DERBY CITY COUNCIL

COUNCIL CABINET
1 AUGUST 2006

ITEM 19

Cabinet Member for Corporate Policy

Treasury Management – Annual Report 2005/06

SUMMARY

1.1 This report details the outturn position for 2005/06 for the prudential indicators and reports on treasury management activity during 2005/06.

1.2 The outturn prudential indicators for 2005/06 are set out in Appendices 2 & 3.

1.3 The results of treasury management borrowing and investment activity in 2005/06 are set out in Appendix 4. This shows that:

- new borrowing in 2005/06 was taken at an average rate of only 4.22%
- returns on investments averaged 4.81% well above the average Bank of England base rate of 4.59%, even after allowing for the slight difference in the methodology used to calculate these two figures.

1.4 Subject to any issues raised at the meeting, I support the following recommendation.

RECOMMENDATION

2.1 To note the prudential indicators in respect of the 2005/06 outturn as outlined in in Appendix 2 and summarised at Appendix 3 to this report.

2.2 To approve the updated prudential indicators for 2006/07 and 2007/08 as listed at Appendix 3 to this report, noting that the changes are as a result of the reported 2005/06 outturn position.

2.3 To approve the Annual Report in respect of Treasury Management activity for 2005/06 as outlined in Appendix 4 to this report.

DERBY CITY COUNCIL

COUNCIL CABINET
1 AUGUST 2006

Report of the Corporate Director – Resources and Housing

Treasury Management – Annual Report 2005/06

SUPPORTING INFORMATION

1.1 The Prudential Code for Capital Finance in Local Authorities requires that the Council adopts a set of annual prudential indicators relating to Capital and Treasury Management, and approves, annually, a Treasury Management Strategy, incorporating an Annual Investment Strategy. This report sets out the outturn position for the prudential indicators and reports on treasury management activity during 2005/06, consistent with the Council's duties under the Code.

1.2 Appendix 2 to this report sets out the approved prudential indicators, together with the outturn position for each, giving explanations for variances as necessary.

1.3 The Annual Treasury Management Report for 2005/06 at Appendix 4 sets out a summary of the approved strategy, together with a summary of the activity during the year.

1.4 Members' attention is drawn specifically to investment activity during 2005/06. Returns on investments have out performed the weighted average Bank of England Base rates.

1.5 Most of the prudential indicators are reported in detail at Appendix 2 to this report. The exceptions are those prudential indicators which relate specifically to treasury management. These are referred to in Appendix 4, the Treasury Management Annual Report for 2005/06. Appendix 3 provides a summary of all the prudential indicators.

1.6 It should be noted that some prudential indicators for 2006/07 and 2007/08 have been updated insofar as they reflect consequential changes from the outturn position for 2005/06.

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Background papers:	Council Cabinet Report 22 February 2005 'Treasury Management Strategy and Prudential Code Indicators 2005/06' Council Cabinet report 'Capital Outturn 2004/05' 12 July 2005 Council Cabinet Report 8 November 2005 'Contract and Financial Procedures Matters Report – Appendix 2' Treasury Management Strategy and Prudential Code indicators 2006/07 21 February 2006 Council Cabinet report 'Capital Programme and Resource Monitoring' 14 March 2006 Council Cabinet report 'Capital Outturn 2005/06' 1 August 2006
List of appendices:	Appendix 1 – Implications Appendix 2 – Prudential Indicators 2005/06 Appendix 3 – Prudential Indicator Summary 2005/06 Actuals Appendix 4 – Treasury Management Annual Report 2005/06

Appendix 1

IMPLICATIONS

Financial

1. As detailed in the report

Legal

2.1 The Council is obliged to set and review prudential indicators in order to comply with the Local Government Act 2003. The Local Government Act 2003 states that the Council must adopt the Prudential Code, which, in turn, requires local authorities to adopt the CIPFA Treasury Management Code of Practice. Unless the government uses its powers under section 4 of that Act, the Council is free to set any reasonable indicators consistent with its other policies.

