**TREASURY MANAGEMENT STRATEGY STATEMENT AND PRUDENTIAL INDICATORS 2005/2006 – 2007/2008**

## 1. Introduction

1.1 The Council has customarily considered an annual Treasury Management Strategy Statement under the requirement of the CIPFA code of practice on Treasury Management, which has been adopted by this Council.

1.2 The 2003 Prudential Code for Capital Finance in local authorities has introduced new requirements from 1 April 2004 for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.

1.3 The Prudential Code requires the Council to set a number of Prudential Indicators, certain of which replace the borrowing/variable limits previously determined as part of the strategy statement, whilst also extending the period covered from one to three years.

1.4 This report therefore incorporates the indicators to which regard should be given when determining the Council's treasury management strategy for the next three years. The strategy for 2005/06 in respect of the following aspects of the treasury management function is based upon the Treasury officers' views on interest rates, supplemented by market forecasts from the Council's treasury advisors.

1.5 The strategy covers:

The current treasury position.
Prospects for interest rates.
Treasury limits in force, which will limit the treasury risk and activities of the Council.
The borrowing strategy.
The investment strategy.
The extent of debt rescheduling opportunities.
Any extraordinary treasury issues.

## 2. Treasury limits for 2005/06 to 2007/08

2.1 It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the " Affordable Borrowing Limit".

2.2 The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax/rent levels in “acceptable”.

2.3 Whilst termed “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate those planned to be financed by both borrowing and other forms of liability, such as credit arrangements. The affordable borrowing limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. It is not envisaged that the Council will borrow beyond the level of Government Supported Borrowing for capital purposes in 2005/6.

## 3. Current Portfolio Position

3.1 The Council’s treasury portfolio position as at 14/01/05 comprised:

Long-term borrowing - Market Loans £24,600,000

All the above loans are at fixed rates with maturity dates of up to 15 years. Interest rates vary from 5.68% to 7.03%.

Temporary borrowing of £1,423,000 at variable interest rates, currently averaging 4.25%.

Loan from English Partnerships £1,302,345 for 29 years at 9.25%.

Other long-term liabilities of £1,000,000

Total debt therefore equal £28,325,345.

The Council also has investments at variable rates of £50,326,043 of which two external fund managers manage £11,488,183. The level of investments is impacted on by the cashflow and will fall considerably before the end of the financial year.

## 4. Treasury Limits and Prudential Indicators 2005/6

***Indicator 8a***
***Upper Limit for Fixed Rate Exposure***

| | 2004/2005 % | 2005/2006 % | 2006/2007 % |
|---|---|---|---|
| Upper Limit for Fixed Rate Exposure | 100 | 100 | 100 |

Nearly all of the Council’s debt at present is fixed rate and therefore 100% is the required percentage.

***Indicator 8b***
***Upper Limit for Variable Rate Exposure***

| | 2004/2005 % | 2005/2006 % | 2006/2007 % |
|---|---|---|---|
| Upper Limit for Variable Rate Exposure | 50 | 50 | 50 |

As a hedge against our variable investment rate it could be useful to change to variable rate borrowing.

***Indicator 9***
***Principal Sums Invested for Periods of Longer than 364 days***

| | 2004/2005 % | 2005/2006 % | 2006/2007 % |
|---|---|---|---|
| Principal Sums Invested for Periods of Longer Than 364 Days | 33 | 33 | 33 |

33% of investments may be over 364 days. This will be used to limit interest rate risk.

***Indicator 10***
***Upper and Lower Limits on the maturity Structure of Borrowing***

| Limits on the Maturity Structure of Borrowing | Upper Limit % | Lower Limit % |
|---|---|---|
| Maturity period | 100 | 0 |
| Under 12 months | 100 | 0 |
| 12 Months and within 24 months | 100 | 0 |
| 2 Years and within 5 years | 100 | 0 |
| 5 Years and within 10 years | 100 | 0 |
| 10 Years and above | 100 | 0 |

This will allow us the maximum flexibility for rescheduling and repayment of debt under the new financial regulations.

***Indicator 11***
***Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services***

The Council has customarily considered an annual Treasury Management Strategy Statement under the requirement of the CIPFA code of practice on Treasury Management, which has been adopted by this Council.

