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## Report of the DIRECTOR OF CORPORATE SERVICES

### Executive Board

Date: 15<sup>th</sup> November 2006

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2006/07

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**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)

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## EXECUTIVE SUMMARY

1. This report provides a review and update of the treasury management strategy for 2006/07.
2. The Council's level of external debt at 31<sup>st</sup> March 2007 is anticipated to be £1,265m, £26m higher than expected when the strategy was approved in February 2006.
3. The 2006/07 budget assumed savings from treasury management activity of £200k and to date revenue savings of £4.9m have been achieved. 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 rates by borrowing future years capital requirements and investing monies in fixed deposits until required.
4. The level of debt is expected to remain within the new Authorised limits for external debt as agreed by Council on 1<sup>st</sup> November 2006.

## 1.0 Purpose Of This Report

1.1 The 2006/07 treasury management strategy was approved by Executive Board on 17<sup>th</sup> February 2006. This report provides a review and update of the strategy for 2006/07.

## 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 2006/2007 was approved by the Executive Board on 17<sup>th</sup> February 2006 and by full Council on 28<sup>th</sup> February 2006. This report provides Members with a review and update of the strategy for 2006/2007.

## 3.0 Main Issues

### 3.1 *Review of Strategy 2006/2007*

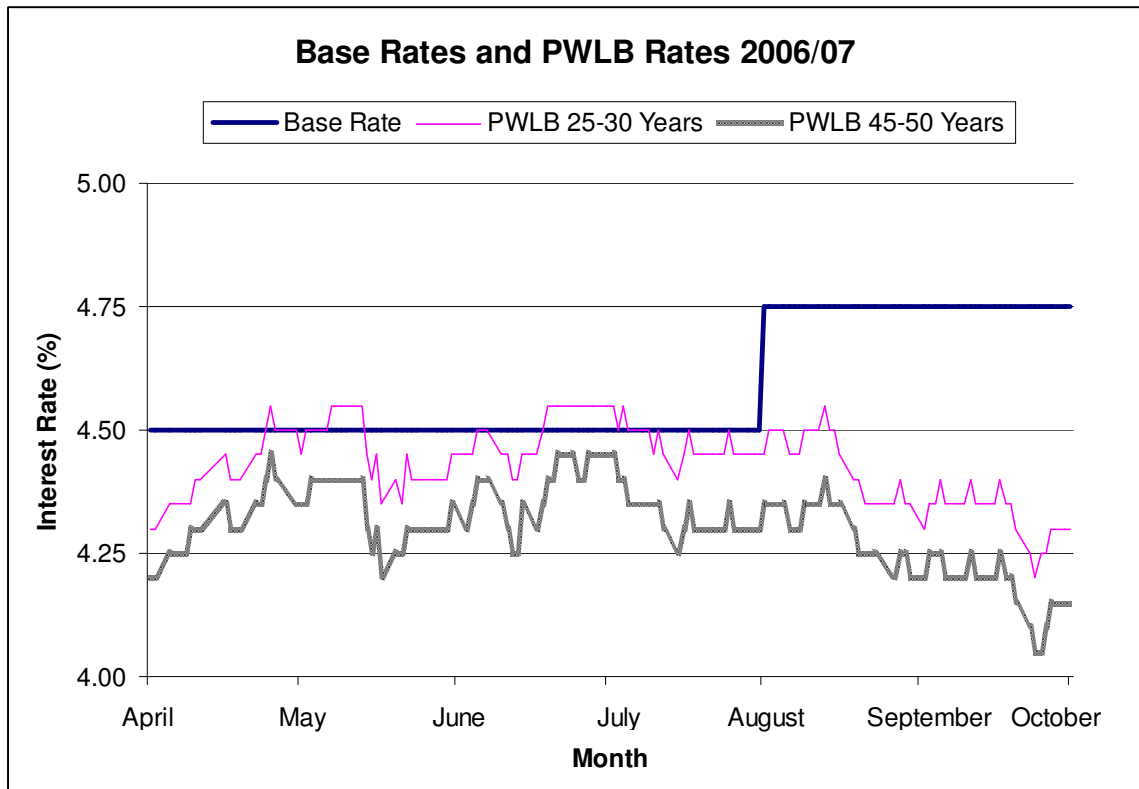
3.1.1 The current borrowing forecasts are shown in Table 1.