2.2 The Prudential Code states that the Prudential indicators for treasury management should be considered together with the local authority's treasury management strategy and the annual report on treasury management activities.

Personnel

3. None

Equalities impact

4. None

Corporate priorities

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

Prudential Indicators

Prudential indicators are grouped into the following categories:

- Plans for capital expenditure
- Borrowing Limits
- Affordability
- Treasury Management

They are set and reviewed having regard to the following:

- Affordability – for example the effect on Council Tax
- Prudence and sustainability – for example the implications of external borrowing on the plans
- Value for money for example through option appraisal
- Stewardship of assets – for example through asset management planning
- Service objectives – for example through strategic planning processes
- Practicality – for example the achievability of the forward plan.

1. Plans for Capital Expenditure

1.1 The actual capital expenditure outturn for 2005/06, which has been reported separately on this agenda. The actual indicators, consistent with this outturn are as follows, split between General Fund, GF, including unsupported borrowing, and Housing Revenue Account, HRA:

	General Fund	HRA	Total
	£m	£m	£m
Original Approval	37.6	32.3	69.8
Actual	45.3	31.1	76.4

1.2 Comparative actual capital expenditure for 2004/05 was £88.3m, of which £39.2m related to the General Fund and £49.1m to the HRA.

1.3 The increase of £7.7m in GF expenditure mainly relates to £5.5m re-phasing of expenditure deferred from 2004/05 to 2005/06. The detail of this can be seen in the capital outturn report for 2004/05 – Cabinet 12 July 2005. In addition, £2.2m of expenditure relating to the 2006/07 capital programme has been brought forward into 2005/06, including the following major projects:

- IRRMS £1.31m
- Friargate Studios £0.16m
- Multi Storey Car Parks £0.15m

1.4 The financial implications of this early general fund expenditure are dealt with in the capital outturn report for 2005/06, on this same Cabinet agenda.

2. Borrowing Limits

2.1 The Capital Financing Requirement, or CFR, is the key indicator against which the Council's external borrowing is measured. The CFR is calculated for the current year using figures extracted from the Council's Balance Sheet as follows:

- Fixed Assets
- Deferred Charges
- Fixed Asset Restatement Account
- Capital Financing Account
- Government Grants Deferred

The sum of these balances represents the maximum amount that the Council might expect to have borrowed to finance previous years' capital investments. Future years CFR's are derived using the previous year's CFR, together with the increase in planned borrowing for the current year, less any principal repayments. The actual CFR's for 2004/05 and 2005/06 are as follows:

CFR	General Fund	HRA	Total
	£m	£m	£m
2004/05 Actual	157.4	169.1	326.5
2004/05 Restated	155.2	169.1	324.3
2005/06 Actual	167.4	188.5	355.9
Increase	12.2	19.4	31.6

The 2004/05 figures have been restated as, during 2005/06 a correction was made to the total amount of transferred debt held by the County Council in respect of District Councils in 1974. This reduced the total debt and consequently the CFR for 2004/05. The Housing increase essentially relates to the final part of the Homes Pride programme, financed by supported borrowing. General Fund increases relate to the extent to which borrowing has financed new capital expenditure.

2.2 Section 3 of the 2003 Local Government Act imposes a duty on the Council to set a limit on how much money it can afford to borrow and to keep this under review. The 'Authorised Limit' is an absolute limit on borrowing, and may not be exceeded. Additionally, the Council must set an 'operational boundary' for borrowing. This is a level of borrowing that, if exceeded frequently, indicates a potential problem with the borrowing strategy. These targets are required to be set on a 'rolling' three-year basis.

2.3 The Council's Operational Boundary and Authorised Limit were set at £382m and £421m respectively for 2005/06. These levels are 5% and 15% respectively above the year's proposed CFR to allow for variability in the timing of the borrowing and spending. Gross external borrowing of £375.1m remained well within these two limits at all times.

