Agenda Item No.10

Title:	**Annual Treasury Management Stewardship Report for 2006-07**
Portfolio Holder:	**Cllr While – Finance Portfolio Holder**
Reporting Officer:	**Andy Brown – Financial Accountant**
Key Decision:	**No**

Purpose
The Annual Treasury Report is a requirement of the Council's reporting procedures and covers the treasury activity for 2006/07. The report also covers the actual Prudential Indicators for 2006/07 in accordance with the requirements of the Prudential Code and reviews some of the 2007/08 indicators that need to be updated as a consequence.

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 2007) and
- review actual activity for the preceding year (this report).

This report sets out:
- The Council's treasury position at 31 March 2007
- The main Prudential Indicators and compliance with limits
- A summary of the economic factors affecting the strategy over 2006/07
- A summary of the strategy agreed for 2006/07
- The treasury decisions taken and their revenue effects
- The associated risks of any of these decisions
- The performance of these decisions

Key Issues

Treasury Position at 31 March 2007

The treasury position at 31 March 2007 compared with the previous is shown below.

	31 March 2006		31 March 2007	
	Principal	Average Rate	Principal	Average Rate
Total Debt	**£0.000m**		**£0.000m**	
Fixed Interest Investments	£8.000m	4.48%	£5.000m	4.68%
Variable Interest Investments	£0.406m	4.25%	£1.923m	4.95%
Total Investments	**£8.406m**	**4.36%**	**£6.923m**	**4.83%**
Net Borrowing Position	**£8.406m**		**£6.923m**	

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.

The Capital Financing Requirement (CFR) – This 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 2006/07 plus the expected changes to the CFR over 2007/08 and 2008/09. The table below highlights that the Council has complied with this requirement.

	31 March 2006 Actual	31 March 2007 Original Indicator	31 March 2007 Actual
Net borrowing position	(£6.406m)	(£8.000m)	(£6.923m)
Capital Financing Requirement	(£0.770m)	(£0.770m)	(£0.775m)

The Authorised Limit - The Authorised Limit is the "Affordable Borrowing Limit" required by section three of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2006/07 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary – The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either above or below the boundary is acceptable subject to the Authorised Limit not being breached.

Actual financing costs as a proportion of net revenue stream - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

BORROWING LIMITS	2006/07
Authorised Limit – Original Indicator	£6.00m
Maximum gross borrowing position	£2.00m
Operational Boundary – Original Indicator	£4.00m
Minimum gross borrowing position	£0.00m
Financing costs as a proportion of net revenue stream	(3.59%)

Economic Background for 2006/07
All treasury activity is directed by both the current market interest rates and expectations of future movements, for instance longer term investment rates for one and two years will reflect anticipated movements in the MPC Bank Rate. Longer term borrowing rates are influenced by inflation and demand and supply considerations.

The 2006/07 financial year featured a rising trend in short term interest rates as policy makers and financial markets responded to the twin effects of strengthening economic activity and rising inflation.
The optimism that prevailed in the first few months of 2006 had evaporated by the beginning of the new financial year. The rebound in economic activity since 2005 proved more robust that consensus expectations. In addition, external pressures on consumer price inflation had continued to escalate. While short-term interest rates remained steady in the first few months of the year, there were growing expectations that a rise in official interest rates would eventually materialise.

The first hike in the Bank Rate from 4.5% to 4.75% was announced in August 2006 as the Bank of England responded to the deteriorating inflation outlook.

The economy's slow response to monetary policy tightening, a less than favourable international backdrop and concerns that deteriorating inflation expectations at home would drive prices higher prompted additional rate hikes. Two quarter point increases in the bank rate were announced in November 2006 to 5% and January 2007 to 5.25%. Further tightening measures were anticipated by the market, and attractive investment opportunities prevailed to the year-end.

The strategy agreed for 2006/07
The strategy for 2006/07 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 2006/07 to range between £5 million and £12 million. Capital spend was earmarked at £3.3 million; however slippage of this spend was anticipated.

A cautious approach to treasury activity was advised for 2006/07, with the forecasting of interest rates during that period proving to be very difficult. Higher growth was expected in the future but rates for 2006/07 were forecast to remain static, increasing in future years.

