

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2006/07

1. INTRODUCTION

- 1.1 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.

2. BACKGROUND

- 2.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:
- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
 - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2005/06);
 - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
 - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
 - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
 - Under the Act the DCLG has issued Investment Guidance to structure and regulate the Council's investment activities.
- 2.2 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 above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.
- 2.3 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); and
 - Review actual activity for the proceeding year (this report).

2.4 This report sets out the information in the following appendices: -

Appendix 1

- A summary of the treasury strategy agreed for 2006/07;
- A summary of the economic factors affecting the strategy over 2006/07;
- The decisions taken and performance of the treasury service and their revenue effects;
- The Council's treasury position at 31 March 2007;

Appendix 2

- The main Prudential Indicators and compliance with limits;
- Performance indicators set for 2007/08;
- Risk and performance.

3. CRIME AND DISORDER, ENVIRONMENTAL AND EQUALITY AND DIVERSITY IMPLICATIONS

3.1 None arising directly from this report.

4. REVIEW PANEL COMMENTS

4.1 The Corporate Overview Panel at their meeting on 21 June 2007 supported the recommendations contained in this report.

5. PORTFOLIO HOLDER COMMENTS

5.1 It is most pleasing to note that investments increased from £16.4m in March 2006 to £22.5m in March 2007.

5.2 The Council has sufficient funds to be able to meet the future medium term capital funding requirements. The report shows that there is an adequate availability of cash and no difficulty in funding expenditure plans is envisaged.

5.3 All prudential indicators have been complied with and the treasury function is managed prudently according to the strategy set for the year.

6. RECOMMENDATIONS

Members are recommended to:

6.1 Note the actual 2006/07 prudential indicators within the report.

6.2 Note the treasury management stewardship report for 2006/07.

Further Information	Background Papers
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TREASURY MANAGEMENT PERFORMANCE - 1 APRIL 2006 TO 31 MARCH 2007

1. INTRODUCTION

1.1 This appendix sets out the performance for the Council's own treasury management activities and those of the managed fund.

2. TREASURY STRATEGY SUMMARY FOR 2006/07

2.1 Borrowing Strategy

The borrowing strategy for 2006/07 estimated that: -

- Bank base rates would average 4.5% for the year;
- Long-term borrowing to a maximum of £5m would be undertaken to meet capital expenditure if required;
- The Council would borrow temporarily for cash flow purposes;
- Interest payments of £40,000 were estimated.

2.2 Investment Strategy

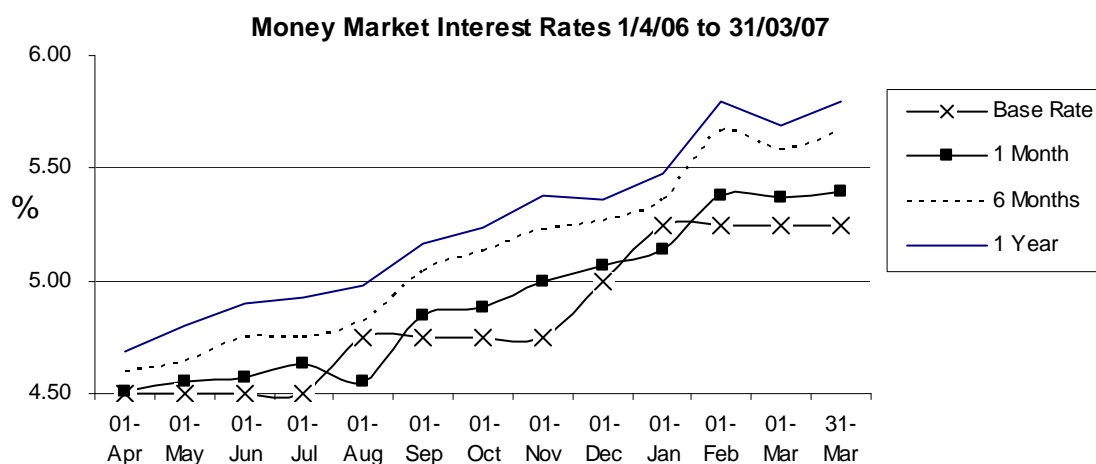
The investment strategy for 2006/07 estimated that: -

- Investments would be made for longer periods with fixed rates when the money markets priced in stronger increases than those forecast by the Council to lock in good value;
- Interest earnings on the Council's temporary cash flow investments was estimated to be £595,000;
- Interest earnings on the In-house Managed Fund was estimated to be £247,000;
- Interest earnings on the Externally Managed Fund was estimated to be £309,000;

