



Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 14th November 2007

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2007/08

Electoral Wards Affected:

Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

Eligible for Call In

no

Not Eligible for Call In

(Details contained in the report)

EXECUTIVE SUMMARY

1. This report provides a review and update of the treasury management strategy for 2007/08.
2. The Council's level of external debt at 31st March 2008 is anticipated to be £1,381m, £16m lower than expected when the strategy was approved in February 2007.
3. The 2007/08 budget assumed savings from treasury management activity of £2m. Monitoring of volatile markets has enabled revenue savings of £9.4m to be made. This is largely due to restructuring of the existing loan portfolio, securing long term borrowing at lower rates than assumed in the strategy and taking advantage of competitive investment rates by lending out unused balances until required.
4. The level of debt is expected to remain within the new Authorised limits for external debt as agreed by Council on 21st February 2007.

1.0 Purpose Of This Report

1.1 The 2007/08 treasury management strategy was approved by Executive Board on 9th February 2007. This report provides a review and update of the strategy for 2007/08.

2.0 Background Information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2.2 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

2.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy statement for 2007/08 was approved by the Executive Board on 9th February 2007 and by full Council on 21st February 2007. This report provides Members with a review and update of the strategy for 2007/08.

3.0 Main Issues

3.1 Review of Strategy 2007/08

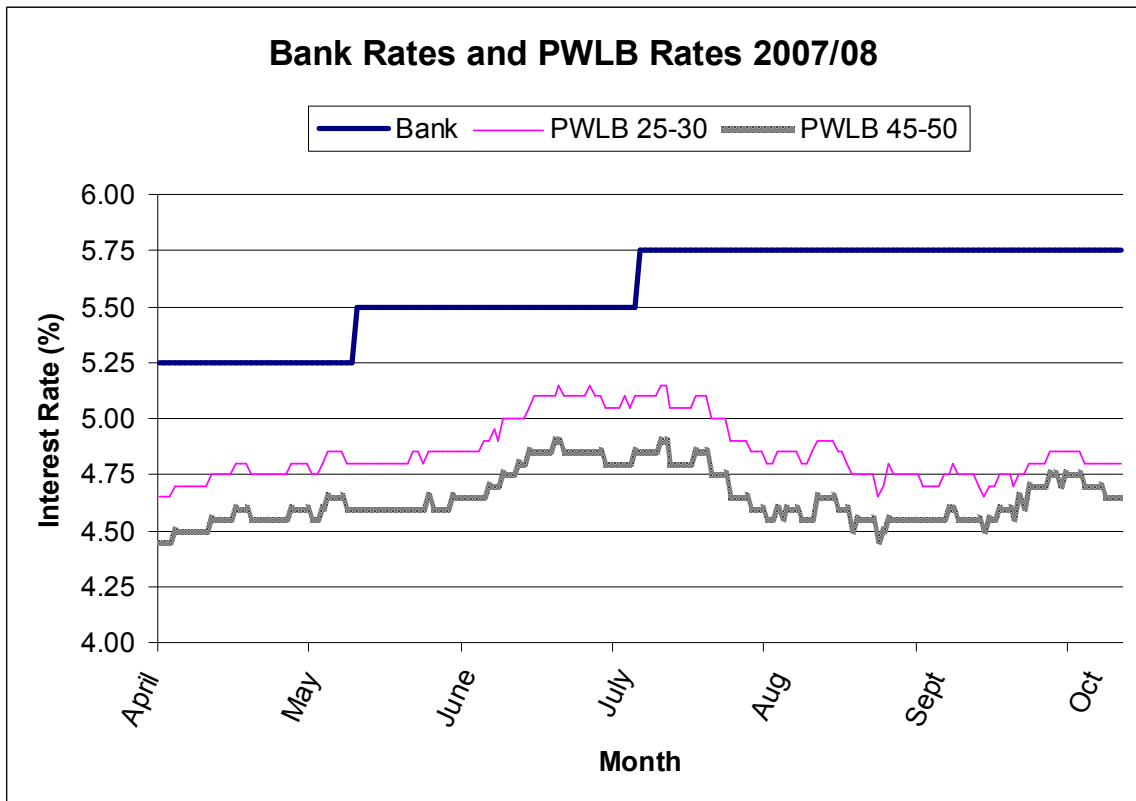
3.1.1 The current borrowing forecasts are shown in Table 1.