3. Prudence

3.1 The Prudential Code requires a comparison between total net external borrowing and the Council's CFR. This is to ensure that overall external borrowing exposure is not excessive. The requirement of the code is that external borrowing, net of any investments, should not exceed the CFR at the end of the final year of a 3 year programme: for the 2005/06 programme, this would be 2007/08 or £370.7m. In addition to the statutory indicator, a local indicator has been set. The intention is to use the local indicator as an initial guide to make sure that there is plenty of room before approaching the official indicator.

3.2 The following sets out the official and local indicators:

	Official Indicator Net External Debt £m	Local Indicator Gross External Debt £m	CFR £m
Original 05/06	315.1	362.5	363.0
Restated 05/06	231.2	362.5	363.0
Actual 05/06	**224.3**	**375.1**	**355.9**
Estimated 06/07	238.2	373.2	364.9
Projected 07/08	256.8	371.5	370.7

3.3 The official indicator is over £100m below the current CFR. This is particularly low due to the exclusion of transferred debt from the official indicator and also a reduction for the level of cash investments held by the Council. Primarily as a result of some advanced borrowing of £15m taken in December 2005 and January 2006 in advance of requirements and following approval by Cabinet, and some slippage in the capital programme, the local indicator of gross debts is above the CFR, and is likely to remain above it for the next couple of years, but only by a small amount. The projected position for 2007/08 indicates that there remains plenty of room for further external borrowing within this indicator.

3.4 Following advice from our Treasury Advisers, Butlers, the calculation of this indicator has been restated to reflect the level of investments as well as debt. The previous indicator used the gross debt of the Council rather than the debt less the investment balance, and was therefore unduly tight.

4. Affordability

4.1 General Fund and HRA borrowing will result in additional revenue servicing costs. The code requires that a ratio of net revenue debt costs to the net revenue stream is produced to measure the relative levels of debt year on year. Based on the latest capital investment proposals, the indicators for Derby's GF and HRA in 2004/05 and 2005/06 are as follows:

	GF	HRA
Actual 2004/05	3.82%	21.49%
Actual 2005/06	4.03%	24.76%

The HRA shows a marked increase as the Council has been allowed to borrow to finance the Homes Pride programme – this is effectively financed through the Housing Subsidy system and is therefore not an additional burden on the Council nor tenants through rents. The General Fund increase reflects the planned increase in borrowing financed by both government approvals and the Council Tax.

4.2 The other affordability measures are the impact of the cost of borrowing on the Council Tax and/or Housing Rents. These measure are supposed to measure the difference between the impact of a programme, with or without prudential borrowing, funded through the Council Tax and/or Housing Rents. In line with the spirit of that objective, the Council has, until now, measured the direct impact of any prudential borrowing only – that is around £2m a year of corporate unsupported borrowing for the general fund – and measured the real impact that such additional borrowing has had on the Council Tax.

4.3 It became evident over the last year that this position could not be sustained as the full impact of capital financing costs were not reflected in such a calculation. The issue was addressed when setting the 2006/07 prudential indicators in February 2006 and it is now necessary to review the treatment of the 2005/06 indicators also. The calculations have had to be restated to include the financing of the whole capital programme, including direct revenue financing of capital and the application of capital receipts. Both of these will impact on the Council's financial position, as does borrowing, both unsupported borrowing financed by service budgets and supported borrowing. Capital grant funded spending has been excluded as this is entirely met by specific grants and therefore has no impact on the Council's financial position.

4.4 Changes to the local government grant process in 2006/07 and onwards mean that even where borrowing is ostensibly supported by the government through approvals, the additional new grant received by the Council is scaled back above the floor grant settlement at a rate that currently runs at 85%, falling to 70% next year. This means that, at the margin, the majority of new supported borrowing is being funded by pressure on the Council Tax rather than from government support. Although the impact of such scaling in 2005/06 was much more limited, scaling back being only at a rate of 6%, a consistent approach has to be taken. Consequently, supported borrowing is now included in the restated 2005/06 indicator.