3. SUMMARY OF ECONOMIC FACTORS

- 3.1 A continued build-up in underlying inflation pressure, the ongoing recovery in the housing market and the unexpected buoyancy of retail activity convinced the markets that the chances of any cut in official interest rates that had been anticipated prior to the beginning of the year had faded completely.
- 3.2 At the start of the year no change in base rates in 2006 was anticipated; any increases were forecast for early in 2007 when a prospective rise in economic activity was expected to generate additional inflation pressures.
- 3.3 The subsequent Bank of England Inflation Report (published in May) caused an expectation that official interest rates could rise, possibly in early 2007. Money market rates steepened to reflect these expectations.
- 3.4 Base rates increased by 0.25% to 4.75% in August with the threat of a further modest rise beyond that point. A further rise to 5% was announced in November 2006.

- 3.5 It was anticipated that the rise in base rates to 5% may be enough to control CPI inflation at the 2% central target rate. But, following a series of strong inflation statistics, rates rebounded quite sharply towards the year end. In particular the one-year deposit rate reaching the highest level seen since early 2001.
- 3.6 The following chart shows how the money market interest rates increased sharply over the year following the first four months of benign expectations.



4. LONG-TERM BORROWING

- 4.1 The Council had no existing long-term borrowing at 1 April 2006 and no long-term loans were raised during the year.

5. TEMPORARY BORROWING AND INVESTMENT

5.1 Borrowing

- 5.1.1 Existing temporary loans of £1 million were repaid on 3 April 2006.
- 5.1.2 Twenty temporary loans were raised during the year for cash flow purposes. The loans were for periods up to 14 days and for amounts up to £2.0 m.
- 5.1.3 There were no temporary loans outstanding at 31 March 2007.

5.2 Temporary Cash flow Investment

- 5.2.1 The original estimate for 2006/07 for interest receivable on temporary investments was £595,000 based on an anticipated earnings benchmark of 4.5% for the year. The actual interest receivable was £828,000; a variation of £233,000.
- 5.2.2 The main cause of this large variation was due to an underspend in capital expenditure for both 2005/06 and 2006/07. This accounted for £125,000. The remaining variation was because of a higher than anticipated interest rate for the year (£41,000) and other cash flow movements and changes in balances (£67,000). Of this variation £202,000 was reported to the Corporate Overview Panel during the year.

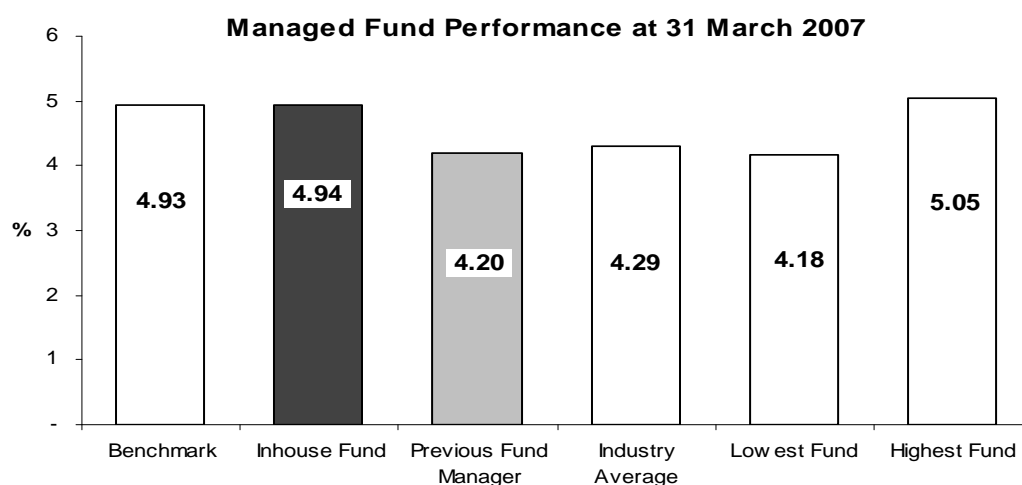
- 5.2.3 The actual interest earned on temporary investments for the year was equivalent to an annual rate of return of 4.86%.
- 5.2.4 The average rate of interest over the year was 4.81%. Therefore, the interest earned on temporary investments was at a marginally higher average rate of interest than the average money market interest rate.
- 5.2.5 All temporary investments have been made in accordance with the parameters set within the Council's Treasury Policy Statement.
- 5.2.6 The table below shows the list of temporary investments at 31 March 2007.

