TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2008/09

1 SUMMARY

1.1 This report sets out the Council's treasury strategy for borrowing and investment for 2008/09.

2 INTRODUCTION

2.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as paragraph 8); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2.3 The suggested Strategy for 2008/09 in respect of the following aspects of the treasury management function is based upon the Treasury Officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:-

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- The current treasury position;
- The borrowing requirement
- Prospects for interest rates;
- The borrowing strategy;
- Debt rescheduling;
- The investment strategy;
- Any extraordinary treasury issues (such as the implications of LSVT).

2.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

- Increases in interest charges caused by increases borrowing to finance additional capital expenditure, and
- Any increases in running costs from new capital projects,

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

3 TREASURY LIMITS FOR 2008/09 TO 2009/10

3.1 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". In England and Wales the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

3.2 The Council must have regard to the Prudential Code when setting the Authorised 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 and council rent levels is 'acceptable'.

3.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

4 PRUDENTIAL INDICATORS FOR 2008/09 – 2009/10

4.1 The following prudential indicators (in Table 2 below) are relevant for the purposes of setting an integrated treasury management strategy. The Indicators in Table 1 also appeared in the Budget setting report, with more detailed explanations.

4.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The full Council adopted this on 19 December 2002.

TABLE 1 - BUDGET AND RENT SETTING PRUDENTIAL INDICATORS	**2006/07**	**2007/08**	**2008/09**	**2009/10**	2010/11
	Actual	**Probable outturn**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Non - HRA	**1,288**	**991**	**2,719**	**705**	712
HRA	**1,279**	**225**	**-**	**-**	-
TOTAL	2,567	1,216	2,719	705	712
	£	£	£	£	£
Incremental Impact on Council Tax (per Band D) per year	(0.61)	(0.02)	4.24	0.34	0.34
Incremental Impact on Rents (per property) per year	1.13	0.00	0.00	0.00	0.00
Ratio of financing costs to net revenue stream					
Non - HRA	(5%)	5%)	(5%)	(2%)	(2%)
HRA	16%	19%	0%	0%	0%

	£'000	£'000	£'000	£'000	£'000
New borrowing requirement	**518**	**73**	**0**	**0**	**0**
Capital Financing Requirement as at 31 March	**10,638**	**10,290**	**172**	**172**	**172**
Annual change in Capital Financing Requirement.					

TABLE 2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
	Actual	**Probable outturn**	**Estimate**	**Estimate**	**Estimate**
Authorised limit for external debt -Borrowing (includes overdraft to cover risk of interrupted cashflows)	**£'000** 10,883	**£'000** 3,700	**£'000** 3,800	**£'000** 3,900	**£'000** 4,000
Other long term liabilities	80	73	66	59	52
TOTAL	10,963	3,773	4,066	4,059	4,052
Operational boundary for external debt					
Borrowing	10,502	10,200	100	100	100
Other long term liabilities	80	73	66	59	52
TOTAL	10,582	10,273	166	159	152
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	10,502	14,000	14,000	14,000	14,000
Upper limit for variable rate exposure					
Net principal re variable rate borrowing/investments	13,750	20,000	20,000	20,000	20,000
Upper limit for total principal sums invested for over 364 days	2,000	2,000	2,000	2,000	2,000

Maturity structure of new fixed rate borrowing during 2007/08	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

5 CURRENT PORTFOLIO POSITION

The Council's treasury portfolio position at 31 December 2007 comprised:-

	Balance £M	Average Rate %
Fixed Rate Loans - PWLB Principal	-	-
Variable Rate Loans	-	-
Investments	13.874	6.18

6 BORROWING REQUIREMENT

	2006/07	2007/08	2008/09	2009/10	2010/11
	£'000 Actual	**£'000 Probable**	**£'000 Estimate**	**£'000 Estimate**	**£'000 Estimate**
New borrowing	519	-	-	-	-
Alternative financing arrangements	-	-	-	-	-
Replacement borrowing	-	-	-	-	-
TOTAL	519	-	-	-	-

6.1 The new borrowing is internal prudential borrowing. The Authority became debt free in October 2007 and it is not anticipated that any future borrowing will be required.

