REPORT TO:	Executive Board Sub-Committee
DATE:	15th March 2007
REPORTING OFFICER:	Operational Director – Financial Services
SUBJECT:	Treasury Management and Investment Strategy 2007/08
WARD(S):	Borough-wide

1.0 PURPOSE OF REPORT

1.1 To agree a Treasury Management and Investment Strategy for 2007/08.

2.0 RECOMMENDED: That the policies and strategies outlined in the report be accepted.

3.0 SUPPORTING INFORMATION

3.1 This Treasury Strategy Statement details the expected activities of the Treasury function in the forthcoming financial year (2007/08). Its production and submission to the Executive Board Sub-Committee is a requirement of the CIPFA Code of Practice on Treasury Management.

3.2 The Local Government Act 2003 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.

3.3 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.4 The ODPM's guidance notes state that Authorities can combine the Treasury Strategy Statement and Annual Investment Strategy into one report. The Council has adopted this approach and the Annual Investment Strategy is therefore included as paragraph 8.

4.0 POLICY IMPLICATIONS

4.1 The successful delivery of the strategy will assist the Council in meeting its budget commitments.

5.0 OTHER IMPLICATIONS

5.1 None.

6.0 RISK ANALYSIS

6.1 The Authority operates its treasury management activity within the approved code of practice and supporting documents.

6.2 The aim at all times is to operate in an environment where risk is clearly identified and managed.

6.3 This strategy sets out clear objectives within these guidelines.

6.4 Regular monitoring is undertaken during the year and reported on a quarterly basis to the Executive Board Sub-Committee.

7.0 EQUALITY AND DIVERSITY ISSUES

7.1 None.

8.0 REASON(S) FOR DECISION

8.1 The Authority must have an approved annual strategy in place before the year commences.

9.0 ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

9.1 None.

10.0 IMPLEMENTATION DATE

10.1 1st April 2007.

11.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

Document	Place of Inspection	Contact Officer
Working papers	Accountancy Section	J. Viggers

TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2007/08

1.0 INTRODUCTION

1.1 The suggested Treasury Management and Investment Strategy for 2007/08 covers the following aspects of the treasury management function and is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.

- 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.

2.0 TREASURY LIMITS FOR 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 their 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 is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate those planned to be financed by both external 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.

3.0 PRUDENTIAL INDICATORS FOR 2007/08-2009/10

3.1 The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

No.	Prudential Indicator	2007/08	2008/09	2009/10
		£	£	£
	(1) Extract from Budget			
	Affordable Borrowing			
3	Increase in Council Tax B7 (Band D, per annum)	3.42	2.78	0.17
7	Capital Financing Requirement (as at 31 March)	£m	£m	£m
	Non-HRA	54.407	64.181	72.048

No.	Prudential Indicator	2007/08	2008/09	2009/10
		£m	£m	£m
	(2) Treasury Management Prudential Indicators			
9	Authorised Limit for External Debt			
	Borrowing	55.06	65.43	74.93
	Other Long Term Liabilities	0.00	0.00	0.00
	TOTAL	55.06	65.43	74.93
10	Operational Boundary for External Debt			
	Borrowing	50.06	60.43	69.93
	Other Long Term Liabilities	0.00	0.00	0.00
	TOTAL	50.06	60.43	69.93
12	Upper Limit for Fixed Interest Rate Exposure			
	Expressed as			
	Net Principal re Fixed Borrowing/ Investments	37.54	45.32	52.44
		(75%)	(75%)	(75%)
13	Upper Limit for Variable Rate Exposure			
	Expressed as			
	Net Principal re Variable Borrowing/ Investments	37.54	45.32	52.44
	Net Interest re Variable Rate Borrowing/ Investments	(75%)	(75%)	(75%)
14	Maturity Structure of New Fixed Rate Borrowing during 2006/07		Upper	Lower
	Under 12 months		50	0
	12 months and within 24 months		75	0
	24 months and within 5 years		50	0
	5 years and within 10 years		50	0
	10 years and above		75	0

No.	Prudential Indicator	2007/08		2008/09		2009/10	
		£m	%	£m	%	£m	%
15	Upper Limit for Total Principal Sums invested for over						
	Up to 1 year (per maturity date)	39.41	100	31.68	100	21.90	100
	Up to 2 years (per maturity date)	23.64	60	19.01	60	13.14	60
	2 Years+ (per maturity date)	21.90	30	13.14	30	6.57	30

