

REPORT TO THE EXECUTIVE AND COUNCIL

Report No. 7

Date of Meeting	19 th April 2007 26 th June 2007
Title of Report	Annual Treasury Management & Investment Strategy 2007/08
Portfolio	Leaders Responsibilities
Link to Corporate Priorities	All
Key Decision	Yes
Executive Workplan Ref	A16
Public Report	Yes

Summary of Report

This report sets out the objectives of the Treasury Management & Investment Strategy & policies in force, to enable their achievement.

Officer Recommendations

- 1) That the Executive, note and adopt, the Annual Treasury Management & Investment Strategy.
- 2) The Executive recommend the revision of PI 11 Upper Limit for Total Principal Sums invested for over 364 (per maturity date) to Council for approval [paragraph 4.4]

Other than those implications agreed with the relevant Officers and referred to below, there are no other implications associated with this report.

Financial Implications	Legal Implications	Community & Environmental Implications	Human Resources Implications	Equality & Diversity Implications
Yes	Yes	No	No	No

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1. Introduction

- 1.1 The Local Government Act 2003 & supporting regulations 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. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2. Background

- 2.1 The strategy for 2007/08 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, Sector. The strategy covers:

Section	Issue
3.	Treasury limits in force which will limit the treasury risk and activities of the Council;
4.	Prudential indicators;
5.	The current treasury position;
6.	Prospects for interest rates;
7.	The borrowing strategy;
8.	Debt rescheduling;
9.	The investment strategy;

- 2.2 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 increased 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 2007/08 to 2009/10

- 3.1 It is a statutory duty under Section 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.
- 3.4 The limits were set as part of the Prudential Indicators (PI's) report to Council, January 30 2007.

4. Prudential Indicators 2007-08 to 2009/10

- 4.1 The Council's PI's for 2007-2010 mentioned in 3.4 above, were reported to and agreed by, Council on the 30th January 2007.
- 4.2 It is the opinion of Officers that, following further research, PI 11 should be revised. This PI sets the upper limit for sums invested over one year. Currently no more than one quarter of the Councils total lending can be for more than one year.
- 4.3 Given the state of markets at the time of writing, returns for cash based money market investments are significantly outstripping fund manager's performance. As a result, we are in the process of liquidating investments via our fund managers so that we can concentrate treasury effort on cash investments.
- 4.4 With the range of money market deals on offer at the moment, 25% is considered too low a limit to maximise the Council's potential treasury returns. **Authority is therefore sought to increase this PI to 85% for each of the next three financial years.** This will give officers sufficient flexibility to maximise investment performance. It must be noted that this is a maximum amount only and actual investments may not be made at this level.
- 4.5 All other PI's remain unchanged.

5. Current Treasury Position

- 5.1 A detailed report of 2005/06 Treasury management performance with an update to the end of November 2006 was submitted to the Executive in January 2006. The Council's treasury portfolio position at 21/03/2007 was as follows:

Table 1: Borrowing & Lending Position, March 2007.

	Source	£000's	£000's	Average Rate %
Borrowing				
Fixed Rate	PWLB Market	0 4,000		4.20
	Total		4,000	4.20
Variable Rate	PWLB Market	0 0		
	Total		0	0.00
Other Long Term Liabilities	PFI		9,310	-
Total Debt			13,310	
Investments				
Fund Managers	Invesco & Investec	21,487		-
In-house		10,100		-
Total Investments			31,587	

6. Prospects for Interest Rates

- 6.1 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. Appendix A draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Table 2: Sector interest rate forecast

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010
Bank rate	5.50%	5.50%	5.25%	5.00%	5.00%	5.00%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%
5yr PWLB rate	5.50%	5.25%	5.00%	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
10yr PWLB rate	5.00%	5.00%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
25yr PWLB rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
50yr PWLB rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

6.2 Sector's current interest rate view is that the Bank Rate will peak at 5.50% in quarter 1 2007, then fall to 5.25% in Q3 2007 and then to 5.00% in Q4 2007. It will fall to 4.75% in Q3 2008 and then to 4.50% in Q1 2009 before rising back to 4.75% in Q1 2010.

7. Borrowing Strategy

7.1 The Council agreed as part of its 2007-08 Budget to enter into prudential borrowing to fund its capital expenditure programme over the next three years. The £15.370 million borrowing requirement has been agreed by officers to be sourced as follows:

- £ 4.00 million Lender Option Borrower Option (LOBO) (arranged with Bayerische Landesbank on a 60 year term with a call (interest rate review) every 5 years at a fixed rate for the first 5 years of 4.2%)
- £11.37 million from the PWLB (a 46 year fixed maturity rate loan is to be arranged)

7.2 The Sector forecast for long term Public Works Loan Board (PWLB) borrowing is that 50 year rates are expected to remain flat at 4.25%. As the Sector forecast is in 25bp segments there is obviously scope for the rate to move around the central forecast by +/- 25bp without affecting this overall forecast.

7.3 As we are trying to minimise our debt interest costs and possible early repayment premium, the strategy is to borrow at 4.25% in line with Sectors' advice. Currently, the rate is at 4.35%. If the rate shows no signs of moving towards the 4.25% level, we may borrow at a rate marginally above this level in the next month or so. PWLB rates are being reviewed by officers daily.

7.4 All borrowing decisions taken will be reported to Council.

8. Debt Rescheduling

8.1 The Council has only just moved from its debt free status into borrowing. As such, it is not necessary to re-schedule its debt profile at this time.