Prospects For Interest Rates

6.2 The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view:-

	2008				2009				2010				2011	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Base Rate (%)	5.50	5.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
5yr PWLB rate (%)	4.80	4.70	4.65	4.55	4.55	4.60	4.70	4.75	4.80	4.80	4.80	4.85	4.85	4.85
10yr PWLB Rate (%)	4.80	4.70	4.60	4.55	4.55	4.55	4.55	4.60	4.70	4.75	4.75	4.80	4.80	4.80
25yr PWLB Rate (%)	4.65	4.60	4.55	4.55	4.50	4.55	4.55	4.60	4.65	4.70	4.70	4.70	4.70	4.75

50yr PWLB rate (%)	4.55	4.50	4.45	4.45	4.45	4.45	4.45	4.50	4.50	4.55	4.55	4.55	4.55	4.60

6.3 Sector’s current interest rate view is that following the downward trend to 5.5% in December 2007, there will be further cuts to 5% in Q2, where it will remain for the following 2 years.

Borrowing Strategy

6.4 The Sector forecast for PWLB is shown in the table above and summarised below:-

- The 50 year PWLB rate is expected to fall marginally from 4.50% in Q1 2008 to 4.45% in Q2 2008 before rising back again to 4.50% in Q3 2009 and to 4.55% in Q1 2010 and to 4.6% in Q1 2011.
- The 25 year PWLB rate is expected to fall from progressively from 4.65% to reach 4.50% in Q4 2008 and to then be on the rise from Q1 2009 to reach 4.70% in Q1 2010 and 4.75% in Q1 2011.
- The 10 year PWLB rate will fall from 4.70% in Q1 2008 to 4.55% in Q3 2008 and to then gradually rise from Q3 2009 to reach 4.80% in Q3 2010.
- The 5 year PWLB rate is expected to fall from 4.70% in Q1 2008 to reach 4.55% in Q3 2008 and to then gradually rise starting in Q1 2009 to reach 4.85% in Q3 2010.

6.5 This forecast indicates, therefore, that the borrowing strategy for 2008/09 should be set to take 25-30 year borrowings towards the end of the financial year but in as much as little variation is expected in average quarterly rates, this is likely to mean that attractive rates could be available at any time in the year when there is a dip down in rates. Variable rate borrowing and borrowing in the five-year area are expected to be more expensive than long-term borrowing and will therefore be unattractive throughout the financial year compared to taking long-term borrowing.

6.6 For authorities wishing to minimise their debt interest costs, the main strategy is therefore as follows:-

- Focus on undertaking new borrowing in or near the 25 – 30 year period.

- When the 25-30 year PWLB rates fall back to the central forecast rate of about 4.60%, borrowing should be made in this area of the market at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4.60%. However, if shorter period loans become available around this rate, these will also be considered.

6.7 Against this background caution will be adopted with the 2008/09 treasury operations. The Capital Programme is financed currently by the use of capital receipts. The Head of Finance, Audit and Performance Management will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, including moving financing to prudential borrowing, reporting any decisions to Council at the next available opportunity.

7 ANNUAL INVESTMENT STRATEGY

Investment Policy

7.1 The Council will have regard to ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:-

- the security of capital and
- the liquidity of its investments.

7.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

7.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

7.4 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

<u>Specified Investments</u>:

7.5 Investment instruments identified for use in-house in the financial year remain the same as those agreed last year, and are listed below:-

Debt Management Agency Deposit Facility (Government Managed)	See below for organisation limits
Term deposits – UK government	
Term deposits – other Local Authorities	
Term deposits – banks and building societies	
Money Market Funds	

7.6 In addition, the Council have added non-UK clearing Banks and Building Societies to the list of authorised organisations in order to enable maximum return on investments. As this is a new instrument, the criteria have been kept tight and this will be monitored for potential changes.