4.0 CURRENT PORTFOLIO POSITION

4.1 The Council's treasury portfolio position at 31st January 2007 comprised:

		Principal		Average Rate
		£m	£m	%
Fixed Rate Funding	PWLB	10.00		3.70
	Market	10.00	20.00	4.42
Variable Rate Funding	PWLB	0.00		-
	Market	0.00	0.00	-
Total Borrowing			20.00	4.06
Other Long Term Liabilities			0.00	
Total Debt			20.00	
Total Investments			30.85	5.03

5.0 BORROWING REQUIREMENT

5.1 The table below summarises the net borrowing requirement for the authority for the next three years based on the current level of supported borrowing indicated by the government for 2006/07.

	2006/07	2007/08	2008/09	2009/10
	£'000	£'000	£'000	£'000
New Borrowing	6,066	7,719	9,774	7,867
Alternative Financing Arrangements	-	-	-	-
Replacement Borrowing*	-	-	-	-
TOTAL	6,066	7,719	9,774	7,867

*5.2 The £10m Lender's Option Borrower's Option (LOBO), currently with Euro Hypo bank is on 6 month options. As such it could fall to be replaced in any of the years.

6.0 PROSPECTS FOR INTEREST RATES

6.1 The Council appointed Sector Treasury Services as a 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 or variable (the base rate or repo rate) and longer fixed interest rates.

6.2 Sector View: Interest rate forecast – January 2007

	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	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.00	5.00	5.00
5 yr Gilt Yield	5.25	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
10 yr 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
25 yr 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
50 yr 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

Sector's current interest rate view is that the Bank Rate will:

- peak at 5.50% in Q1 2007;
- fall to 5.00% in Q4 2007 and then to 4.75% in Q2 2008;
- before rising back to 5.00% in Q3 2009.

The risk to this forecast is to the downside in as much as the cuts in rates could occur earlier than our forecast suggests, although this will not necessarily affect the timing of the first upward move in Q1 2007.

6.3 Economic background

International

- The US, UK and EU economies have all been on the upswing of the economic cycle in 2005 and 2006 and so have been raising interest rates in order to cool their economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices which could feed through into increases in wage inflation, producer prices etc.;

- The US is ahead of the UK and EU in the business cycle and it looks as if the Fed. rate has probably already peaked at 5.25% whereas there is still an expectation in the financial markets of further increases in the EU and UK;

- The major feature of the US economy is a still steepening downturn in the housing market which is likely to drag consumer spending, and so the wider economy, down with it (e.g. house building, employment etc.). Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure;

- The Fed. may be reluctant and tardy to respond to the aforementioned downturn in the economy if inflationary pressures remain stubbornly high. This could exacerbate the downturn both in the US and the world economies;

- EU growth picked up strongly in the first half of 2006 and remained healthy in the second half. Growth to slow moderately in 2007 due to weaker US and global demand;

- Despite sharply increased energy prices, disinflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3% and will fall as the energy effects go into reverse.

United Kingdom

- GDP: the UK is on the upswing of the economic cycle from a low point reached in June 2005. Robust growth is expected to continue for a little longer but a modest cooling is expected in 2007 (2006 2.7%, 2007 2.2%) and to continue at below the trend rate of 2.5% thereafter;

- Recovery in consumer spending and retail sales has underpinned this upswing in GDP;

- The housing market has proved more robust than expected; house price inflation over 8% p.a.;

- Higher than expected immigration from Eastern Europe has strengthened growth and dampened wage inflation;

- The MPC's decision to raise Bank Rate in November 2006 and January 2007 were needed to bring CPI inflation down to the 2% target level two years ahead. The MPC has been concerned that short term price increases (CPI has been significantly above target since June 2006) could feed through into wage settlements in the current pay round and anchor inflation expectations at a higher level;

- Household income growth to recover in 2007 as inflation falls and pay rises. But extra income likely to go into a recovery of the savings rate, pension saving and servicing debt costs (as rates rise) rather than consumer expenditure;

- Public sector real increase in expenditure per annum to weaken to 2.5% over the next few years from 3% average over 2000-2005;

- The three increases in Bank Rate in August and November 2006 and then January 2007, are expected to dampen the housing market and increases in unsecured borrowing although one more increase in Bank Rate is forecast;

- World slowdown in growth in 2007 will dampen UK exports;

- OUTLOOK: Once inflation is back under control, Bank Rate will switch to a falling trend in late 2007 to counter above negative effects on the economy and growth.

