lower limit %			30		**30**	30	30
Local	**Investments - Variable rate**							
	Upper limit %			70	26.82	**70**	70	70
	Lower limit %			0		**0**	0	0
74	**Maturity Structure of Debt - % of all debt**	Upper Limit %		Lower Limit %				
	Under a year	15		0	2.47			
	Between 1 and 2 years	15		0	6.95			
	Between 2 and 5 years	30		0	4.96			
	Between 5 and 10 years	50		0	7.32			
	Over 10 years	100		50	78.3			
77	**Investments over a year - limit £m**			£25m	£15m	**£35m**	**£35m**	**£35m**
	Additionally, no investment to be longer than two years from date of investment							