Table 1

ANALYSIS OF BORROWING 2007/08 – 2009/10	2007/08 This Report £m	2008/09 £m	2009/10 £m
Net Borrowing at 1 April	1,198	1,381	1,450
New Borrowing for the Capital Programme – non HRA	95	61	10
New Borrowing for the Capital Programme – HRA	115	38	15
Debt redemption costs charged to Revenue	(24)	(27)	(28)
Reduced/(Increased) level of Revenue Balances	(3)	(3)	(3)
Net Borrowing at 31 March *	1,381	1,450	1,444
* Comprised as follows			
Long term Borrowing			
Existing Fixed	1,277	1,266	1,370
Existing Variable	35	115	80
New Borrowing	69	69	-6
Short term Borrowing	0	0	0
Total External Borrowing	1,381	1,450	1,444
Less Investments	0	0	0
Net External Borrowing	1,381	1,450	1,444
% Gross borrowing exposed to interest rate risk	8%	13%	5%
Capital Financing Requirement	1,496	1,569	1,566

Note: The Capital Financing Requirement (CFR) is the maximum the Council can borrow for capital purposes.

- 3.1.2 Table 1 above shows that 2007/08 net external borrowing is now forecast at £1,381m, which is £16m lower than forecast in the report to Executive Board on 9th February 2007. This is partly due to slippage on schemes from 2006/7 but also due to the need to make additional borrowing provision to fund equal pay claims following the issuing of a capitalisation directive by the Department for Communities and Local Government. In addition, provision has been retained to meet any additional borrowing costs required to smooth the incidence of capital payments and receipts where it is not possible to reprofile expenditure.
- 3.1.3 Also, the net borrowing as at 01/04/2007 is £63m less than anticipated in the February report largely due to short term revenue balances of £29m but also slippage in the capital programme and a large capital receipt completing in 2006/07 rather than 2007/08. The forecast borrowing requirement for 2007/08 is now £183m of which £100m was pre-funded in 2006/07. This leaves a borrowing requirement of £83m to be arranged in 2007/08.
- 3.1.4 Interest rate movements during the year are shown in the graph on the next page. The bank rate moved upwards in May 2007 to 5.5% and July 2007 to 5.75%. These increases were to counter the threat of inflation. The rate of inflation (CPI) hit 3.1% in March and forced the Chancellor of The Exchequer to write an open letter to the Bank of England (BoE) asking why the inflation target of keeping within 1% either way of 2% had been breached. This was the first time in 10 years that the target inflation rate had been breached. The reply and subsequent acknowledgement by the Chancellor recognised that inflationary pressures caused by sharp increases in world energy prices were being felt by all the major industrial economies. The BoE subsequently raised the bank rate twice as pressures on inflation over the medium term continued and cited firm growth in the economy, increased asset prices and rapid growth in the supply of money and credit as continuing pressures on inflation. At the time of the last increase in July, economists were still predicting another quarter point rise in the bank rate.
- 3.1.5 However in August the fall-out of the American sub prime crisis caused a severe liquidity crisis in America, Europe and the UK, the impact of which is still being felt in the UK money markets. As the price of money has increased risk levels have been re-assessed leading to sharp falls in the equity markets in August. There is still some uncertainty around the impact on future growth levels, but economists and the Council's advisors now predict that interest rates have peaked and are likely to fall in the first half of 2008.



- 3.1.6 Long term rates have steadily risen as inflationary pressures on the economy were starting to take hold. However since August when the sub-prime crisis occurred, steep equity falls caused investors to turn to the safe haven of government gilts. The 45-50 year PWLB has steadily risen though the year from 4.45% to a peak of 4.90% before falling back to 4.5% for two days and 4.45% as an intra-day adjustment by the PWLB as a response to the extreme volatility being experienced in the markets in August. The Council's advisors predict that the 45-50 year PWLB rate will fall back to 4.50% by the end of the financial year.
- 3.1.7 Monitoring of the long term rates has presented opportunities to restructure £645.19m of loans as shown in Table 2 to generate current and future year savings. This included £575.19m of PWLB loans and £35m of market loans that were rescheduled prior to the start of 2007/08. These market loans have been restructured with the objective of reducing the number of opportunities for the lender to vary the interest rate on the loans and thereby reduce volatility. A further £35m of market loans termed Lenders Option Borrowers Option (LOBO) were called by the lenders and subsequently re-borrowed in 2007/08. The revenue budget set in February this year assumed that savings of £2m would be delivered through rescheduling and improved balances. Market conditions have enabled restructuring of loans to generate savings to date of £9.4m. The Director of Resources will continue to monitor market conditions to identify any further opportunities.