7.0 CAPITAL BORROWINGS AND THE BORROWING PORTFOLIO STRATEGY

7.1 The Sector forecast is as follows:

- The 50 year PWLB rate is 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;

- The 25-30 year PWLB rate is expected to stay at 4.50%. for the foreseeable future;

- The 10 year PWLB rate will fall from 5.00% to 4.75.% in Q3 2007 and then fall again to 4.50% in Q1 2008 and remain at that rate for the foreseeable future;

- 5 year PWLB rate will fall from 5.25% to 5.0% in Q3 2007 and continue falling until reaching 4.5% in Q1 2008 when it will remain at that rate for the foreseeable future.

7.2 This forecast indicates, therefore, that the borrowing strategy for 2007/08 should be set to take very long dated borrowing at any time in the financial year. 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.

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

- With 50 year PWLB rate at 4.25%, borrowing should be made in this area of the market at any time in the financial year. This rate will be lower than the forecast rates for shorter maturities in the 5 year and 10 year area. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4.25%.

7.4 Against this background caution will be adopted with the 2007/08 treasury operations. The Operational Director – Financial Services will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Executive Board Sub-Committee at the next available opportunity.

7.5 Sensitivity of the forecast – The main sensitivities of the forecast 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 or further increases in inflation, 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, and potential rescheduling from fixed rate funding into short term funding will be considered.

8.0 ANNUAL INVESTMENT STRATEGY

8.1 Investment Policy

The Council will have 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”). The Council’s investment priorities are:

(a) the security of capital; and

(b) the liquidity of its investments.

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

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.

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 approved lending list.

Specified Investments:

(All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum ‘high’ rating criteria where applicable)

	Minimum ‘High’ Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term Deposits – UK Government	--	In-house
Term Deposits – Other LAs	--	In-house
Term Deposits – Banks and Building Societies	On Approved List	In-house

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

Non-Specified Investments:

A maximum of 30% will be held in aggregate in non-specified investments for 2-3 years and 60% in 1 to 2 years.

	Minimum Credit Criteria	Use	Max % of Total Investments	Max. Maturity Period
Term deposits – UK government (with maturities in excess of 1 year)		In-house	30% 60%	2-3 years 1-2 years
Term deposits – other LAs (with maturities in excess of 1 year)		In-house	30% 50%	2-3 years 1-2 years
Term deposits – banks and building societies (with maturities in excess of 1 year)	On Approved List	In-house	30% 60%	2-3 years 1-2 years

The Council uses Moody's ratings to derive its criteria. Where a counterparty does not have a Moody's rating, the equivalent Fitch rating will be used. All credit ratings will be monitored on a regular basis. The Council is alerted to changes in credit 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.

8.2 Investment Strategy

In-house funds: The Council's in-house managed funds have during the past twelve months been in the value range of £32.5m to £49.1m with a core balance of around £20m which is available for investment over a longer (say) 2-3 year period. 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).

The Council already has investments that span the financial year e.g. longer-dated deposits including callable deposits, which were taken out at various peaks of the last rate cycles as shown below.

	Amount	Maturity	Rate
Chelsea BS	£2,500	22.07.07.	4.63
Stroud & Swindon BS	£2,500	23.07.07.	4.63
Northern Rock BS	£2,500	15.10.07.	5.33
Nationwide BS	£5,000	26.10.07.	5.30
Bristol & West BS	£2,500	05.12.07.	5.35
Nottingham BS	£2,000	21.01.08.	5.87
Chelsea BS	£2,500	22.01.08.	4.75
Newcastle BS	£2,500	05.06.08.	5.00
Northern Rock BS	£2,500	05.06.08.	5.13
Kent Reliance BS	£2,500	18.12.08.	5.53

It is unlikely therefore that further long dated investments will be undertaken until these investments mature.