At the start of the year the council had £8 million of long term investments, all of which matured during the year. It was considered prudent that £5 million of its overall fund balance could be committed to longer term investments (i.e. those with a maturity exceeding a year), the remaining fund balances being managed through the business reserve accounts to facilitate their access.

Actual Strategy during 2006/07

Borrowing - Capital expenditure for the year was £3.598 million. No borrowing was required to finance this.

Investment Policy – The Council's investment policy is governed by CLG Guidance, which is implemented in the annual investment strategy approved by Council on 22 February 2006. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Councils core cash resources comprised:

Balance Sheet Resources	31 March 2006	31 March 2007
Balances	£1.385m	£1.938m
Earmarked reserves	£0.778m	£0.759m
Usable capital receipts	£4.198m	£1.964m
Total	**£6.361m**	**£4.661m**

Investments Held by the Council – The Council maintained an average balance of £11.314 million and received an average return of 4.83%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.82%.

At 31 March 2007 the council held £5 million in a long term investment earning 4.75%. The balance was held in a business reserve account, fluctuating at a variable rate, tracking the base rate.

Review of 2007/08 Prudential Indicators
The original prudential indicators for 2007/08 were considered by Cabinet on 7 February 2007 and determined by Council on 21 February 2007. 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 the 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
The Audit Committee are recommended to:

1. Note the treasury management stewardship report for 2006/07.
2. To advise Council that the Audit Committee is satisfied that the revised Prudential Indicators for 2007/08, as set out in Appendix B are appropriate for accurate reporting of the Council's position.

Background papers
Butlers [treasury advisors] annual stewardship report. Room F35

Appendix A

Estimated and Actual Treasury Position and Prudential Indicators

	Figures are for the financial year unless otherwise titled in italics	2006/07 Actual	2006/07 Revised Indicator
1	**Capital Expenditure**	£3.598m	£5.045m
2	**Capital Financing Requirement (CFR) at 31 March**	£0.775m	£0.770m
3	**Treasury Position at 31 March**		
	Borrowing	£0.0m	
	Other long term liabilities	£0.0m	Nil
	Total Debt	£0.0m	
	Investments	£6.923m	£2.600m
	Net Borrowing	(£6.923m)	(£2.600m)
4	**Authorised Limit (against maximum position)**	£4m	£4m
5	**Operational Boundary**	£0m	£2m
6	**Ratio of financing costs to net revenue stream**	(3.59%)	(3.26%)
7	**Incremental impact of capital investment decisions on the Band D council tax**	£3.91	£5.53
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 2007/08

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	2006/07 Actual £m	2007/08 Estimate £m	2007/08 Revised £m	2008/09 Estimate £m	2009/10 Estimate £m
Gross	3.598	2.571	3.963	2.338	2.372
Less Grants and Contributions	1.327	1.237	1.477	1.355	1.556
Net	2.271	1.334	2.486	0.983	0.816

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.

	2006/07 Actual £m	2007/08 Estimate £m	2007/08 Revised £m	2008/09 Estimate £m	2009/10 Estimate £m
Capital Financing Requirement	(0.775)	(0.016)	(0.025)	0.958	1.667

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 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.

	2007/08 Estimate £m	2007/08 Revised £m
Gross borrowing	1.800	2.000
Investments	(1.000)	(3.000)
Net borrowing	0.800	(1.000)
Capital Financing Requirement	(0.016)	(0.025)

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	2007/08 Estimate £m	2007/08 Revised £m	2008/09 Estimate £m	2009/10 Estimate £m
Up to 1 year	5.000	5.000	3.000	2.000
1 – 2 Years	0	0	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.

	2007/08 Estimate	2007/08 Revised	2008/09 Estimate	2009/10 Estimate
Financing costs to net revenue stream	(1.89%)	(1.68%)	(0.82%)	0.45%

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.

	2007/08 Estimate	2007/08 Revised	2008/09 Estimate	2009/10 Estimate
Incremental impact of capital investment decisions on Council Tax	£3.25	£3.78	£3.59	£4.69