Borrower	Amount £	Interest Rate %
HSBC	1,000,000	4.81
Cheshire Building Society	1,000,000	4.65
Kaupthing, Singer & Friedlander	1,000,000	4.95
Kaupthing, Singer & Friedlander	1,000,000	5.00
Norwich and Peterborough Building Soc	2,000,000	4.75
Leeds Building Society	500,000	5.305
Dunfermline Building Society	500,000	5.33
Glitner Bank	500,000	5.50
Landesbanki Islands	1,250,000	5.42
Furness Building Society	1,250,000	5.42
Total	10,000,000	

6. MANAGED FUNDS

- 6.1 At 1 April 2006 the Council had £12m invested in managed funds. An external fund manager (Fund 1) managed £6.5m and council staff (Fund 2) managed £5.5m.
- 6.2 Because of a continual poor performance by the external fund manager over the previous few years, notice of withdrawal was given in March 2006 and the full fund value was repaid to the Council on 3 April 2006. These funds are to be managed by council staff for the time being.
- 6.3 The in-house fund now totals £12m.
- 6.4 The fund is expected to achieve a benchmark return during the year. The benchmark is based on the return the Council could achieve by investing the funds on a short-term basis and compounding the interest weekly.
- 6.5 The compounded benchmark return for the period 1 April 2006 to 31 March 2007 was 4.93%. The in-house fund achieved a rate of return of 4.94%.

6.6 The chart below shows the difference in performance of the funds against the benchmark, the industry average and other fund managers.



6.7 The performance of the in-house fund was marginally higher than the benchmark.

6.8 The in-house fund earnings exceeded the industry average and the previous fund manager for the year.

6.9 The in-house fund earnings were lower than the one managed fund which was the highest performing fund in the local authority market.

6.10 Results to 31 March 2007 are summarised as follows: -

	In-house Fund %	Previous Manager %	Industry Average %
Actual Return	4.94	4.20	4.29
Benchmark Return	4.93	4.93	4.93
	£000	£000	£000
Actual Return	593	504	515
Benchmark Return	592	592	592
Return above/(-)below benchmark	1	-88	-77

6.11 The value of the interest earned on the in-house fund as at 31 March 2007 was £1,000 above the benchmark figure as shown at paragraph 6.10 and £78,000 higher than the industry average.

6.12 The interest earned on the in-house fund was significantly higher than that of the previous external fund manager.

6.13 The original estimate for the managed fund interest earnings for 2006/07 was £556,000 based on a budgeted return of 4.64%.

6.14 In January 2007 a revised forecast of £589,000 was reported to Cabinet based on a combined return of 4.91%.

6.15 The actual earnings for 2006/07 were £593,000 and the return 4.94%.

6.16 Investment Portfolio Strategy

- 6.16.1 The in-house fund is invested in cash deposits. Gilts and CD's are not used as the fund is managed by council staff.
- 6.16.2 At the start on the year the portfolio was invested in instruments with interest rates averaging 4.49%.
- 6.16.3 At the beginning of the year the outlook for interest rates was benign. As the year progressed the expectations of the money markets changed forecasting marginal increases in interest rates.
- 6.16.4 Through the year one-year deposit rates were deemed to be good value and a portion of the in-house fund was invested in this period.
- 6.16.5 As the year progressed so further increases in interest rates were forecast and the portfolio of investments was further lengthened in duration to take advantage of the positive yield curve.
- 6.16.6 The continued increase in money market rate expectations through 2006/07 resulted in the benchmark being higher than initially forecast.
- 6.16.7 Interest rates continued to rise resulting in some of the earlier one-year investments producing a more inferior return than had been anticipated.

7. TREASURY POSITION AT 31 MARCH 2007

The following table shows the treasury position at the 31 March 2007 compared with the previous year. All debt and investments have interest payable at a fixed coupon rate for the period of the investment other than the Call Account which is variable: -

	31 March 2006		31 March 2007	
	Principal	Average Rate	Principal	Average Rate
Total Debt	£1.0m	4.5%	£0	0%
Managed Funds				
Externally Managed Fund	£6.5m	4.6%	-	-
In-house Managed Fund	£5.5m	4.9%	£12.0m	5.3%
Total Managed Funds	£12.0m	4.8%	£12.0m	5.3%
Temporary Cash-flow Investments	£5.0m	4.5%	£10.0m	5.1%
Call Account	£0.4m	4.0%	£0.5m	4.8%
Total Investments	£17.4m	4.7%	£22.5m	5.2%

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES TO 31 MARCH 2007

1. INTRODUCTION

- 1.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year-end.
- 1.2 The following table, at Paragraph 2, provides a schedule of all the mandatory prudential indicators.
- 1.3 Certain of these indicators must be compared to others and are detailed later in this appendix.

2. ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

- 2.1 The following table compares the actual figure for 2006/07 with the original indicator for 2006/07 and the actual figure for 2005/06.
- 2.2 The original indicator for 2006/07 is the same as was included in the Treasury Strategy Report 2006/07.

		2005/06 Actual £000	2006/07 Original Indicator £000	2006/07 Actual £000
1	Capital Expenditure	10,586	13,385	11,753
2	Capital Financing Requirement (CFR) at 31 March			
	Housing	1,897	1,897	1,897
	Non Housing	<u>3,990</u>	<u>5,687</u>	<u>2,822</u>
	Total	5,887	7,584	4,719
3	Treasury Position at 31 March			
	Borrowing	1,000	5,000	0
	Other long term liabilities	<u>0</u>	<u>0</u>	<u>0</u>
	Total Debt	1,000	5,000	0
	Investments	<u>17,400</u>	<u>12,000</u>	<u>22,550</u>
	Net Borrowing/Investments (-)	-16,400	-7,000	-22,550
4	Authorised Limit (against maximum position)	Maximum 4,172	Limit 28,000	Maximum 3,797
5	Operational Boundary	4,172	10,000	3,797
6	Ratio of financing costs to net revenue stream	-3%	-4%	-3%
7	Incremental impact of capital investment decisions on the Band D council tax	£ 9.77	£ 2.99	£ 8.30

8	Incremental impact of capital investment decisions on the housing rent levels	£ 1.57	£ 2.74	£ 1.09
9	Upper limits on fixed interest rates (against maximum position)	Maximum 100%	Maximum 100%	Maximum 99%
10	Upper limits on variable interest rates (against maximum position)	Maximum 0%	Maximum 50%	Maximum 4%
11	Maturity structure of fixed rate borrowing (against maximum position)			
	Under 12 months	100%	Upper Limit 100%	100%
	12 months to 2 years	0%	100%	0%
	2 years to 5 years	0%	100%	0%
	5 years to 10 years	0%	100%	0%
	10 years and above	0%	100%	0%
12	Estimated maximum principal funds invested (against maximum position)	Maximum 38,300	Maximum 38,000	Maximum 44,192

2.3 Any indicators that were exceeded were guideline limits only. There were no breaches of statutory limits during the year.

2.4 In addition to the above the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice. The compliance for this indicator is shown at paragraph 2.2 in the body of the report.
- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR). The compliance for this indicator is shown at paragraph 3.1 below.

3. LIMITS TO BORROWING ACTIVITY

3.1 Net external borrowing

	31 March 2006 Actual	31 March 2006 Original Indicator	31 March 2007 Actual
Net borrowing position	-£16.4m	-£7.0m	-£22.5
Capital Financing Requirement	£5.9m	£8.0m	£4.7m

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is an indication of the Council's debt position. In order to ensure that borrowing net of investments will only be for a capital purpose, net borrowing should not exceed the CFR for 2006/07.

The table above shows that the Council has complied with this requirement.

3.2 Borrowing Limits

	2006/07
Authorised Limit	£28.0m
Operational Boundary	£10.0m
Maximum gross borrowing position during the year	£3.8m
Minimum gross borrowing position during the year	£0.0m

The Authorised Limit must not be breached. The table demonstrates that during 2006/07 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary is the expected average 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.

4. TREASURY SERVICE PERFORMANCE INDICATORS FOR 2006/07

The treasury service has set the following performance indicators:

- The In-house fund performance should be higher than a benchmark of the 7-day LIBID rate compounded weekly.

5. RISK AND PERFORMANCE

- 5.1 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 that its capital expenditure is prudent, affordable and sustainable, and that its treasury practices demonstrate a low risk approach.
- 5.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed the investments over the year.
- 5.3 Shorter-term market rates and likely future movements of interest 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.
- 5.4 Section 6 of appendix 1 shows the returns for 2006/07.
- 5.5 For investments managed in-house returns have been marginally higher than the benchmark and there is a low risk associated with these types of investments.