4.5 The new presentation is arguably less clear and meaningful, as it includes an element of spending that is actually covered by grant, but ii is necessary to better meet the requirements of the Prudential Code.

4.6 The Housing Rent calculation is purely notional as actual rents are guided by the rent restructuring regime rather than by levels of expenditure. The amounts represent the equivalent cost of capital being funded by the HRA from within the overall business plan – largely the cost of the proposed Estates Pride programme.

4.7 The 2005/06 general fund cost of £26.66 per Band D property represents the accumulated cost of the capital programme since the 1 April 2004 start of the prudential borrowing regime. The 2004/05 figure of £11.43 included £5.08 of one off costs of direct revenue financing of capital and an underlying borrowing cost of £6.35. The additional cost in 2005/06 was £20.31.

4.8 Much of the increase to the General Fund unsupported borrowing in 2005/06 is in relation to schemes that will broadly generate net savings at least equal to the cost of additional borrowing. Cabinet approval has been given that basis. The HCI, Creative Industries, Energy Policy and the Revenues and Benefits system replacement schemes are planned to generate revenue savings or additional income. The Rethink Rubbish project and the purchase of refuse vehicles, street cleaning and grounds maintenance machines involve the substitution of leasing costs for cheaper borrowing costs.

4.9 A local indicator of the costs of additional unsupported borrowing are also shown in Appendix 3 to try and maintain the original idea of estimating the impact of individual decisions on the Council Tax. The impact of a notional programme of £1m a year is shown. The effect is to increase Band D Council Tax by around £1.27 a year for each full year of the programme. The first year cost works out much less as the cost of interest is estimated at half a year, and the repayment of the principal has not yet commenced. The calculation is done on an Minimum Revenue Provision, MRP, basis whereby only 4% of the outstanding debt is paid off each year. This approximates to the actual cost of major works including land and buildings. Any investment that had a shorter lifespan – for instance vehicles or ICT equipment – would be considerably more expensive as there would be a need to pay off the principal over the expected, much shorter, life of the asset.

5. Treasury Management

5.1 It is a requirement of the code to have adopted the CIPFA Code of Practice for Treasury Management. As previously reported, the Council adopted the code in April 2002, and has adhered to it since.

5.2 The other prudential indicators required for Treasury Management relate to the split of borrowing and investments between fixed and variable rates, and the maturity profile of long term loans and long term investments. The split in respect of 2005/06, and the comparative figures for 2004/05, are as follows:

	Upper Limit	Lower Limit	Actual 31 March 2006
	%	%	%
Interest Rate Exposure – Fixed	120	80	101.92
Interest Rate Exposure – Variable	20	-20	- 1.92

	Upper Limit	Lower Limit	Actual 31 March 2005
	%	%	%
Interest Rate Exposure – Fixed	120	80	91.80
Interest Rate Exposure – Variable	20	-20	8.20

The indicators, as at 31 March 2006, were within the limits, and were adhered to throughout the year.

5.3 Although not required by the code the Council has set local indicators in respect of long term borrowing and investments, separately. The split as at 31 March 2006 and comparable figures for 2004/05 are as follows:

	Upper Limit	Lower Limit	Actual 31 March 2006
	%	%	%
Fixed Rates – Debt	100	80	93.09
Variable Rates – Debt	20	0	6.91
Fixed Rates – Investments	100	30	73.18
Variable Rates – Investments	70	0	26.92

	Upper Limit	Lower Limit	Actual 31 March 2005
	%	%	%
Fixed Rates – Debt	100	80	92.05
Variable Rates – Debt	20	0	7.95
Fixed Rates – Investments	100	30	97.31
Variable Rates – Investments	70	0	2.69

The limits were adhered to, in all respects, throughout 2005/06. The increase in variable rate investments was due to preferential rates on our Business Reserve Accounts compared to other fixed short term investments of less than 3 months.

