ANNUAL REPORT ON

TREASURY MANAGEMENT & ACTUAL PRUDENTIAL INDICATORS

2006/07

INTRODUCTION

1. The Council undertakes capital expenditure on long-term assets. These activities may either be:-
   - Financed immediately through capital receipts, capital grants etc.; or
   - Through borrowing.

2. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilizing temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimize performance. The CIPFA Code of Practice on Treasury Management regulates this area of activity.

3. Wider information on the regulatory requirements is shown in paragraphs 27 to 30.

THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2006/07

4. Actual capital expenditure forms one of the required prudential indicators. The table below also shows how this was financed.

	2005/06	2006/07	
	Actual £000's	**Estimate £000's**	**Actual £000's**
Total capital expenditure	64,897	32,794	53,162
Resourced by:			
Capital Receipts	6,969	6,155	8,121
Capital grants	31,151	18,192	34,231
Capital reserves	8,935	688	1,437
Revenue	3,475	82	2,366
Unfinanced capital expenditure (additional need to borrow)	14,367	7,677	7,007

THE COUNCIL'S OVERALL BORROWING NEED

5. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position and represents 2006/07 and prior years net capital expenditure that has not been charged to revenue. The process for charging the capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP). The Council has the option to charge more than the statutory MRP each year through a Voluntary Revenue Provision, however the Council has declined the opportunity to do this. The Council's CFR for the year is shown below, and represents a key prudential indicator.

Capital Financing Requirement	31st March 2006	31st March 2007	
	Actual £000's	Original Indicator £000's	Actual £000's
Opening balance 1st April	250,398	258,644	258,778
Plus unfinanced capital expenditure	14,367	7,677	7,008
Less MRP	5,987	5,905	5,910
Closing balance 31st March	258,778	260,416	259,876

TREASURY POSITION at 31st MARCH 2007

6. Whilst the Council's gauge of its underlying need to borrow is the Capital Financing Requirement, the Corporate Director of Resources can manage the Council's actual borrowing position by either:-
   - Borrowing to the CFR;
   - choosing to utilize some temporary cash flow funds instead of borrowing (under borrowing); or
   - borrowing for future increases in the CFR (borrowing in advance of need).

7. During 2006/07 the Corporate Director of Resources decided to take advantage of low long term interest rates and borrow £8.034m in advance of need. The treasury position at the 31st March 2007 compared with the previous year is shown in the table below.

	31st March 2006		31st March 2007	
	Principal £m	Average Rate %	Principal £m	Average Rate %
BORROWING				
Fixed Interest Rate Debt	253.344	5.96	255.258	5.90
Variable Interest rate Debt	11.000	4.99	12.652	4.97
Total Debt	264.344	6.03	267.910	5.69

	31st March 2006		31st March 2007	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
INVESTMENTS				
Fixed Interest Investments	89.695	4.72	100.865	4.87
Variable Interest Investments	0	0	0	0
Total Investments	89.695	4.72	100.865	4.87
Net Borrowing Position	174.649		167.045	

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

8. Some of the required prudential indicators provide either an overview or specific limits on treasury management activity. These are shown below:-

9. Net borrowing and the Capital Financing Requirement – In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, exceed the Capital Financing Requirement for 2006/07 plus the expected changes to the Capital Financing Requirement in 2007/08 and 2008/09. The table below highlights that the Council has complied with this requirement.

	31st March 2006	31st March 2007	
	Actual £m	**Original Indicator £m**	**Actual £m**
Net borrowing position	174.649	190.416	167.045
Capital Financing Requirement	258.778	260.416	259.876

10. The Authorised Limit - is the "Affordable Borrowing Limit" required by section 3 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.

11. The Operational Boundary - is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

12. 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.

	2006/07
Original Indicator - Authorised Limit	£302.800m
Maximum gross borrowing position during 2006/07	£278.337m
Original Indicator - Operational Boundary	£279.000m
Average Gross Borrowing position during 2006/07	£264.735m
Minimum Gross Borrowing position during 2006/07	£257.088m
Financing costs as a proportion of net revenue stream	
HRA	22.5%
General Fund	3.5%

ECONOMIC BACKGROUND FOR 2006/07

13. The optimism that prevailed in the first few months of 2006 had evaporated by the beginning of the new financial year. The 2006/07 financial year was characterized by a rising trend in short term interest rates as the Bank of England and the financial markets responded to a strengthening economy and rising inflation.

14. 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 this monetary tightening and concerns about deteriorating inflation expectations prompted additional rate hikes. Two quarter-point increases in Bank Rate were announced in November 2006 to 5% and January 2007 to 5.25%. Despite these rises the market anticipated that there were further monetary tightening measures in the pipeline.

15. Long-term (PWLB) fixed interest rates followed an erratic path but the overall trend was towards higher levels. Deteriorating inflation expectations on the domestic and international fronts, in reaction to strong economic growth, was the principal force driving yields higher. Occasional rallies in the gilt market caused dips in rates and presented favourable borrowing opportunities. However these were short lived and by the close of the year rates were close to the highest levels seen since early 2005.

THE STRATEGY AGREED FOR 2006/07

16. The borrowing strategy for 2006/07 was set against an expected modest rise in long-term fixed interest rates and an initial fall in base rates. However, it was expected that base rates would rise again in 2007/08. If base rates remained relatively cheap, borrowing would be kept short till longer-term rates fell. The strategy was to undertake long-term fixed borrowing just as base rates started to rise. It was also envisaged that should circumstances allow it may be prudent to undertake some borrowing in advance of requirements. Excluding any Prudential borrowing, the Council's borrowing requirement for 2006/07 was estimated to be approximately £9.25m, of which loan repayments accounted for approximately £7.5m.

