Report No.15

Annual Treasury Management and Investment Strategy 2006/07

1. Purpose of Report

1.1 To present the annual treasury management and investment strategy for Members' approval.

2. Recommendations

That the Executive:

2.1 Approves the actions proposed within the treasury management statement (outlined in Section 5 below).

2.2 Approves the investment strategy (outlined in para's 6.4 – 6.9 below).

2.3 Recommends the report for approval to the full Council.

3. Links to the Corporate Business Plan

3.1 Effective financial management underpins delivery of all of the Council's work.

3.2 An annual treasury management and investment strategy is a statutory requirement.

4. Background

4.1 The Local Government Act 2003 requires the Council to have regard to the Prudential Code for Capital Finance, and to set prudential indicators for the next three years. The Act also requires the Council to set its treasury strategy for borrowing and to prepare an annual investment strategy, setting out policies for managing its investments.

4.2 The Council has a statutory duty under the 2003 Act to determine and keep under review how much it can afford to borrow. The Council must have regard to the Prudential Code when setting its 'affordable borrowing limit', which essentially requires it to ensure total capital investments remain within sustainable limits and that the impact on future council tax levels is affordable.

4.3 The Prudential Indicators including the borrowing limit were reported to the Executive's February meeting and subsequently approved by Council.

4.4 The treasury strategy covers :
- the current treasury position
- prospects for interest rates
- treasury limits in force to limit the treasury risk
- the borrowing strategy
- investment strategy

5. Treasury Position and Interest Rate Forecasts

5.1 The Council's treasury position as at the end of January 2006 was :

	Principal	Avg. rate %
Long term Liabilities	£9.296 million	N/A
Investments - Fund Managers - In House	 £20.70 million £12.88 million	 c. 4.50 %
Total Investments	£33.58 m (£30.54m in Jan2005)	

- The Council's long term liability is for future payments due under the PFI agreement.
- Note it is expected the cash invested by the in-house team will decrease substantially by the year end, as the cash in-flow from Council Tax and NNDR reduces in February and March.

5.2 The Council has no external borrowing at present and anticipates not needing to take any long term borrowing in 2006/07 or the following two years.

5.3 The Council has appointed Sector Treasury Services as its treasury adviser and part of their service is to advise the Council on interest rates. The following table gives the Sector central view of rates as at February 2006 :

	End Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q1 2008	Q1 2009
Base Rate %	4.50	4.25	4.25	4.00	4.25	4.75	4.75
5 yr Gilt yield %	4.00	4.00	4.00	4.25	4.50	4.75	4.75
10 yr PWLB %	4.25	4.25	4.25	4.50	4.50	4.75	4.75
25 yr PWLB %	4.25	4.25	4.25	4.50	4.50	5.00	4.75

In summary, Sector's current view is that the base rate will:

- Remain on hold at 4.5% until the end of March 2006
- Fall to 4% by the end of Quarter 4 2006/07
- Increase in 0.25% steps during 2007 to end the year at 4.75%

5.4 The relevant economic background to this forecast is:

For the UK

- GDP growth was relatively weak in 2005 at 1.7% (compared with 3.2% in 2004) owing to monetary and fiscal tightening and the effect of oil price increases on household spending. Growth is expected to recover slightly to 2.0% in 2006 and further increase in 2007.
- House price inflation has fallen to low levels and may now stabilise
- Inflation is forecast to be around the Government's target despite oil price increases. The MPC will be alert for cost pressures feeding into retail prices.
- The public sector deficit is expected to decline steadily over the next few years, as the growth in government spending decreases.

5.5 Interest rate forecast: Commentators are now expecting the base rate will remain at 4.5 % until the end of March and will then decline to 4% by the end of 2006/07. Interest rates on borrowing are also forecast to be relatively steady in the medium term.

5.6 Borrowing strategy – It is anticipated there will be no capital borrowings required during 2006/07 other than to meet short term cash flow needs. Moreover the receipts from anticipated property sales will substantially add to cash balances, further reducing the likelihood of borrowing. Any borrowing would be for a short period (i.e. for a week or less) and at fixed interest rates.

6. Investment Strategy

6.1 The Council's treasury activities have regard to the ODPM's guidance on Local Government Investment issued in March 2004. The overriding investment strategy is therefore to ensure balances are prudently invested in a way which protects the capital and also minimises liquidity risks. A secondary objective is to achieve optimum returns commensurate with appropriate levels of security and liquidity.

