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CABINET – 5 FEBRUARY 2003 PORTFOLIO: FINANCE AND SUPPORT

CORPORATE AND FINANCE REVIEW PANEL – 20 MARCH 2003

TREASURY MANAGEMENT STRATEGY FOR THE FINANCIAL YEAR 2003/04

1. INTRODUCTION

1.1 In accordance with this Council's policy on Treasury Management, this report sets out and recommends a strategy for 2003/04.

1.2 A glossary is attached as appendix 1.

2. INTEREST RATES FORECAST

2.1 The current Bank of England base rate is 4%. The Council's treasury consultant's main forecasts suggest a possible reduction of 0.25% before the end of the 2002/03 financial year. A rise in bank base rate is forecast towards the year-end.

2.2 Longer-term interest rates are forecast to remain stable until the middle of 2003/04 then rise towards March 2004.

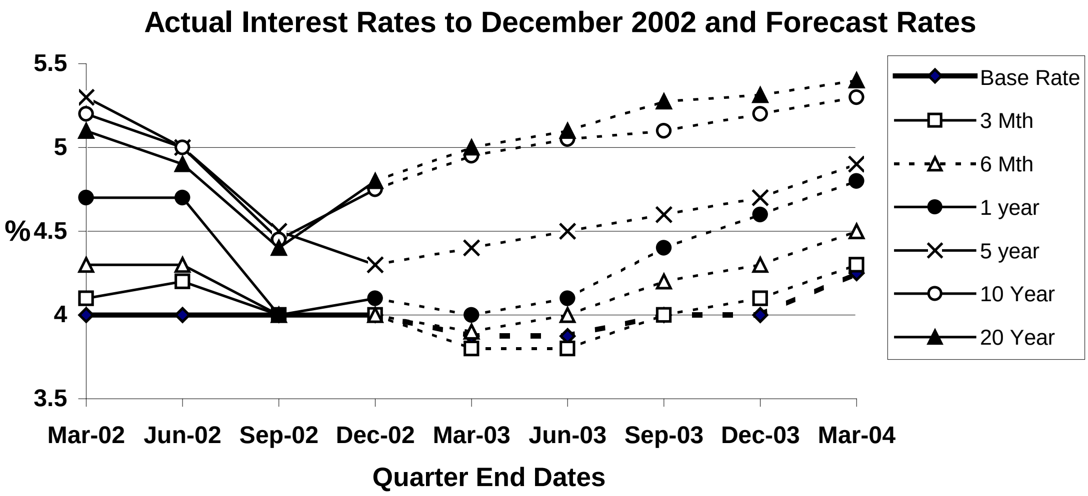
2.3 The main considerations for these forecasts are:

- The continuing weakness of US and Euro-zone economies well into 2003, resulting in continuing low international interest rates.
- The UK economy avoiding any significant slowdown owing to buoyant consumer spending and strong Government expenditure.
- Current concerns about the strength of the housing market will encourage the Monetary Policy Committee to reduce rates very little in the foreseeable future.
- There is evidence of an eventual increase in US and Euro-zone activity, which will promote an improvement in world trade growth.
- This will benefit the UK economy and growth will improve. The bank base rate will increase gradually to counter future inflation pressures.
- Long-term rates will be pushed gradually higher as the supply of gilt-edged stock is increased to meet public spending.

2.4 The following table shows the actual position to December 2002 and the forecast position until March 2004.

Year	Period End	BASE RATE %	3 mth %	6 mth %	12 mth %	5 yr %	10 yr %	20 yr %
2002	Mar	4.00	4.1	4.3	4.7	5.3	5.2	5.1
	Jun	4.00	4.2	4.3	4.7	5.0	5.0	4.9
	Sep	4.00	4.0	4.0	4.0	4.5	4.4	4.4
	Dec	4.00	4.0	4.0	4.1	4.3	4.8	4.8
2003	Mar	3.75/4.00	3.8	3.9	4.0	4.4	5.0	5.0
	Jun	3.75/4.00	3.8	4.0	4.1	4.5	5.1	5.1
	Sep	4.00	4.0	4.2	4.4	4.6	5.1	5.3
	Dec	4.00	4.1	4.3	4.6	4.7	5.2	5.3
2004	Mar	4.25	4.3	4.5	4.8	4.9	5.3	5.4

This is represented by the graph below:



3. BORROWING REQUIREMENT

3.1 An estimated £3.646 million may be required in 2003/04. Of this amount £0.630 million of new borrowing may be needed to meet forecast capital expenditure proposals, and £3.016 million of replacement borrowing may be required to meet maturing long-term debt. Therefore, potential net new borrowing could be estimated as £0.63 million.