8.2 The reasons for any debt rescheduling to take place in future will include the generation of cash savings at minimum risk and to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.3 Debt profiles will be reviewed at least once a year during the budget as a minimum standard. Any future rescheduling will be reported to the Council at the meeting following its action.

9. Annual Investment Strategy

Investment Policy

- 9.1 The Council has set its Investment Policy with regard to the 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").
- 9.2 The Council's investment priorities are:
- (a) the security of capital and,
 - (b) the liquidity of its investments.
- 9.3 The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.
- 9.4 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.

Specified Investments

- 9.5 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable

Sources	Security / Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility*	Government Backed	In-house
Term deposits – UK Government & Local Authorities	High security although LA's not credit rated	In-house
Term deposits – Banks & Building Societies	Short-term F1, Long-term A	In-house & Fund Managers
Callable deposits	Short-term F1+, Long-term AA-	In-house
Certificates of Deposits issued by Banks & Building Societies	Short-term F1+, Long-term A	Fund Managers
Bonds issued by multilateral development banks	Long term AAA	Fund Managers
Money Market Funds	Short-term F1+, Long-term AA-	In-house
UK Government Gilt's	Government Backed	Fund Managers
Bond Funds	AA-	Fund Managers
Gilt Funds	AA-	Fund Managers
Treasury Bills	Government Backed	Fund Managers

* This facility is currently only available for investments up to 6 months

** The Council is free to determine its own criteria and as such the Section 151 Officer has delegated authority to add/delete from the Counterparty list as appropriate.

Non-Specified Investments

- 9.6 A maximum of 80% will be held in aggregate in non-specified investments.

Source	Security / Minimum Credit Criteria	Use	Max % of Total	Max Term
Term deposits – UK Government & Local Authorities	Government Backed although LA's	In-house & Fund Managers	20%	<= 5

	not credit rated			
Callable deposits	Short-term F1+, Long-term AA-	In-house	10%	<= 5
Certificates of deposits issued by Banks & Building Societies	Short-term F1+, Long-term AA-	Fund Managers	10%	<= 5
UK Government Gilts	Long term AAA	Fund Managers	60%*	<=10
Bonds issued by multilateral development banks	Long term AAA	Fund Managers	60%*	<=10
Bonds issued by an institution guaranteed by the UK Government	Long term AAA Government Backed	Fund Managers	60%*	<=10
Sovereign Bond Issues (non UK)	Long term AAA	Fund Managers	60%*	<=10

* 60% for all Gilts/Bonds maturity > 1 year

- 9.7 The Council's external fund managers, whilst they remain in the Councils employ, will comply with the Annual Investment Strategy. The agreement between the Council and the fund managers additionally stipulate guidelines and duration and other limits in order to contain and control risk.
- 9.8 The Council uses Fitch ratings to derive its Counterparty criteria. Where a Counterparty does not have a Fitch rating, the equivalent Moody's (or other rating agency if applicable) rating will be used. All credit ratings will be monitored on a monthly basis. The Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

Investment Strategy

- 9.9 With the move away from our Fund Managers, coupled with new borrowing, in-house funds will peak at c. £43 million before the commencement of the 2007/08 capital programme. The vast majority of these funds are a core balance that could be used for investments between 2-3 years, subject suitable investments and PI 11 restricting up to 85% of total balances (subject to Council approval).
- 9.10 Investments will, accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates i.e. rates for investments up to 12 months.
- 9.11 The following investments have already committed some of the balance into 2007/08 & beyond:

Counterparty	Amount £ millions	Maturity Date	Rate %
Northern Rock (Fixed rate)	3.0	05/11/2007	5.77
Singer & Friedlander (Fixed rate)	2.5	05/11/2007	5.80
Kent Reliance (3 month LIBOR)	2.0	28/01/2008	5.65
National Australia Bank	4.0	07/03/2010	5.99

- 9.12 Interest rate outlook: Sector is forecasting that the Bank base rate will peak at 5.5% in Q1 2007 before falling to 5.25% in Q3 2007, to 5.00% in Q4 2007, to 4.75% in Q3 2008 and then to trough at 4.50% in Q1 2009, remaining at that level before rising again to 4.75% in Q1 2010
- 9.13 The advice suggests we should seek to lock in longer period investments at higher rates before this fall starts to take effect.

9.14 The Council has identified the following trigger points for investments as follows:

<< 5.60% >> for 1-year lending

<< 5.60% >> for 2 year lending

<< 5.60% >> for 3 year lending

<< 5.50% >> for 4 year lending

<< 5.50% >> for 5 year lending

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

9.16 An overall investment return of c 5% of balances has been budgeted in the revenue estimates for 2007/08.

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

10. End of Year Investment Report

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

Appendices:	<ul style="list-style-type: none"> • Annex 1: Interest Rate Forecasts
Background documents Used in the preparation of this Report:	<ul style="list-style-type: none"> • Sector Reports & advice • CIPFA Treasury Management in Public Services Code of Practice & Cross Sectoral Guidance Notes • CIPFA The Prudential Code • Statutory Instrument 2003 No. 3146 - The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 • Local Government Act 2003 • ODPM

Previous Decisions Connected with this Report

Report	Committee & Date	Minute Reference
Annual Report on Treasury Management 2004-05	Executive 13 October 2005	10
Annual Report on Treasury Management 2005-06	Executive 18 January 2007	E140
2007-2010 Prudential Indicators	Council 30 January 2007	C81