6.2 The ODPM guidance makes it clear that the borrowing of funds purely to invest or on-lend and make a return is unlawful. This Council will not engage in such activities.

6.3 The guidance also identifies a range of investment instruments which authorities can utilise, and classifies these as 'specified' or 'non-specified' investments. Those which will be used by in-house staff and external fund managers are set out in the tables below :

6.4 Specified investments are denominated in sterling and where the investment is due to be repaid within 12 months of the date on which it was made. Such investments must also be made with a bank or body which has a high credit rating or with the UK Government or a local authority in England or Wales. All other investments are deemed 'non-specified'.

Specified investments are:

	Minimum High Credit Criteria*	**Use**
Debt management Agency Deposits	-	In- House
Term Deposits – other LA's	-	In- House
Term Deposits – banks & building societies	F1, long term A	In-House & Fund Managers
Callable Deposits	F1+	In- House
Certificates of deposit – issued by banks	F1, Long term A	Fund Managers
Bonds Issued by multi- lateral development banks	AAA	Fund Managers
Money Market Funds	AAA	In- House
UK Govt Gilts	Govt. backed	Fund Managers
Gilt Funds & Bond Funds	AA-	Fund Managers
Treasury Bills	Govt. backed	Fund Managers

* This terminology (eg. F1, A or AA-) is that used by Fitch Ratings which is a leading credit rating agency used by the Council and its advisors. Essentially the Council's lending will only be with local authorities, banks or financial institutions having a very high credit rating.

6.4 Non – Specified Investments :

	Minimum High Credit Criteria	**Use**	**Max. % of Overall Investments**	**Max. Maturity**
Term deposits – banks & building societies	F1+, AA-	In house & Fund Managers	20%	5 years
Callable deposits	F1+, AA-	In House	10%	5 years
Bonds Issued by multi-lateral development banks	AAA	Fund Managers	60%	10 years
Forward deals – credit rated banks & building societies	F1+, AA-	In house & Fund Managers	20%	5 years
Certificates of deposit	F1+, AA-	Fund Managers	10%	5 years
UK Govt. Gilts	Govt. backed	Fund Managers	60%for all gilts/bonds maturity > 1year	10 years
Sovereign bond issues (i.e. not UK Govt.)	AAA	Fund Managers	60% - as above	10 years
Bonds issued by a financial body guaranteed by UK Govt.	AAA / Govt. backed	Fund Managers	60% - as above	10 years

6.5 Investment Strategy - The Council's funds are invested via two fund managers and by in- house Finance staff. The in- house funds have increased in 2005/06 resulting from asset sales and will increase by the anticipated receipts in the coming year. Investments are accordingly made with reference to cash flow requirements and the outlook for interest rates. The Council will seek to use business reserve accounts with specific banks and short dated deposits (1 - 3 months) in order to benefit from the compounding of interest.

6.6 The fund managers will be contractually required to comply with this Investment strategy. The management agreements with the fund managers formally document the guidelines and parameters for using specific lending instruments. In practice the fund managers are able to access a wider range of instruments than are available to in-house staff.

6.7 The Council receives quarterly reports on the activities and performance of its fund managers and they are expected to exceed a benchmark rate of return (the 7 day LIBID rate) which is also the target rate for in- house investments. Their performance is the subject of regular reports to the Finance and Performance Monitoring sub Committee.

6.8 The Council's investment activity for the year will be reported on as part of its annual treasury report, in the summer of 2006.

7. Financial Implications

The interest income from the funds invested supports the Council's revenue budget.

8. Community & Environmental Implications

None arising from this report.

9. Equal Opportunities Implications

None arising from this report.

10. Human Resources Implications

None arising from this report.

11. Legal Implications

The Local Government Act 2003 requires the Council to have regard to the Prudential Code for Capital Finance. It also requires the Council to set an annual treasury and investment strategy, including policies for managing its investments.

REPORT OF THE FINANCE TEAM LEADER TO THE EXECUTIVE – 9TH MARCH 2006
9th MARCH 2006

Report Author: Peter Tovey
Chief Accountant
01249 706282
ptovey@northwilts.gov.uk