**Table 1**

<b>ANALYSIS OF BORROWING 2006/07 – 2008/09</b>	<b>2006/07 This Report £m</b>	<b>2007/08 £m</b>	<b>2008/09 £m</b>
<b>Net Borrowing at 1 April</b>	1,054	1,265	1,397
New Borrowing for the Capital Programme – HRA	117	111	35
New Borrowing for the Capital Programme – Non HRA	118	49	18
Debt redemption costs charged to Revenue (Incl HRA)	( 21)	( 25)	( 26)
Reduced/(Increased) level of Revenue Balances	( 3)	( 3)	( 3)
<b>Net Borrowing at 31 March *</b>	<b>1,265</b>	<b>1,397</b>	<b>1,421</b>
* Comprised as follows			
Long term Borrowing			
Existing Fixed	1,313	1,298	1,313
Existing Variable	40	55	65
New Borrowing		25	24
Short term Borrowing	12	19	19
Total External Borrowing	1,365	1,397	1,421
Less Investments	100	0	0
Net External Borrowing	1,265	1,397	1,421
% Gross borrowing exposed to interest rate risk	4%	8%	8%
Capital Financing Requirement	1,351	1,487	1,512

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

- 3.1.2 Table 1 above shows that 2006/07 net external borrowing is now forecast at £1,265m, which is £26m higher than forecast in the report to Executive Board on 17th February 2006. This is due to increases in capital programme borrowing for both the Housing Revenue account and the General Fund. The increase in the borrowing requirement is explained in the Capital Programme half year update which is a separate report on this agenda.
- 3.1.3 The net borrowing as at 01/04/2006 is £44m less than anticipated in the February report largely due to short term revenue balances of £41m. The forecast borrowing requirement for 2006/07 is now forecast at £235m (which includes replacing £24m of 13.5% stock which matured on 01/10/06) of which £77m was pre-funded in 2005/06. This leaves a borrowing requirement of £158m in 2006/07.
- 3.1.4 Interest rate movements during the year are shown in the graph below. The base rate moved upwards in August 2006 to 4.75%. This increase was earlier than anticipated by most forecasters and was against a background of firm growth in the economy, rapid growth in the supply of money and credit and indications that inflation was likely to remain significantly above the target of 2.0%. Forecasters now predict a rise of 0.25% in November 2006 before rates fall back towards the second half of 2007.
- 3.1.5 Long term rates have fallen during the year and have ranged between 4.45% and 4.05% for the 45 to 50 year period. The long term rate hit 4.05% at the end of September and was based upon poor US data that had not been predicted by economists. The Council's treasury advisors latest forecasts are for long term rates to remain within 4.2% and 4.95% through to 2008. There is the possibility however of long term rates falling lower than this towards the end of the year when traditionally demand for government gilts increases.



- 3.1.6 Monitoring of the long term rates has presented opportunities to restructure £289m of loans as shown in Table 2 to generate current and future year savings. This included £194m of PWLB loans and a further £95m of market loans, including £45m that was pre-arranged before 01/04/06. The restructuring of market loans also had the objective of removing the number of opportunities for the lender to vary the interest rate on the loans and thereby reduce volatility. The revenue budget set in February this year assumed that savings of £200k would be delivered through rescheduling and improved balances. Market conditions have enabled restructuring to generate savings to date of £4.9m. The Director of Corporate Services will continue to monitor market conditions to identify any further opportunities.