5.4 The current loan maturity profile, approved by Cabinet on 22 February 2005, along with the actual structure as at 31 March 2006, is as follows:

	Upper Limit	Lower Limit	Actual 2005/06
	%	%	%
Under a year	15	0	2.47
> 1 year and < 2 years	15	0	6.95
> 2 years and < 5 years	30	0	4.96
> 5 years and < 10 years	50	0	7.32
> 10 years	100	50	78.30

All actual profiles were comfortably within the boundaries set at the year end and during the 2005/06 year.

5.5 The final treasury management indicator required is the limit on investments of one year and over in length. The limit is currently, as at 31 March 2006, and has been throughout the financial year, is £25m. The actual level of investments maturing more than one year ranged between £0m and £25m during 2005/06 and did not, therefore, exceed the limit. The balance at the end of the financial year was £15m.

APPENDIX 3

Prudential Code Indicators Summary 2005/06 - 2007/08

Prudential Code Reference	Indicator	Actual 2003/04	Actual 2004/05	Estimated: 2005/06	Actual 2005/06	Estimated 2006/07	Estimated: 2007/08
Affordability							
	Forecast Financing cost to Net Revenue Stream Ratio						
35	- General Fund %			4.78%		4.72%	4.53%
36	- HRA %			22.35%		23.27%	23.75%
	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 cumulative**		11.43		**26.66**	60.31	81.23
	Incremental Impact on Council Tax: Band D £/year year's programme		11.43		**20.31**	33.65	26.28
Local	**Impact on Counci Tax of new borrowing: £1m a year band D / yr cumulative**		0.35		**1.62**	**2.86**	**4.08**
	Impact on Counci Tax of new borrowing: £1m a year band D / yr years programme				**1.27**	**1.24**	**1.22**
40-41	**Incremental Impact on Housing Rents £/week - year's programme = cumulative**		0.28		**0.41**	1.70	2.99
Prudence							
45	**Actual / Forecast Borrowing compared to CFR**						
	-Net External Debt £m	216.7	201.8	231.2	**224.3**	238.2	256.8
	- CFR £m	272.6	326.5	363.0	**355.9**	364.9	370.7
Local	- Gross External Debt £m		332.7	362.4	**375.1**	373.2	371.5
	- CFR £m	272.6	326.5	363.0	**355.9**	364.9	370.7
Capital Expenditure							
51-52	**Total Capital Expenditure**						
	- General Fund £m			37.6	**45.3**	32.2	26.5
	- HRA £m			32.3	**31.1**	8.0	8.1
	- Total £m			69.8	**76.4**	40.1	34.5
53-54	**Estimated Capital Financing Requirement**						
	- General Fund £m		157.4	169.4	**167.4**	175.4	180.2
	- HRA £m		169.1	193.7	**188.5**	189.5	190.5
	- Total £m		326.5	363.0	**355.9**	364.9	370.7
57-58	**Actual Total CFR £m**	272.6	326.5		**355.9**		
External Debt							
59	Authorised Limit for borrowing £m			417	**417**	420	426
	Authorised Limit for other long term liabilities £m			1	**1**	1	1
	Authorised Limit £m			418	**418**	421	427
60	Operational Boundary for borrowing £m			381	**381**	383	389
	Operational Boundary for other long term liabilities £m			1	**1**	1	1
	Operational Boundary £m			382	**382**	384	390
Treasury Management							
66	**Adopted CIPFA Treasury Management Code of Practice**	Yes	Yes	Yes	**Yes**	Yes	Yes
67-70	**Interest Rate Exposure - Fixed**						
	Upper limit %			120	**101.92**	120	120
	Lower limit %			80		80	80
67-70	**Interest Rate Exposure - Variable**						
	Upper limit %			20	**-1.92**	20	20
	Lower limit %			-20		-20	-20
Local	**Long term Borrowing - Fixed rate**						
	Upper limit %			100	**93.09**	100	100
	Lower limit %			80		80	80
Local	**Long term Borrowing - Variable rate**						
	Upper limit %			20	**6.01**	20	20
	Lower limit %			0		0	0
Local	**Investments - Fixed rate**						
	Upper limit %			100	**73.18**	100	100
	Lower limit %			30		30	30
Local	**Investments - Variable rate**						
	Upper limit %			70	**26.82**	70	70
	Lower limit %			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**	£25m	£25m
	Additionally, no investment to be longer than two years from date of investment						