3.2 Further borrowing may be required to replace any debt that is rescheduled during the year (see paragraph 9).

3.3 In addition, borrowing may be needed to finance purchases from reserve funds. The Council does not hold cash backed reserves (see glossary). Most of the money credited to funds has been invested internally to maintain a policy of reducing debt over recent years. No new debt has been raised since April 1998. This has benefited the Council and reduced interest payments.

3.4 All borrowing decisions will take into account any other sources of finance available.

4. SOURCES OF LONG TERM BORROWING

4.1 There are two sources of long term borrowing available to the Council for 2003/04.

4.1.1 Public Works Loan Board (See Glossary)

As it is anticipated that no change will be made from the current formula to determine available quota, the Council should be allocated an estimated £2.242m of quota for 2003/04.

4.1.2 Money Market Loans

The Council can raise loans from the Money Market for which there is no quota limit.

5. FUNDING AND LONG TERM BORROWING STRATEGY

There are four funding options available to the Council for 2003/04:

5.1 Long Term Borrowing

5.1.1 If the Council takes its quota from the PWLB, the new loans will provide flexibility in future years for premature repayment and rescheduling opportunities (see glossary).

5.1.2 Money market loans can often be negotiated with more competitive interest rates than PWLB loans. Market loans can also provide rescheduling opportunities.

5.1.3 The Council may incur a penalty on the early redemption of any new long-term loan.

5.1.4 It is estimated that if any long-term loans are raised during 2003/04 they will be at interest rates of 5.00% or less for periods of up to 40 years.

5.1.5 Any long-term loans that are raised purely for funding purposes will increase costs to the General Fund.

5.2 Use of Set Aside Capital Receipts (see glossary)

5.2.1 The Policy and Resources Committee agreed on 13 October 1999 that up to £10m of set aside capital receipts could be used to repay outstanding debt. In 1999/2000, £8m was used which leaves £2m available for future use if required.

5.3 Temporary Borrowing

5.3.1 The Council can borrow temporarily (see glossary) at an interest rate that reflects the prevailing bank base rate.

5.3.2 Loans are raised for a maximum of 364 days. This option is more flexible in the short term.

5.4 Use of Temporary Surpluses

5.4.1 The Council invests temporary surpluses through the Money Markets. These cash surpluses can be used as a funding option in the short-term.

6. OUTSTANDING DEBT (See schedule at appendix 2)

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6.1 The PWLB debt outstanding at 31 December 2002 was £1.25m and is estimated to be unchanged at 1 April 2003.

6.2 All of the PWLB debt outstanding at 31 December 2002 is fixed rate maturity loans.

6.3 The market loan debt outstanding at 31 December 2002 was £9.375m and is estimated to be £9.372m at 1 April 2003.

6.4 If no loans are repaid prematurely the balance of market loan debt outstanding at 31 March 2004 is estimated to be £6.356m.

6.5 Of the market loan debt outstanding at 31 December 2002, £9m is fixed rate maturity loans; the remainder is annuity loans.

6.6 All debt outstanding relates to Housing Services.

7. PREMATURE REPAYMENT OF LOANS

7.1 There is a possibility that a reduction in the amount of debt outstanding in 2003/04 would be beneficial to the General Fund without disadvantaging the Housing Revenue Account due to housing subsidy rules.

7.2 If such a possibility does arise the Council will consider repaying debt prematurely.

8. RESCHEDULING AND REPLACEMENT

8.1 Any opportunity to reschedule or replace outstanding loans will be considered.

8.2 The replacement of fixed rate loans with variable rate loans will also be considered if this helps to reduce the cost of the Council's debt.

9. EXTERNALISED MANAGED FUNDS (See Glossary)

9.1 A fund manager manages surplus funds of £8.5m, representing set aside capital receipts.

9.2 The manager is expected to achieve a better rate of return than could be achieved from short-term investments.

9.3 The forecast benchmark for earnings for 2003/04 is 4.00%.

9.4 The forecast rate of return for 2003/04 is 4.50%. This is a cash value of £382,500 assuming the full £8.5 million is invested for the year.

10. IN - HOUSE MANAGED FUNDS (See Glossary)

10.1 The Council's staff manages surplus funds of £8.5m, representing set aside capital receipts, in-house.

10.2 The forecast benchmark for earnings for 2003/04 is 4.00%.

10.3 The rate of return for 2003/04 is estimated at 4.25%. This is a cash value of £361,250 assuming the full £8.5 million is invested for the year.

10.4 The average return for the externally managed fund and the in-house fund, a total investment of £17 million, is 4.375%.

11. TEMPORARY INVESTMENTS

11.1 During the year, the Council's staff manage the daily cash flow.

11.2 Investments are made through the money markets with the maturity dates of the investments coinciding with the Council's expenditure profile.

