ANNUAL REPORT ON TREASURY MANAGEMENT & ACTUAL PRUDENTIAL INDICATORS

2005/06

INTRODUCTION

1. The Council undertakes capital expenditure on long-term assets. These activities can be funded immediately through capital receipts, capital grants etc., although any residue which cannot be immediately paid for will give rise to a borrowing need. This borrowing need will be charged to revenue over a number of years. The area of capital expenditure activity is regulated by the CIPFA Prudential Code, which requires actual outturn to be reported in the following areas:-
   - Capital expenditure;
   - Capital Financing Requirement;
   - Debt;
   - Ratio of financing costs to net revenue stream.

   The remaining indicators are included to make the annual reporting comprehensive.

2. Part of the Council's treasury activities is to address any 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 paragraph 27.

THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2005/06

4. This forms one of the required prudential indicators (a list of all mandatory indicators is at Appendix A), and shows total capital expenditure for the year and how it was financed.

	2005/06	
	Actual £000's	**Estimate £000's**
Total capital expenditure	64,897	55,003
Resourced by:		
Capital Receipts	6,969	3,993
Capital grants	31,151	38,074
Capital reserves	8,935	632
Revenue	3,475	2,194
Unfinanced capital expenditure (additional need to borrow)	14,367	10,110

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 2005/06 and historic net capital expenditure which has not yet 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	
	Actual £ £000's	**Original Indicator £000's**
Opening balance 1st April 2005	250,398	249,527
Plus unfinanced capital expenditure	14,367	10,074
Less MRP	5,987	5,571
Closing balance 31st March 2006	258,778	254,030

TREASURY POSITION at 31st MARCH 2006

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 2005/06 the Corporate Director of Resources decided to take advantage of very low interest rates and borrow £5.566m in advance of need. The treasury position at the 31st March 2006 compared with the previous year is shown in the table below.

	31st March 2006		31st March 2005	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
BORROWING				
Fixed Interest Rate Debt	253.344	5.96	251.622	6.44
Variable Interest rate Debt	11.000	4.99	5.000	5.03
Total Debt	264.344	5.93	256.622	6.44

	31st March 2006		31st March 2005	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
INVESTMENTS				
Fixed Interest Investments	89.695	4.72	81.387	4.66
Variable Interest Investments	0	0	0	0
Total Investments	89.695	4.72	81.387	4.66
Net Borrowing Position	174.649		175.235	

THE STRATEGY AGREED FOR 2005/06

8. The borrowing strategy for 2005/06 was set against an expected rise in long-term interest rates but relatively flat base rates. If base rates remained relatively cheap, borrowing would be kept short till longer-term rates fell. Excluding any Prudential borrowing, it was expected that the Council would require approximately £16m of borrowing during 2005/06, of which loan repayments accounted for approximately £12m.

9. The Council's investment strategy was based on the expectation of shorter-term interest rates falling from those that existed in 2004/05. In this case the strategy was to make investment decisions over longer periods with fixed interest rates and so lock in good value and security of return.

10. 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

11. Borrowing – Loans were drawn to finance the net capital spend, naturally maturing debt and to reschedule some loans. The loans drawn were:-

Lender	Principal £m	Fixed or Variable Rate	Interest Rate %	Maturity date	Range of interest rates available during the year	
					High %	Low %
PWLB	5.0	Fixed	4.60%	31/03/2034	4.80%	3.85%
PWLB	5.0	Fixed	4.40%	31/03/2035	4.75%	3.80%
PWLB	5.0	Fixed	4.25%	30/09/2035	4.75%	3.80%
PWLB	8.0	Fixed	3.70%	31/03/2051	4.20%	3.70%

12. This compares with a budget assumption of borrowing at an interest rate of 5% when interest rates were expected to rise during 2005/06 (paragraphs 21 - 23 refers).

13. Rescheduling – On 17/01/2006 the Council repaid £3m at an average rate of 4.15% and received a discount of £23,762. These loans were replaced with £3m at 3.7%. As a result annual savings of £3,039 will be made to the General Fund after taking account of the effect on the Housing Revenue Account.

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

15. Summary of Debt Transactions – the overall position of the debt activity resulted in a fall in the average rate by 0.16%, representing a net General Fund saving of £198,786 p.a.