Appendix 4

Annual Treasury Management Report 2005/06

1. Annual Report

1.1 This Annual Report is prepared for the consideration of the Council Cabinet, under the CIPFA Code of Practice for Treasury Management. The Code was adopted by the Council in March 2002.

Part of the Code requires that a report on the whole of the financial year's activities of the treasury operation be presented to members with a responsibility for Treasury Management.

This report is made to the Council Cabinet and covers the financial year ending 31 March 2006.

The report deals separately with the Council's borrowing and investment decisions, setting out activity in these areas during the year, the revenue effect of decisions and comparative performance. Performance against prudential indicators has been reported elsewhere in this same Cabinet report.

2. Borrowing

2.1 Borrowing Strategy

The strategy for 2005/06 was approved on 22 February 2005. It identified a potential borrowing requirement of £44.29m, reduced by funding already available in the form of advanced borrowing. The table below indicates the expected position under the original strategy, the revised estimate reported to Cabinet on 14 March 2006 and the final outturn:

	Plan £m	Rev £m	Actual £m
New borrowing using central government Supported Capital Expenditure (SCE(R) allocations for 2005/06 (including SCA funding for ALMO expenditure)	38.98	33.30	32.94
Unsupported Borrowing	5.19	7.20	5.59
Total capital financed by borrowing	**44.17**	**40.50**	**38.53**
Long Term loan repayments 2005/06	0.12	0.12	0.12
Potential borrowing requirement 2005/06	44.29	40.65	38.65
Of which, relates to previous years ALMO funding	(5.60)	0	0
Less: earmarked for repayment of debt	(4.27)	(4.27)	(4.49)
Net increase in expected debt	**34.42**	**36.38**	**34.16**
Less: Borrowing in Advance of 2005/06	(9.50)	(9.50)	(9.50)
Expected external borrowing 2005/06	24.92	26.88	24.56

Total capital spending financed by borrowing has risen by £38.53m during 2005/06, £5.64m less than originally expected, as detailed in Table 4 of the Capital Outturn 2005/06 elsewhere in the agenda.
Actual external borrowing was £28m net of restructuring and advanced borrowing, just above the revised estimate. The additional borrowing of £3.4m will be carried forward to be applied to the new year's borrowing requirement to finance slippage in some parts of the capital programme.

The advice from our advisers at the time of compiling the Borrowing Strategy was that long dated PWLB debt and some variable rate debt offered the best value for borrowing, and that commitment to medium dated debt should be avoided. PWLB rates were expected to rise slightly early in 2005/06, but to drop back towards the end of the financial year. Reliance on variable debt was to be avoided as it would leave the Council exposed to market fluctuations, and would not, therefore, minimise risk.

The Strategy approved was that the Council should continue with its approach of taking mostly long dated fixed rate debt, where borrowing is necessary, with the preference for long over medium and short dated loans.

Options would be considered for the Council to reschedule further long term loans in 2005/06 which may be running at disadvantageous interest rates, or where savings can be made to reduce the debt charge costs to the authority. The Council could also, under delegated powers, enter into further LOBO loans should market conditions appear advantageous.

2.2 Borrowing Activity – Long Term

2.2.1 Changes to the Capital programme reduced the 2005/06 potential borrowing requirement to £36.4m by the time of the report to Cabinet in March 2006 as indicated in 2.1 above.