11.3 The interest earnings on temporary investments for 2003/04 are estimated to be 4.00%.

12. TREASURY CONSULTANTS

12.1 The Council currently uses the services of Butlers Treasury Consultants.

12.2 The consultants advise the Council in all aspects of treasury management.

13. CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT

13.1 This Council, as recommended by the CIPFA Code of practice, adopted the current Treasury Management Policy Statement, in February 2002.

13.2 A requirement for a Treasury Management Practices document is currently being determined and will be reported back to cabinet for approval in 2003/04.

13.3 All treasury procedures and functions will comply with the CIPFA code, unless specifically stated.

14. ENVIRONMENTAL IMPLICATIONS

14.1 There are no environmental implications arising from this report.

15. CRIME AND DISORDER IMPLICATIONS

15.1 There are no crime and disorder implications arising from this report.

16. CONCLUSIONS

16.1 Interest rates are forecast to increase slightly at the end of the year.

16.2 Although set-aside capital receipts, PWLB quota and market loans are available, temporary borrowing and use of temporary surpluses in 2003/04 are likely to provide the Council with the most flexibility should debt need to be repaid prematurely in the future.

16.3 The premature repayment of debt during 2003/04 may be beneficial to the Council; this will be evaluated and reported to Members in due course.

16.4 £2m of set-aside capital receipts can be used to repay outstanding debt under existing approval of the Policy and Resources Committee on 13 October 1999.

16.5 Use of the managed funds to repay debt would reduce the value of the estimated investment interest earnings for 2003/04.

17. RECOMMENDATIONS

It is recommended that: -

17.1 the borrowing requirement of the Council for 2003/04 is met by raising temporary loans or using temporary surpluses;

17.2 up to £2m of invested set aside capital receipts be used to repay outstanding debt if financially beneficial to the Council;

17.3 the premature repayment of debt is undertaken if financially beneficial to the Council;

17.4 rescheduling and replacement of loans be undertaken if financially beneficial to the Council;

17.5 full consideration is given to financial advice provided by the Council's treasury consultants.

Further information
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Background Papers
Published Papers

APPENDIX 1

GLOSSARY OF TERMS

CASH BACKED RESERVES

Money that is received by the Council from certain sources, or money that has been allocated for a specific purpose, is held as reserves in the Council's accounts. These reserves are not matched by cash invested externally. The cash has been invested internally in order to reduce the need to raise debt. If funds held in the reserves are to be spent it may be necessary to raise loans to provide the cash to meet the expenditure.

PUBLIC WORKS LOAN BOARD

A Government agency, which provides loans to local authorities. Each year, it issues a circular setting out the basis on which loans will be made available and a quota formula for the amount that can be borrowed. Loans can be either at a fixed rate or on a variable rate basis. They can be repaid on an annuity, equal instalment of principal or maturity basis. The interest rate charged is linked to the cost at which the Government itself borrows.

PREMATURE REPAYMENT OF LOANS

A facility for loans where the Council can repay loans prior to the original maturity date. If the loan repaid has a lower interest rate than the current rate for a loan of the same maturity period the Council can secure a cash discount on the repayment of the original loan. If the loan replaced has a higher rate of interest than the current rate for a loan of the same maturity period, a cash penalty is payable to the lender.

SET ASIDE CAPITAL RECEIPTS

A proportion of money received by the Council for the sale of fixed assets must be set aside to repay debt.

TEMPORARY BORROWING AND INVESTMENT

Loans, which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.

MANAGED FUNDS

IN-HOUSE FUND MANAGEMENT

Surplus cash arising from unused capital receipts can be managed either by external fund managers or by the Council's staff in-house. The in-house funds are invested in fixed deposits through the money markets for periods up to one year.

EXTERNALLY MANAGED FUNDS

Fund managers appointed by the Council invest surplus cash arising from unused capital receipts in liquid instruments such as bank certificates of deposit and government stocks. The fund managers' specialist knowledge should ensure a higher rate of earnings on the managed funds than would be otherwise obtained.

APPENDIX 2

OUTSTANDING DEBT AT 31 DECEMBER 2002

Lender	Loan Principal	Coupon Rate	Maturity Date
PWLB	£1,000,000	10.25%	4 March 2015
PWLB	£250,000	10.25%	31 March 2017
Deutsche Bank Plc	£3,000,000	9.55%	21 Sept. 2004
Deutsche Bank Plc	£3,000,000	9.44%	23 Feb 2004
Depfa Bank Plc	£3,000,000	6.6%	6 April 2010
Annuity Loans	£375,464	5.72% average	Various
Total	**£10,625,464**		