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

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

17. 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 2005/06 plus the expected changes to the Capital Financing Requirement in 2006/07 and 2007/08. The table below highlights that the Council has complied with this requirement.

	31st March 2006	
	Actual £m	Original Indicator £m
Net borrowing position	£174.649	£204.030

Capital Financing Requirement	£258.778	£254.030

18. 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 2005/06 the Council has maintained gross borrowing within its Authorised Limit.

19. 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.

20. 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.

	2005/06
Original Indicator - Authorised Limit	£296.800m
Maximum gross borrowing position during 2005/06	£264.753m
Original Indicator - Operational Boundary	£273.000m
Average Gross Borrowing position during 2005/06	£260.967m
Minimum Gross Borrowing position during 2005/06	£256.517m
Financing costs as a proportion of net revenue stream	
HRA	24.8%
General Fund	4.5%

ECONOMIC BACKGROUND FOR 2005/06

21. UK interest rates remained within a tight range during 2005/06 financial year. Base rates opened the period at 4.75% and ended a quarter-point lower at 4.5%. In spite of this, longer-dated fixed interest rates fluctuated more, rising and falling in response to notable shifts in market expectations.

22. The year started on a pessimistic note. The apparent failure of consumer spending and the housing market to respond to the Bank of England's policy base rises (since November 2003) supported suggestions that base rates had further to rise before peaking in the later stages of 2005. These concerns faded quickly and base rates were finally cut by 0.25% to 4.5% in August. There were hopes of further reductions in the autumn of 2005 and spring of 2006 but this optimism gradually faded.

23. Long-term (PWLB) fixed interest rates followed an erratic path. Matters came to a head late in 2005 and early 2006 when demand was not sufficient to match supply and interest rates were driven to historic lows. This trend was seen most clearly for very long interest rates and the rate on the new 45-50 year PWLB loan (introduced in early December 2005) reached a low of 3.7%. This downward trend did not continue

and long term interest rates rebounded in February and March but still ended the year some 0.25% below where they had started.

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 02/03/2005. 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 £90.0m and received an average return of 4.72%. The comparable performance indicator is the average 7-day LIBID rate, which was 4.54%.

PERFORMANCE INDICATORS SET FOR 2005/06

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 15 refers);
    - Debt – rate of new borrowing taken out during the year compared to the rates that were available (paragraph 11 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 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 ODPM 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

ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

		2005/06		2004/05
		Actual £000's	Original Indicator £000's	Actual £000's
1.	Capital Expenditure	64,897	55,003	76,943
2.	Capital Financing Requirement (CFR) at 31st March			
	Housing	134,788	134,788	134,002
	Non-Housing	123,990	119,242	116,396
	Total	258,778	254,030	250,398
3.	Treasury Position at 31st March			
	Borrowing	264,344	254,030	256,622
	Other long term Liabilities	0	0	0
	Total Debt	264,344	254,030	256,622
	Investments	(89,695)	(50,000)	(81.387)
	Net Borrowing	174,649	204,030	175,235
4.	Maximum Debt (Actual) compared to Authorised Limit (Original Indicator)	-8,247		-13,897
5.	Average Debt compared to Operational Boundary (Original Indicator)	-12,021		-30,453
6.	Ratio of financing costs to net revenue stream			
	Housing	24.8%	18.5%	17.6%
	Non-Housing	4.5%	5.1%	4.6%
7.	Incremental impact of capital investment decisions on Band D Council Tax.	£0.45	£0.47	£0.94
8.	Incremental impact of capital investment decisions on Housing rent Levels.	£0	£0	£0
9.	Upper limits on fixed interest rates.	100%	100%	100%
10.	Upper limits on variable interest rates.	25%	25%	25%
11.	Maturity structure of fixed rate borrowing			
	Under 12 months	3.0%	15%	4.7%
	12 months to 2 years	1.0%	15%	2.9%
	2 years to 5 years	5.3%	45%	3.7%
	5 years to 10 years	7.5%	75%	10.9%
	10 years and above	83.2%	90%	77.8%
12.	Maximum principal funds invested over 364 days	£5,000	£5,000	£0

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

- Adopt the CIPFA Code of Practice.
- 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 these indicators are highlighted in the body of the report.