Table 2

Rescheduling 2007/08								
Premature Repayments					New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Premium/ (Discount) (£m)	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB					PWLB			
02/05/07	24	4.70	4.80	-0.360	04/05/07	50	49.5	4.55
02/05/07	25	4.75	4.80	-0.188	04/05/07	19	48.5	4.55
02/05/07	20	4.70	4.80	-0.303	30/05/07	86	45	4.60
09/05/07	25	5.625	5.10	1.476	30/05/07	56	46	4.60
09/05/07	25	5.625	5.10	1.530	30/05/07	30	46.5	4.60
09/05/07	20	5.625	5.10	1.266	30/05/07	34	47.5	4.60
09/05/07	20	5.625	5.25	0.756	30/05/07	112	49	4.60
09/05/07	6.75	5.625	4.95	0.578	30/05/07	42	49.5	4.60
09/05/07	22	4.40	4.70	-1.227	22/06/07	42.23	47.5	4.85
09/05/07	22	4.40	4.65	-1.039	22/06/07	10	49.5	4.85
09/05/07	26	4.40	4.65	-1.235	02/08/07	79	45	4.55
09/05/07	22	4.40	4.65	-1.051	02/08/07	14	49.5	4.55
09/05/07	22	4.40	4.65	-1.058				
31/05/07	30	4.25	4.70	-2.447				
31/05/07	20	4.25	4.70	-1.645				
31/05/07	20	4.25	4.70	-1.658				
08/06/07	10	10.875	5.50	3.852				
08/06/07	9.4	11.25	5.50	3.864				
08/06/07	10.35	7.875	5.45	1.987				
08/06/07	2.4	6.25	5.25	0.263				
08/06/07	.75	5.625	5.10	0.049				
08/06/07	20	4.30	4.80	-1.689				
08/06/07	30	4.25	4.70	-2.576				
26/06/07	19.21	7.875	5.65	3.339				
26/06/07	30	4.25	4.85	-3.339				
20/07/07	0.32	7.875	4.65	0.055				
20/07/07	31	5.875	5.25	2.428				
20/07/07	7.01	7.75	4.85	3.796				
20/07/07	30	4.25	4.90	-3.529				
20/07/07	25	4.25	4.85	-2.750				
Sub Total	575.19			-0.855		574.23		
LOBOs					LOBOs			
Arranged in 06/07					Arranged in 06/07			
18/04/07	20	4.5			18/04/07	20	70	4.45
25/04/07	15	4.4			25/04/07	15	70	4.25
Sub Total	35			0	Sub Total	35		
Arranged in 07/08					Arranged in 07/08			
03/04/07	5	3.40			02/07/08	15	70	4.295
03/04/07	10	3.38			03/07/08	10	70	4.290
05/04/07	10	3.48		-0.554	03/07/08	10	70	4.285
Sub Total	35			-0.554	Sub Total	35		
Total	645.19			-1.409	Total	644.23		

3.1.8 To meet the 2007/08 borrowing requirement of £183m, new PWLB loans of £100m had been taken in 2006/07 (the details of were presented to Executive Board on 9th February 2007 but are shown again for completeness) and £15m has been taken from the PWLB in 2007/08. Details of borrowing for the 2007/08 requirement are shown in Table 3.

Table 3

Pre Funding for 2007/08 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
19/05/06	PWLB	20	43	4.25
19/05/06	PWLB	20	44	4.25
19/05/06	PWLB	30	50	4.25
19/05/06	PWLB	30	42	4.25
		100		
New Borrowing for 2007/08 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
02/08/07	PWLB	15	45.5	4.55
		15		

3.2 **Borrowing Limits for 2007/08, 2008/09 and 2009/10**

- 3.2.1 The Council is required to set various limits for 2007/08, 2008/09 and 2009/10 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code. These limits including prudential indicators are detailed in Appendix A.
- 3.2.2 New borrowing limits for 2007/08 were approved by Council on 21st February 2007 and are set out below in Table 4.

Table 4

	2007/08 February 2007 £m	2007/08 This Report £m
Authorised Limits		
Borrowing	1,600	1,600
Other Long Term Liabilities	40	40
Total	1,640	1,640
Operational Boundary		
Borrowing	1,460	1,460
Other Long Term Liabilities	30	30
Total	1,490	1,490

- 3.2.3 It is anticipated that the authority will continue to remain within the authorised limits for 2007/08. Both the authorised limit and operational boundary are made up of a limit for borrowing and one for other long term liabilities and the Director of Resources has authority, under the Prudential Code, to vary these two elements within the overall limits. Current performance against borrowing limits is shown in Appendix B. The operational limit was breached on 30/05/07 for 1 day as part of a rescheduling exercise.