7.7 The Council uses Fitch ratings to derive its organisation criteria. Where a organisation does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings are monitored monthly and the Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the organisation/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

7.8 The approved Organisation list is determined by the following minimum criteria:-

ORGANISATION	CRITERIA	MAX AMOUNT	MAX PERIOD
U.K. Clearing Bank & U.K. Building Society	Minimum F1+ short term backed up by AA long-term credit rating and support rating of 1 or 2.	£3M	3 Years
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or {1 short term backed up by AAA or AA- long-term credit rating, individual rating B and support ratings of 1,2 or 3.	£7M	364 Days
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or P1 short term backed up by A long-term credit rating, individual rating B and support ratings of 1, 2 or 3.	£4M	3 Months
U.K. Local Authorities		£7M	364 Days
Other U.K. Financial Institutions & Government Bodies	Minimum F1+ short term backed up by AA+ long-term credit rating and support rating of 1.	£7M	364 Days
Money Market Funds	Minimum AAA long-term credit rating.	£7M	364 Days
Non UK Clearing Bank and Building Society.	Minimum F1 or P1 short term backed up by A long-term credit rating, individual rating B and support ratings of 1, 2 or 3.	£3M	3 Months

Investment Strategy

7.9 The Council does not use a fund manager and the funds managed in-house are a split between those cashflow derived and core balances. Investments will accordingly be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

7.10 Sector is forecasting that the Bank Rate has now started on a downward trend to 5.25% in Q1 2008 and again to 5.00% in Q2 2008. It is then expected to remain unchanged for the next two years.

7.11 The Council will, therefore, seek to lock in longer period investments at higher rates for some element of their investment portfolio which represents their core balances. For 2008/09 the Council has budgeted for an investment return of 5.00%.

7.12 The Council has identified 5.55% as a trigger rate for 1-3 year lending.

The trigger point will be kept under review and discussed with Sector so that investments can be made at the appropriate time.

7.13 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight-3 months) in order to benefit from the compounding of interest.

7.14 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

8 RISK IMPLICATIONS

8.1 It is necessary to outline the risks involved in the investments made by the Council. There is of course always a risk that a building society or bank may fail during the duration of an investment but this is not considered likely where the institution has a minimum credit rating as specified in our Investment Strategy.

8.2 With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. Therefore no investments for more than 1 year will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment.

8.3 The Council may use Money Market Funds from AAA-rated institutions for cash balances. These are funds with the highest credit rating, providing excellent security for the council's money. Surplus balances not invested in pure cash deposits can earn a rate similar to 1 month London Interbank Bid Rate, and funds can be accessed with minimal notice. Returns are not fixed, however, and will rise and fall in line with the market. As a result, these funds will not be used to take a view on the likely future path of interest rates, or as a protection against falling rates. Their natural use is for balances too small to place with banks and building societies, or as an alternative to a bank call account. No investments will be made in Money Market Funds without the advice of our Treasury Consultants.

Resource Risk

8.4 Investment income is a material source of income to the Authority. The amount of income generated is dependent upon interest rates and there is always a risk of falling rates.

Interest Risk

8.5 The main sensitivities of the interest rate forecasts are likely to be the two scenarios below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:-

- *If it were felt that there was a significant risk of a sharp rise in long and short term rates,* perhaps arising from a greater than expected increase in world economic activity, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

- *If it were felt that there was a significant risk of a sharp fall in long and short term rates,* due to e.g. growth rates weakening, then long term borrowings will be postponed.

- If concerns regarding inflation subside, there is a risk that the Bank of England will feel able to make further cuts to the Base Rate.

Operational Risk

8.6 The treasury management function cannot take place without an agreed Treasury Management Strategy in place before the start of the financial year.

Reputation Risk

8.7 The Authority is responsible for managing the investment of public funds and must be seen to be adopting a pragmatic and prudent approach.

Regulatory Risk

8.8 The treasury management function cannot take place without an agreed Treasury Management Strategy in place before the start of the financial year.

9 RESOURCE IMPLICATIONS

9.1 All interest paid and received is accounted for within the General Fund.

10 RECOMMENDATION

10.1 It is proposed that the Council **RESOLVES**

(1) To agree the Treasury Management Strategy Statement and Annual Investment Strategy including the limits contained within the report.

(2) To agree the Authorised Limit and Operational Boundary for external debt as laid down in the report and delegate authority to the Head of Finance, Audit and Performance Management, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities.

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Background Papers:-

CIPFA Prudential Code CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes Local Government Act 2003 ODPM's Guidance on Local Government Investments March 2004

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