2.2.2 Interest Rates

The following table provides a snapshot of month end interest rates available on long term borrowing for 2005/06:

Rates	**April 05**	**June 05**	**Oct 05**	**Jan 06**	**March 06**	**Current 18 July 06**
	%	%	%	%	%	%
Base rate	4.75	4.75	4.50	4.50	4.50	4.50
PWLB 3 years	4.65	4.25	4.50	4.35	4.60	4.85
PWLB 7- 8 years	4.65	4.35	4.50	4.25	4.55	4.80
PWLB 20 – 25 years	4.65	4.40	4.45	4.00	4.35	4.55
PWLB 25 – 30 years	4.65	4.40	4.45	3.90	4.25	4.45
PWLB 45 – 50 years	N/A	N/A	N/A	3.70	4.15	4.30

There was a considerable dip in rates across the yield curve to reach a yearly low in mid January 2006 of 3.70% for 40 – 50 year maturities. It should be noted that the PWLB enabled local authorities to borrow for periods between 30 and 50 years with effect from 6 December 2005, in a change of policy. In the first quarter of 2006/07, rates have risen further, such that the cheapest long term loan available in early July 2006 is 4.40% for 45 years – 50 years duration.

2.2.3 During 2005/06 net PWLB borrowing totalled £43m, £28m of which was used to finance 2005/06 capital expenditure and PWLB principal repayments during the year. An additional £15m was borrowed in advance of 2006/07 in order to take advantage of low market rates. In addition, a further £8m of PWLB debt was rescheduled, following advice from our external treasury advisers, in order to take advantage of low market rates and to obtain savings in our debt management costs.

2.2.4 The strategy on borrowing was adapted in response to the steady fall in rates between April 2005 and January 2006 and the change in PWLB policy to allow longer loans. This, and the careful timing of loans, enabled the authority to borrow at an average of 4.22%, considerably below the budgeted rate of 4.75%, for an average period of 31.53 years. This created an average saving of approximately 0.53% or £154k on PWLB borrowing for 2005/06 and £270k in a full year, against a budgeted benchmark of 4.75%, and resulted in a reduction to the average external interest rate paid on PWLB borrowing from 5.34% on 1 April 2005 to 5.18% on 31 March 2006. These savings were shared between the General Fund and Housing Revenue Account, as is required by regulations, although the subsidy available to the HRA reduces to reflect the saving.

2.2.5 The table shows the detail of borrowing activity, including £8m debt rescheduling.

Date	**Amount £m**	**%**	**Maturity years**
26 April 2005	5.0	4.65	30
6 May 2005	5.0	4.60	30
23 May 2005	10.0	4.45	29 - 30
14 June 2005	2.0	4.35	30
30 June 2005	5.0	4.30	10
8 September 2005	1.0	4.30	27
6 December 2005	5.0	4.25	25
19 December 2005	5.0	4.10	45
23 January 2006	13.0	3.70	40 - 41
Total/Average	**£51.0m**	**4.22%**	**31.53 years**

2.2.6 All of these loans were from the PWLB. Use of money market loans was avoided and the new availability of very long term PWLB debt to 50 years duration has reduced the possible benefits of such loans.

2.2.7 There was no temporary or short term variable borrowing during 2005/06.

2.2.8 Restructuring of PWLB debt was undertaken on 23 Janaury 2006 following advice from our treasury management advisers. A total of £8m (£6m and £2m) was borrowed, in order to take advantage of the low point in the year for interest rates

(3.70%).Three loans were repaid on 1 February 2006, two of which generated discounts totalling £77.3k and the other generated a premium of £11.6k. The annual savings to the General Fund totalled £21.55k.