## 5. Prospects for interest rates

### 5.1 Short-term interest rates

5.11 The base rate increased from 4.00% at the start of the financial year to 4.75% in August 2004, the highest reached since September 2001. The increase was needed to keep inflation on track to meet its target in the medium term.

5.12 With hindsight, the economic data released during last year prompted markets to moderate their expectations of the extent of likely future money tightening. CPI (consumer prices index) inflation remains low, averaging 1.3% below the Governments' 2% target. CPI has been running at 1.1 – 1.6% throughout 2004 and is forecast to average 1.4% in 2004, 1.75% in 2005 and 2% in 2006 i.e. reaching the MPC (Monetary Policy Committee) target.

5.13 In addition, in the economy manufacturing and service forward indicators are weaker which indicates that the base rate may rise to 5% at the end of Quarter 1 of 2005 but with a definite downside risk.

5.14 The level of the housing market price movements can influence the direction of interest rates. In December 2004 new mortgage approvals fell from 77,000 from 85,000 in November 2004 indicating a decrease in house prices which also has an impact on the interest rate level.

5.15 The forecast for the US is an increase in rates due to the jump in inflation from 2.5% in September 2004 to 3.5% in November 2004, partly caused by the damage from hurricanes which continues to affect energy and food prices as well as insurance costs. The impact of the US data is likely to be negative to UK rates as their rates are on an upward trend. However in the Eurozone the growth in 2005 is expected to be around 1.5%, therefore giving no reason for the rates to rise. The chances of export growth are slim and with an expected fall in inflation from 2.3% in December, a rate cut although not ruled out is unlikely to occur throughout 2005.

### 5.2 Long-term rates

5.21 During the financial year PWLB rates were at a steady level for the 1-5 year period, therefore creating a flat yield curve for most periods out to 5 years. The longer term PWLB rates have decreased over the financial year from 5.1% in April 2004 to the current level of 4.6%.

5.22 The market remains convinced that the base rate has peaked at 4.75%, with a chance of reduction towards the end of 2005, although on the whole the outlook is stable for 2005/2006.

## 6. Capital borrowing and borrowing portfolio strategy

6.1 It is expected that the Council will not borrow externally for capital purposes in the next financial year but will instead use capital receipts and/or supported capital grant.

## 7. Investment strategy

7.1 This authority views the markets' expectation for base rates as being too high and so investments will be made long when cash-flow allows, with a view to locking in higher rates of return than may be available at a later stage when market expectations are corrected. In addition it is envisaged that an investment for 3-5 years may be made to reduce volatility in the investment returns.

## 8. Retention of the provision for credit liabilities

8.1 Money market conditions in recent years have made premature debt repayment using reserved capital receipts an attractive option as the equivalent yield on the repayment has exceeded what could be obtained by investments. The option to prematurely repay was exercised by the Council in 2001/2, 2002/3 and 2003/4. Any decision to repay further will be delayed until issues regarding the accounting treatment of premia have been resolved with the District Auditor. (see 10.3)

## 9. Debt Rescheduling

9.1 We will continue to consider rescheduling debt in 2005/6, although only three market loans remain. By rescheduling debt we can spread premiums over a number of years and this could enable us to afford the repayments, which otherwise would have too great an impact on general fund in the year of the transaction.

9.2 Prudence would dictate that we constantly monitor the market environment and we would only act to reschedule should advantageous circumstances arise. A further benefit of rescheduling our debt could be to obtain a more balanced maturity profile.

## 10. Other issues

10.1 The Council has in previous years dealt forward on investments. This has mainly been advantageous and has allowed a greater rate of return on investments than would otherwise have been possible.

10.2 During 2000/2001 District Audit issued a guidance notice stating that they believed the practice to be possibly unlawful. Since that release Northampton had ceased dealing forward, however, with the change in regulations during 2003 this has again become possible and it is hoped that this may again prove advantageous during 2005/6.

10.3 The Council is currently in dialogue with the District Auditor on the past accounting treatment of premia on long term debt. The outcomes of these discussions will have a significant impact on future debt repayment/rescheduling decisions.