**Table 2**

<b>Rescheduling 2006/07</b>				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
24/04/06	Market Loan	5	60	4.15
24/04/06	Market Loan	10	60	4.81
24/04/06	Market Loan	5	60	3.995
28/04/06	PWLB	22	45	4.4
28/04/06	PWLB	22	46	4.4
28/04/06	PWLB	26	47	4.4
28/04/06	PWLB	22	48	4.4
28/04/06	PWLB	22	50	4.4
02/05/06	Market Loan	10	60	3.96
02/05/06	Market Loan	10	60	3.96
08/05/06	Market Loan	5	60	4.33
19/05/06	PWLB	20	36	4.3
16/06/06	PWLB	30	50	4.25
19/07/06	PWLB	30	47	4.25
19/09/06	Market Loan	15	70	4.25
21/09/06	Market Loan	20	70	4.45
21/09/06	Market Loan	15	70	4.24
		<b>289</b>		

- 3.1.7 To meet the borrowing requirement for the year, new loans of £158m have been taken, £93m from PWLB and £65m in market loans of which £35m were arranged before 01/04/06. These market loans are termed Lenders Option Borrowers Option (LOBO) and contain clauses which allow the lender, at pre-determined dates, to vary the interest rate on the loan. If one of these options is exercised and the new rate is not accepted, the borrower then has the option to repay the loan. Details of new borrowing for 2006/07 undertaken during the year are set out in Table 3.

**Table 3**

<b>New Borrowing for 2006/07 Requirement</b>				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
03/04/06	Market Loan	10	60	3.52
03/04/06	Market Loan	10	60	3.58
03/04/06	Market Loan	5	60	3.40
03/04/06	Market Loan	10	60	3.38
01/06/06	Market Loan	10	60	3.68
01/06/06	Market Loan	10	60	3.78
01/06/06	Market Loan	10	60	3.83
19/07/06	PWLB	25	46	4.25
14/09/06	PWLB	30	49	4.20
14/09/06	PWLB	25	48	4.20
29/09/09	PWLB	13	48	4.05
		<b>158</b>		

- 3.1.8 In addition to funding the 2006/07 requirement, historically low PWLB interest rates in the 45-50 year band presented the opportunity to borrow in advance a substantial part of the 2007/08 borrowing requirement, investing the amounts until they are required. The opportunity was taken to borrow £107m from the PWLB to fund the 2007/08 capital programme as shown in Table 4. £100m of this sum has then been invested until the required dates at an average annual rate of 5.02%.

**Table 4**

<b>Pre Funding for 2007/08 Requirement</b>				
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
29/09/09	PWLB	7	48	4.05
		<b>107</b>		

3.2 ***Borrowing Limits for 2006/07 , 2007/08 and 2008/09***

- 3.2.1 The Council is required to set various limits for 2006/07, 2007/08 and 2008/09 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 A report seeking to increase borrowing limits for 2006/07 was approved by Council on 1<sup>st</sup> November 2006. The new agreed limits for 2006/07 are set out below in Table 5.

**Table 5**

	<b>2006/07 February 2006 £m</b>	<b>2006/07 This Report £m</b>
<b>Authorised Limits</b>		
Borrowing	1,410	1,550
Other Long Term Liabilities	40	40
<b>Total</b>	<b>1,450</b>	<b>1,590</b>
<b>Operational Boundary</b>		
Borrowing	1,260	1,460
Other Long Term Liabilities	30	30
<b>Total</b>	<b>1,290</b>	<b>1,490</b>

- 3.2.3 The limits specific to Treasury Management were revised by Full Council on 1<sup>st</sup> November 2006. It is anticipated that the authority will remain within the new authorised limits for 2006/07. 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 Corporate Services has authority, under the Prudential Code, to vary these two elements within the overall limits.

- 3.2.4 Current performance against borrowing limits is shown in Appendix B. A full review of the borrowing limits for 2007/08 onwards will be undertaken when the capital programme is reviewed for the Council meeting in February 2007.

