Agenda Item No: 11

Title:	**Annual Treasury Management Report**
Lead Member:	**Cllr Hames - Chair of Audit Committee**
Reporting Officer:	**Andy Brown – Financial Accountant**

Purpose

The Annual Treasury Report is a requirement of the Council's reporting procedures and covers the treasury activity for 2005/06.

The report also covers the actual Prudential Indicators for 2005/06 (Appendix A) in accordance with the requirements of the Prudential Code. It reviews and updates the 2006/07 indicators. The revised indicators are set out in Appendix B.

The Audit Committee will need to provide assurance to Council as to the sound basis of estimation making up the revised Prudential Indicators 2006/07 set out in Appendix B.

Background

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance.

This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the other statutory requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that borrowing activities are undertaken on a prudent, affordable and sustainable basis.

The Code requires, as a minimum, the regular reporting of treasury management activities to:

- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report – Cabinet February 2006); and
- Review actual activity for the proceeding year (this report).

This report sets out:

- A summary of the strategy agreed for 2005/06;
- The Council's treasury position at 31 March 2006;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2005/06;
- The treasury decisions taken and their revenue effects;
- The associated risks of any of these decisions;
- The performance of these decisions;
- Risk and performance.

Key Issues

The Strategy Agreed for 2005/06

The strategy for 2005/06 was based upon the Head of Finance's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.

The Council's investment priorities were the security of its capital and the liquidity of investments whilst aiming to achieve optimum returns.

The Council anticipated its fund balances for 2005/06 to range between £8 million and £10 million. Capital spend was earmarked at £4.09 million, however slippage of this spend was anticipated.

£8 million was committed to long term investments and it was considered prudent to manage surplus funds through the business reserve accounts to facilitate their access.

Base rate rises were anticipated to level off and then decrease slightly in 2005/06.

Treasury Position at 31 March 2006

The treasury position at the 31 March 2006 compared with the previous year was:

	31 March 2006		**31 March 2005**	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Fixed Interest Investments	£8m	4.475%	£8m	4.475%
Variable Interest Investments	£0.406m	4.25%	£2.610m	4.75%
Total Investments	**£8.406m**	**4.36%**	**£10.610m**	**4.61%**

The change in the treasury position was due to movements in the Council's working balances and slippage on the capital programme.

Prudential Indicators and Compliance Issues

The Council is required by the Prudential Code to report the actual prudential indicators after the year-end. Appendix A provides a schedule of all the mandatory prudential indicators. A number of these indicators provide either an overview or a limit on treasury activity, and these are shown below:

	31 March 2006 Actual	**31 March 2006 Original Indicator**
Net borrowing position	(£6.406m)	(£8.0m)
Capital Financing Requirement	(£0.770m)	(£0.784m)

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, a measure of the Council's debt position as shown above. Over the medium term borrowing net of investments must be for capital purposes. This should not, except in the short term, exceed the CFR for 2005/06 plus the expected changes to the CFR over 2006/07 and 2007/08. The table above highlights that the Council has complied with this requirement.

BORROWING LIMITS	**2005/06**
Original Indicator - Authorised Limit	£6m
Original Indicator - Operational Boundary	£4m
Maximum gross borrowing position during the year	£2m
Minimum gross borrowing position during the year	£0m

The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The table demonstrates that during 2005/06 the Council has maintained gross borrowing within its Authorised Limit.
The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.
These boundaries have been set to control short-term borrowing requirements and are not limits that relate to the Council's Capital Programme directly.

Economic Background for 2005/06
UK Interest rates remained within a tight range during the 2005/06 financial year. Base rates opened the period at 4.75%. In spite of this, longer-dated fixed interest rates fluctuated more, rising and falling in response to notable shifts in market expectations.

The year started on a pessimistic note. The apparent failure of consumer spending and the housing market to respond to the Bank of England's policy base rate rises supported suggestions that base rates had further to rise before peaking in the later stages of 2005.

These concerns faded quickly, in spite of an unfavourable international background where the rise in US interest rates showed no signs of abating. UK economic data suggested the economy was slowing down faster than had been assumed just a few months earlier. As evidence of this slowdown gathered, expectations of a return to a more stable monetary policy strengthened.

Base rates were finally cut by 0.25% to 4.5% in August and hopes of further reductions in the autumn and spring 2006 were widespread. However optimism faded as signs of a recovery in UK activity increased whilst the international interest rate backdrop deteriorated.

Actual Strategy During 2005/06
Borrowing - Capital expenditure for the year was £4.763 million. No borrowing was required to finance this.
Investment Policy – The Council's investment policy is governed by ODPM Guidance, which is implemented in the annual investment strategy approved by Council on 21 February 2005. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
Investments Held by the Council – The Council maintained an average balance of £13.049 million and received an average return of 4.46%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.54%.

Alliance and Leicester	£5 million @ 4.5%
National Australia Bank	£3 million @ 4.45%
Abbey Business Reserve	fluctuating short/medium term cash @ variable rate, following the base rate.

Review of 2006/07 Prudential Indicators
The original prudential indicators for 2006/07 were considered by Cabinet on 2 February and determined by Council on 22 February. They may be revised at any time during the financial year. Changes to the capital programme arising from slippage and additional schemes and a treasury management review means that some indicators need to be revised.
The revised indicators are attached at appendix B.
Only Council can undertake the formal setting of the indicators.

Effect on strategies and codes
This report complies with CIPFA Code of Practice for Treasury Management and is part of the Council's corporate governance arrangements.