2.2.9 The total debt outstanding at 1 April 2006 was £328.5m. This was made up of £305.8m PWLB loans and £22.7m LOBO (money market) loans. Including the £43m net, new PWLB loans, the restructured debt of £8m and the repaid annuity PWLB loans principal, the maturity profile of external debt at 31 March 2006 was as follows:

Maturity Within	PWLB	Average rate	Market Loans*	Average rate
	£m	%	£m	%
1 year	8.123	9.311		
1 – 2 years	0.122	3.166	22.700	4.450
2 – 3 years	3.114	9.269		
3– 4 years	10.102	9.560		
4– 5 years	3.091	8.831		
5 – 6 years	0.018	3.940		
6 – 10 years	8.518	6.282		
10 – 15 years	15.505	4.851		
15+ years	257.181	4.766		
31 March 2006	305.774	5.178	22.700	4.450
1 April 2005	262.894	5.339	22.700	0.750

2.2.10 It has been assumed in the table that the market LOBO loans will be repaid at the next window for the lender to exercise their option; that is June 2007.

2.2.11 The average rate to date on external PWLB borrowing in 2005/06 has reduced from 5.339% at the beginning of the financial year to 5.178%. The equivalent rate as at 1 April 2004 was 5.511%. The £22.7m of LOBO loans reverted, in June 2005, to their higher rate of 4.45% after a two year discounted rate of 0.75%, consistent with the commitment made in June 2003.

2.3 Externally Managed Debt

2.3.1 A review undertaken last year of our payments to the County Council highlighted a technical issue relating to the detailed calculation of debt charges levied by the County Council on the share of their old pre 1997 debt that was ‘transferred’ to the Council on reorganisation in 1997. Transfer involved the Council taking responsibility for the cost of the debt, but with the debts themselves left with the County Council. This is to avoid the additional costs that would have been involved had the County Council repaid their existing debts early.

2.3.2 As a result, two issues were highlighted where the detailed calculation of the interest charged to the Council by the County Council was amended. The County Council has negotiated with us a new methodology for the calculation of debt charges in future which will reduce the charges that are being made to the Council by around £123,000 a year. In addition, restrospective adjustments have been made resulting in a refund of £99,000. These savings have been taken into account in setting the 2006/07 budget.

3. Investment

3.1 Investment Strategy

3.1.1 In accordance with the CIPFA Code of Practice the primary objectives of the Council's investment strategy is to obtain the best rate of return whilst maintaining effective control of associated risks.

3.1.2 The authority's general policy continues to be the maintenance of a positive cashflow by using capital receipts and revenue reserves and balances to avoid the need to borrow externally in the short term. It has, however, an option to borrow in the short term should any unforeseen cash shortages arise on a day-to-day basis.

Short term surpluses are invested only with institutions on the Council's approved list of counterparties. Our investment counterparty criteria and limits are subject to continual review, which takes account of mergers/takeovers in the banking sector, movements in the 'league table' of the top 20 Building Societies as well as the introduction of the new opportunities for investment for local authorities.

3.2 Investment Activity

Temporary Investments

3.2.1 The borrowing strategy for 2005/06 provided for an option to rely more on internal funding if long term borrowing rates were considered to provide poor value. In practice, external borrowing was used and £15m of advanced borrowing was undertaken. This, together with an increase in cash backed reserves, led to an increase in external investment balances.

3.2.2 The following investment activity took place during 2005/06.

Total Number of Investments	294
Value of Investments held at:	
1 April 2005	£83.791m
31 March 2006	£104.230m
Average Value of Investments 2005/06	£115.083m
Total Interest earned on Investments	£5.534m
Average return on portfolio	4.809%
Weighted Average Base Rate	4.587%
Weighted Average period of investments at 31 March 2006	263 days

3.2.3 The interest earned for 2005/06 represents a return of 4.809%. Base rate however, has reduced from 4.75% to 4.5%, in August 2005, giving a weighted average Base Rate of 4.587%. Investments have clearly outperformed Base Rate although the difference would be slightly narrower if the average return were calculated on a compounded basis. This performance reflected the scale of investments in 2004 and 2005 in 364 day deposits and forward investments, when markets were expecting interest rates to be at higher levels in future. It also reflects careful management of surplus deposits on a day to day basis.