Interest rate outlook: Sector is forecasting Bank Rate to peak at 5.5% in Q1 2007 before falling to 5.00% in Q4 2007 and then to trough at 4.75% in Q2 2008, remaining at that level before rising again to 5.00% in Q3 2009. Councils should, therefore, seek to lock in longer period investments at higher rates before this fall starts for some element of their investment portfolio which represents their core balances. For 2007/8 clients should budget for an investment return of 5.00%. The 'trigger points' will be kept under review and discussed with Sector so that investments can be made at the appropriate time.

The Council has identified 5.75% as an attractive trigger rate for 1-year lending and 5.65% for *2-3* year lending. The 'trigger points' will be kept under review and discussed with Sector so that investments can be made at the appropriate time.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest.

End of year Investment Report

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

9.0 DEBT RESCHEDULING

9.1 As the first fall in Bank Rate is expected in Q4 2007,there will be a sharp difference between higher shorter term rates and cheaper long term rates in quarters 2 to 4 of 2007. Later on in 2007/08, this advantage will diminish once Bank Rate, and short term rates generally, start falling. There will therefore be opportunity during quarters 2 to 4 of 2007 to restructure shorter term debt into long term in order to optimise the potential savings achievable in the financial year 2007/08. Any positions taken via rescheduling will be in accordance with the strategy position outlined in paragraph 7 above.

9.2 In addition, the Council will actively give consideration during the year to taking advantage of small movements in PWLB rates to reduce the cost of existing debt in the portfolio by reborrowing at lower rates without making significant changes to the type of debt (fixed / variable) or maturity periods.

9.3 The reasons for any rescheduling to take place will include:

- the generation of cash savings at minimum risk;
- help fulfil the strategy outlined in paragraph 7 above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

9.4 CIPFA issued a draft accounting standards document (SORP 2007) on 18 October 2006, and a final draft in November, which includes major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premia and discounts arising from debt rescheduling. There will be a three month consultation period before proposals are finalised. It is also expected that these proposals, once finalised, may make necessary the issue of legislation by the Government to take effect from 1.4.2007 (the DCLG issued draft regulations in November / December 2006). The Authority’s treasury management strategy will be reviewed once the final decisions in this area are known to see whether any changes will be required in borrowing, investment or debt rescheduling strategies.

All rescheduling will be reported to the Executive Board Sub-Committee at the meeting following its action.

APPENDIX A

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 15.1.07.

	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	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.00	5.00	5.00
5 yr Gilt Yield	5.25	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
10 yr 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
25 yr 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
50 yr 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

Capital Economics interest rate forecast – 15.1.07.

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008
Base Rate	5.25%	5.50%	5.50%	5.25%	4.75%	4.50%	4.50%	4.50%
5 yr Gilt Yield	5.35%	5.05%	4.85%	4.65%	4.45%	4.55%	4.65%	4.75%
10 yr PWLB Rate	4.95%	4.75%	4.45%	4.45%	4.55%	4.65%	4.75%	4.85%
25 yr PWLB Rate	4.45%	4.35%	4.25%	4.25%	4.25%	4.35%	4.45%	4.55%
30 yr PWLB Rate	4.25%	4.15%	3.95%	4.05%	4.05%	4.15%	4.25%	4.35%
50 yr PWLB Rate	4.05%	3.95%	3.95%	4.05%	4.05%	4.15%	4.15%	4.25%

UBS Economic interest rate forecast (for quarter ends) - 15.1.07.

	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007
Base Rate	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%
10 yr PWLB Rate	4.85%	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%	4.90%
25 yr PWLB Rate	4.25%	4.25%	4.25%	4.30%	4.35%	4.40%	4.45%	4.55%
50 yr PWLB Rate	4.15%	4.15%	4.25%	4.35%	4.40%	4.45%	4.55%	4.65%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – January 2007 (pre Bank Rate increase 15.1.07) summary of forecasts of 26 City and 14 academic analysts for Q4 2006 and 2007. (2008-2010 are as at November 2006 but are based on 18 forecasts)

	Bank Rate Actual	Quarter Ended		Annual Average Bank Rate		
		Q4 2006	Q4 2007	Average 2008	Average 2009	Average 2010
Indep. Forecasters BoE Base Rate	5.00%	4.96%	4.89%	4.86%	4.88%	4.85%
Highest Base Rate	5.00%	5.00%	6.00%	5.90%	5.60%	6.10%
Lowest Base Rate	5.00%	4.50%	4.00%	3.75%	4.00%	4.00%