3.3 **Investment Strategy & Limits**

- 3.3.1 With effect from the 1st April 2004, new legislation and guidance on Local Government Investments was issued and this allows Councils with external debt to hold investments for more than 364 days, a freedom not previously allowed. Councils are required to set a limit on these investments before the start of the year. Council on 21st February 2007 approved a limit on investments for periods longer than 364 days of £150m. No further change is proposed to this limit.
- 3.3.2 The criteria for determining the lending list of approved investment counterparties is based upon an investment matrix provided by Sector Treasury Services and was approved by Executive Board initially in February 2002 and more recently in the February 2007 report. This matrix has been used to select investment counterparties where the Council has borrowed in advance and invested the sums until required to fund the capital programme. Sector continually update the list based upon the latest market ratings. The list will be kept under review as the treasury strategy develops.

4.0 Implications For Council Policy and Governance

- 4.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.
- 4.2 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.
- 4.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy statement for 2007/08 was approved by the Executive Board on 9th February 2007 and by full Council on 21st February 2007.

5.0 Legal and Resource Implications

- 5.1 This update on the treasury strategy recognises the increase in borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where there is additional supported borrowing the revenue costs are met by the Government. The revenue costs for additional unsupported borrowing on the General Fund are offset against Treasury Management savings generated so far in the year.

6.0 Conclusions

- 6.1 The Council's level of external debt at 31st March 2008 is anticipated to be £1,381m, £16m lower than expected when the strategy was approved in February 2007.
- 6.2 Treasury Management activity has enabled revenue savings of £9.4m to be generated to date. The Director of Resources will continue to monitor market conditions to identify any further opportunities for increasing revenue savings.
- 6.3 It is anticipated that the authority will remain within the approved limits for 2007/08 as outlined in Table 5 and paragraph 3.3.1.

7.0 Recommendations

That the Executive Board:

- 7.1 Note the update on Treasury Management borrowing and investment strategy for 2007/08.

Leeds City Council - Prudential Indicators 2007/08 - 2009/10

No.	PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
1	Ratio of Financing Costs to Net Revenue Stream General Fund - Excluding DSG (Note 1)	8.78%	10.24%	10.44%
2	HRA	15.55%	15.98%	15.75%
Impact of Unsupported Borrowing on Council Tax & Housing Rents				
3	increase in council tax B7(band D, per annum) (Note 2)	£ . P	£ . P	£ . P
4	increase in housing rent per week	48.67	56.86	62.69
5	Net Borrowing and the capital financing requirement (Note 3)	0.00	0.00	0.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
Estimate of total capital expenditure				
6	Non HRA	301,456	148,860	122,805
7	HRA	169,084	82,460	58,733
	TOTAL	470,540	231,320	181,538
Capital Financing Requirement (as at 31 March)				
8	Non HRA	£'000	£'000	£'000
9	HRA	738,898	773,378	755,398
	TOTAL	757,568	795,729	810,440
	TOTAL	1,496,466	1,569,107	1,565,838

No.	PRUDENTIAL INDICATOR	2007/08	2008/09	2008/09
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS				
		£'000	£'000	£'000
10	Authorised limit for external debt - (Note 5)			
	borrowing	1,600,000	1,600,000	1,600,000
	other long term liabilities	40,000	40,000	40,000
	TOTAL	1,640,000	1,640,000	1,640,000
11	Operational boundary - (Note 5)			
	borrowing	1,460,000	1,460,000	1,460,000
	other long term liabilities	30,000	30,000	30,000
	TOTAL	1,490,000	1,490,000	1,490,000
14	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
15	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
17	Upper limit for total principal sums invested for over 364 days (Note 5) (per maturity date)	150,000	150,000	150,000

16	Maturity structure of fixed rate borrowing 2007/08	Cumulative Upper Limit	Projected 31/03/08
	under 12 months	30%	0.00%
	12 months and within 24 months	30%	6.85%
	24 months and within 5 years	40%	11.99%
	5 years and within 10 years	50%	2.57%
	10 years and above	90%	78.60%

Notes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.
- The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.
- In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.
- Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.
- Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003.

Prudential Code Monitoring 2007/08 - Debt