### **3.3 Investment Strategy & Limits**

- 3.3.1 With effect from the 1<sup>st</sup> April 2004, to coincide with the introduction of the prudential code, legislation and guidance on Local Government Investments was issued. This legislation allows Councils with external debt to hold investments for more than 364 days, a freedom not previously allowed. Further freedoms were also introduced which give Councils greater flexibility and hence access to higher returns, provided that any investment strategy is consistent with the Prudential framework. The Prudential code requires that Councils set limits on investments for periods longer than 364 days. In February 2006, in view of the new strategy to consider borrowing in the current year for part of the 2007/08 requirement, this limit was set at £100m.
- 3.3.2 The capital programme borrowing requirements for 2007/08 and 2008/09 are now higher than assumed in setting the above limit. Should rates be advantageous, this limit needs to be sufficient to allow borrowing for future years, with this advanced funding being invested until it is required. It was therefore agreed by Council on 1<sup>st</sup> November 2006 to increase the limit on investments for periods longer than 364 days to £150m.
- 3.3.3 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 in February 2002. 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 2006/2007 was approved by the Executive Board on 17<sup>th</sup> February 2006 and by full Council on 28<sup>th</sup> February 2006.

### **5.0 Legal And Resource Implications**

- 5.1 This update on the treasury strategy recognises the increase in borrowing required 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 Treasury Management activity has enabled revenue savings of £4.9m to be generated to date. The Director of Corporate Services will continue to monitor market conditions to identify any further opportunities for increasing revenue savings.
- 6.2 It is anticipated that the authority will remain within the new authorised limits for 2006/07 as outlined in Table 5.

## **7.0 Recommendations**

That the Executive Board:

- 7.1 Notes the update on Treasury Management borrowing and investment strategy for 2006/07.

## Leeds City Council - Prudential Indicators 2006/07 - 2008/09

No.	PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09
<b>(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS</b>				
1	<b>Ratio of Financing Costs to Net Revenue Stream</b> General Fund - Excluding DSG (Note 1)	8.89%	10.72%	10.61%
2	HRA	15.16%	16.22%	16.58%
<b>Impact of Unsupported Borrowing on Council Tax &amp; Housing Rents</b>				
3	increase in council tax B7(band D, per annum) (Note 2)	£ . P 36.59	£ . P 52.67	£ . P 53.85
4	increase in housing rent per week	0.00	0.00	0.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
<b>Estimate of total capital expenditure</b>				
6	Non HRA	209,038	196,051	101,625
7	HRA	168,030	152,491	76,061
	<b>TOTAL</b>	<b>377,068</b>	<b>348,542</b>	<b>177,686</b>
<b>Capital Financing Requirement (as at 31 March)</b>				
8	Non HRA	£'000 725,389	£'000 722,225	£'000 714,429
9	HRA	625,373	763,280	797,894
	<b>TOTAL</b>	<b>1,350,762</b>	<b>1,485,505</b>	<b>1,512,323</b>

No.	PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>				
		£'000	£'000	£'000
10	<b>Authorised limit for external debt - (Note 5)</b> borrowing other long term liabilities <b>TOTAL</b>	1,550,000 40,000 1,590,000	1,490,000 40,000 1,530,000	1,570,000 40,000 1,610,000
11	<b>Operational boundary - (Note 5)</b> borrowing other long term liabilities <b>TOTAL</b>	1,460,000 30,000 1,490,000	1,365,000 30,000 1,395,000	1,415,000 30,000 1,445,000
14	<b>Upper limit for fixed interest rate exposure</b> Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
15	<b>Upper limit for variable rate exposure</b> Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
17	<b>Upper limit for total principal sums invested for over 364 days (Note 5)</b> (per maturity date)	150,000	100,000	100,000

16	Maturity structure of fixed rate borrowing 2006/07 -> 2008/9	Lower Limit	Upper Limit	Projected 31/03/2006
	under 12 months	0%	30%	0.01%
	12 months and within 24 months	0%	30%	4.11%
	24 months and within 5 years	0%	40%	14.95%
	5 years and within 10 years	0%	50%	3.51%
	10 years and above	25%	90%	77.42%

## 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.
- Limits for 2007/08 and 2008/09 are as set in the February 06 report, but will be reviewed in the February 07 Treasury Management Strategy report.



# Prudential Code Monitoring 2006/07 - Debt