17. The Council's investment strategy was based on the expectation of shorter-term interest rates falling 0.25% in early 2006 and potentially rising again in 2007. In this case the strategy was to make investment decisions over shorter periods till it was felt that the peak in interest rates had been reached. Then investments would be undertaken over longer periods with fixed interest rates and so lock in good value and security of return.

18. These strategies were set on the understanding that the Corporate Director of Resources would undertake the most appropriate form of borrowing and investments depending on the prevailing interest rates at the time.

ACTUAL DEBT MANAGEMENT ACTIVITY DURING 2005/06

19. Borrowing – Loans totaling £140.075m were drawn to finance the net capital spend, naturally maturing debt and to reschedule loans. An analysis of these loans is shown at Appendix A.

20. The actual interest rate on these loans varied from a high of 4.97% to a low of 4.05% and compares with a budget assumption of borrowing at an interest rate of 5%.

21. Rescheduling – During the year the Council undertook 5 rescheduling exercises, rescheduling 50 loans totaling just under £108m and resulting in annual savings of just under £0.5m to the General Fund after taking account of the effect on the Housing Revenue Account. Details of these transactions are shown in Appendix B.

22. Repayment – during the year the Council did not choose to voluntarily repay any debt.

23. Summary of Debt Transactions – the overall position of the debt activity resulted in a fall in the average rate by 0.34%, representing a net General Fund saving of £431,238 p.a.

INVESTMENT POSITION

24. The Council's investment policy is governed by ODPM Guidance, which is implemented in the annual investment strategy approved by Council on 01/03/2006. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

25. The Council does not have the expertise or the resources to use a wide range of investment products and therefore opportunities to invest are limited to cash deposits. During the year the Council maintained an average balance of £105.6m and received an average return of 4.87%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.84%. This compares with a budget assumption of £70m investment balances at 4.5% interest rate.

PERFORMANCE INDICATORS SET FOR 2006/07

26. The Treasury Management service has set the following performance indicators:-
    - Debt – movement in the Council's consolidated rate of interest over the year (paragraph 23 refers);
    - Debt – rate of new borrowing taken out during the year compared to the rates that were available (paragraph 21 & Appendix A refers);
    - Investments-returns above the 7 day LIBID rate (paragraph 25 refers)

REGULATORY FRAMEWORK RISK AND PERFORMANCE

27. 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 2006/07);
    - 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 ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.

28. The Council has complied with all the above relevant statutory and regulatory requirements which 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 management practices demonstrate a low risk approach.

29. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed the debt and investments over the year. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, using long-term loans.

30. Shorter-term 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.

J Danks
Corporate Director of Resources

Appendix A

ANALYSIS OF LOANS DRAWN DURING 2006/07

Lender	Principal £m	Fixed or Variable Rate	Interest Rate %	Maturity date	Range of interest rates available during the year High %	Low %
PWLB	12.652	Variable	4.97	02/05/2007	4.99	4.99
PWLB	4.000	Fixed	4.25	31/03/2047	4.335	4.10
PWLB	3.250	Fixed	4.25	31/03/2048	4.335	4.10
PWLB	5.000	Fixed	4.25	30/09/2051	4.50	4.05
PWLB	5.000	Fixed	4.25	30/09/2052	4.50	4.05
PWLB	4.000	Fixed	4.25	30/09/2053	4.50	4.05
PWLB	5.000	Fixed	4.25	31/01/2052	4.50	4.05
PWLB	5.000	Fixed	4.25	30/09/2051	4.50	4.05
PWLB	5.000	Fixed	4.25	31/03/2052	4.50	4.05
PWLB	5.000	Fixed	4.25	30/09/2052	4.50	4.05
PWLB	2.473	Fixed	4.25	31/03/2053	4.50	4.05
PWLB	3.000	Fixed	4.05	30/09/2053	4.50	4.05
PWLB	3.000	Fixed	4.05	31/03/2054	4.50	4.05
PWLB	5.000	Fixed	4.40	31/01/2053	4.50	4.05
PWLB	2.500	Fixed	4.40	31/03/2053	4.50	4.05
PWLB	4.200	Fixed	4.40	31/03/2055	4.50	4.05
PWLB	5.000	Fixed	4.40	30/09/2055	4.50	4.05
PWLB	5.000	Fixed	4.40	30/09/2055	4.50	4.05
PWLB	5.000	Fixed	4.40	31/03/2056	4.50	4.05
PWLB	5.000	Fixed	4.40	31/03/2056	4.50	4.05

PWLB	5.000	Fixed	4.40	30/09/2056	4.50	4.05
PWLB	5.000	Fixed	4.40	30/09/2056	4.50	4.05
PWLB	5.000	Fixed	4.40	31/01/2057	4.50	4.05
PWLB	5.000	Fixed	4.40	31/01/2057	4.50	4.05
PWLB	5.000	Fixed	4.25	30/09/2054	4.50	4.05
Market	6.000	Fixed	4.81	07/03/2077	N/a	N/a
Market	15.000	Fixed	4.71	07/03/2077	N/a	N/a

Appendix B

DEBT RESTRUCTURING UNDERTAKEN DURING 2006/07

Date of Restru-cturing	Old loans			New Loans			
	No. of Loans	Amount £m	Average Interest Rate %	Fixed/ Variable	Discount Received/ (Premium Paid) £	Interest Rate %	Annual General Fund Saving £
02/05/06	6	12.652	4.55	Variable	256,855	4.97	(53,138)
19/05/06	7	7.256	4.75	Fixed	44,819	4.25	17,877
19/07/06	4	13.726	5.6	Fixed	541	4.25	88,559
24/08/06	15	22.473	5.21	Fixed	3	4.25	103,209
15/02/07	18	51.685	5.03	Fixed	0	4.40	157,151