Risk management implications
The Council has complied with all of the relevant statutory and regulatory requirements that limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Finance and Performance implications
The finance and performance implications are detailed within the report.

Legal & Human Rights Implications:
There are no legal or human rights implications arising from this report.

Next Steps
Treasury Management performance continues to be monitored in accordance with the CIPFA Code of Practice for Treasury Management.

Recommendations

1. Note the Treasury Management Stewardship Report for 2005/06.
2. Recommend Council to approve the revised Prudential Indicators for 2006/07.

Background papers

Butlers Treasury Advisor annual report

Appendix A

Estimated and Actual Treasury Position and Prudential Indicators

	Figures are for the financial year unless otherwise titled in italics	2005/06 Actual	2005/06 Original Indicator
1	**Capital Expenditure**	£4.763m	£3.388m
2	**Capital Financing Requirement (CFR)** ***at 31 March***	£0.770m	£0.784m
3	**Treasury Position at** ***31 March***		
	Borrowing	£2.0m	
	Other long term liabilities	£0.0m	Nil
	Total Debt	£2.0m	
	Investments	£8.406m	£8m
	Net Borrowing	(£6.406m)	(£8m)
4	**Authorised Limit** ***(against maximum position)***	£2m	£6m
5	**Operational Boundary**	£2m	£4m
6	**Ratio of financing costs to net revenue stream**	(4.47%)	(2.12%)
7	**Incremental impact of capital investment decisions on the Band D council tax**	£4.02	£3.08
9	**Upper limits on fixed interest rates** ***(against maximum position)***	100%	100%
10	**Upper limits on variable interest rates** ***(against maximum position)***	0%	65%
11	**Maturity structure of fixed rate borrowing** ***(against maximum position)***		
	Under 12 months	100%	100%
	12 months to 2 years		
	2 years to 5 years		
	5 years to 10 years		
	10 years and above		

Appendix B

PRUDENTIAL INDICATORS Revised 2006/07

Indicator: The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the current financial year and at least the following two financial years.

Capital Programme	2005/06 Actual £,000	2006/07 Estimate £,000	2006/07 Revised £,000	2007/08 Estimate £,000	2008/09 Estimate £,000
Gross	4,763	4,133	5,433	2,260	1,779
Less Grants and Contributions	1,434	801	1,240	669	572
Net	3,315	3,332	4,193	1,591	1,207

Indicator: The local authority will make reasonable estimates of the total capital financing requirement at the end of the current financial year and the following two years.

	2005/06 Actual £,000	2006/07 Estimate £,000	2006/07 Revised £,000	2007/08 Estimate £,000	2008/09 Estimate £,000
Capital Financing Requirement	(770)	(784)	(770)	(241)	1,413

The capital financing requirement is a measure of the Council's underlying need to borrow money long term. There is no requirement to borrow when the figures above are negative. At the end of each financial year the actual capital financing requirement will be calculated directly from the Council's balance sheet.

Local authorities have available to them a number of ways of financing capital investment. In all cases cash will be paid out, the term "financing" does not refer to the payment of cash but the resources that are used to pay for schemes. A number of financing options are available to local authorities, these include;

- The application of useable capital receipts
- A direct charge to revenue
- Application of a capital grant
- Contributions received from another party

Capital expenditure that is not financed by one of these methods will increase the Capital Financing Requirement (CFR) of the Council or reduce the negative CFR as the case may be.

Indicator: The local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding financial year plus the estimates of any additional capital financing requirement for the current and next two financial years.

	2006/07 Estimate £,000	2006/07 Revised £,000
Gross borrowing	3,000	2,000
Investments	(8,000)	(8,000)
Net borrowing	(5,000)	(6,000)
Capital Financing Requirement	2,898	2,183

This indicator is to show that, apart from short-term cash flow movements, the Council's net borrowing is for capital purposes only. The gross borrowing shown is for a short-term period only at year-end and is repaid early in the new financial year. The reason for measuring the requirement over a three-year period is to give the Council flexibility in borrowing with the aim of reducing borrowing costs.

Indicator: Where a local authority invests for periods longer than 364 days the authority will set an upper limit for each forward financial period for the maturing of such investments.

Maturity	2006/07 Estimate £,000	2006/07 Revised £,000	2007/08 Estimate £,000	2008/09 Estimate £,000
Up to 1 year	£8,000	£8,000	£5,000	£3,000
1 – 2 Years	£5,000	£5,000	£0	£0
2 – 5 Years	£0	£0	£0	£0
5 – 10 Years	£0	£0	£0	£0
Over 10 Years	£0	£0	£0	£0

Indicator: The local authority will estimate for the current financial year and the following two financial years the ratio of financing costs to net revenue stream.

	2006/07 Estimate	2006/07 Revised	2007/08 Estimate	2008/09 Estimate
Financing costs to net revenue stream	(2.67%)	(2.67%)	(1.89%)	(1.18%)

The indicator has been calculated as net loss of interest on investments (interest from investments less interest paid) plus any revenue consequences of capital schemes, divided by the net General Fund revenue budget.

Indicator: The local authority will estimate for the current financial year and the following two financial years the incremental impact of capital investment decisions on the Council Tax.

	2006/07 Estimate	2006/07 Revised	2007/08 Estimate	2008/09 Estimate
Incremental impact of capital investment decisions on Council Tax	£5.01	£5.80	£3.25	£2.97