REPORT TO:	Executive Board Sub Committee
DATE:	9 September 2009
REPORTING OFFICER:	Operational Director – Financial Services
SUBJECT:	Treasury Management 2008/09
WARD(S):	Borough-wide

1.0 PURPOSE OF REPORT

1.1 To review treasury management during 2008/09 in accordance with the Council's Treasury Management Policy Statement.

2.0 RECOMMENDED: That the report be noted.

3.0 SUPPORTING INFORMATION

3.1 The annual review is attached in the Appendix. The 2008/9 year was the most volatile in living memory. The failure of the Icelandic banking system and the writing down of toxic debt led to the failure of other banks some of whom were household names and previously deemed too large to fail. This resulted in a severe credit crunch in the financial sector and many organisations stopped lending to each other. A concerted effort by the G7 governments to avoid a collapse of the banking system and a severe and prolonged recession saw massive sums pumped into the system by the way of guarantees against toxic debt and a coordinated cut in interest rate across the world.

4.0 POLICY IMPLICATIONS

4.1 The failure and credit downgrading of so many financial institutions resulted in some investments not being repaid. This in turn led to an interim code being issued by CIPFA to highlight best practice. Halton undertook an interim review of it's counterparty list in January to reflect the downgadings.

5.0 OTHER IMPLICATIONS

5.1 The Treasury Management function has consistently contributed to the budget and helped fund local services. In 2008/9 it generated £0.8m additional investment income by investing in longer investments before the interest rates fell in October. These investments will provide some degree of cover into the early part of 2009/10. However, as they unwind the ability to find suitable counterparties offering a good rate of return is limited and the level of income will drop dramatically in the latter part of the year. The rates are not forecast to pick up for some time so the full impact of the falling rates will be felt in 2010/11.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 **Children and Young People in Halton**

None.

6.2 **Employment, Learning and Skills in Halton**

None.

6.3 **A Healthy Halton**

None.

6.4 **A Safer Halton**

None.

6.5 **Halton's Urban Renewal**

None.

7.0 RISK ANALYSIS

7.1 The main risks associated with Treasury Management are security of investment and volatility of return. To combat this, the Authority operates within a clearly defined Treasury Management Policy and an annual borrowing and investment strategy which sets out the control framework.

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 There are no issues under this heading.

9.0 REASON(S) FOR DECISION

9.1 Requirement of the Treasury Management function.

10.0 ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

10.1 None.

11.0 IMPLEMENTATION DATE

11.1 Not applicable.

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

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

APPENDIX

TREASURY MANAGEMENT – ANNUAL REVIEW 2008/09

1.0 INTRODUCTION AND BACKGROUND

1.1 Treasury management in local government is regulated by the 1996 CIPFA Code of Practice on Treasury Management in Local Authorities (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Operational Director – Financial Services' responsibilities, and delegation and reporting arrangements. (A revision of the Code was published in December 2001 which was adopted in March 2002 for the 2002/03 year onwards.) A further revision is expected in the autumn of 2009.

1.2 A requirement of the Council's Treasury Policy Statement is the reporting to the Executive Board Sub-Committee of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council's treasury management activities in that year (this annual treasury report). Treasury management in this context is defined as:

"The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

1.3 This annual report covers:

- the Council's current treasury position;
- performance measurement;
- the borrowing strategy for 2008/09 (Appendix A & B);
- the borrowing outturn for 2008/09;
- compliance with treasury limits;
- investments strategy for 2008/09 (Appendix C);
- investments outturn for 2008/09;
- debt rescheduling;
- other issues.

2.0 CURRENT PORTFOLIO POSITION

2.1 The Council's debt position at the beginning and end of year was as follows:

	31st March 2009				31st March 2008		
	Principal £m	£m	Rate %	Life Yrs	Principal	Rate %	Life Yrs
Fixed Rate Funding							
– PWLB	10.00		3.70	48	10.00	3.70	49
– Market	10.00	20.00	4.42	0-58	10.00	4.42	0-58
Variable Rate Funding							
– PWLB	10.00				0.00	0.00	
– Market	10.70	20.70	1.78		6.00	5.48	
Total Debt		**40.70**	**2.90**		**26.000**	**4.38**	
Investments							
– In-house	39.00		6.17		41.00	5.93	
– With Managers	0.00				0.00		
Total Investments		**39.00**	**6.17**		**41.00**	**5.93**	

3.0 PERFORMANCE MEASUREMENT

3.1 One of the key changes in the revision of the Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 2). CIPFA has however issued draft indicators, although accompanied by a cautionary note. In effect these represent a potential range of statistics which will not give a definitive set of indicators, but will rather aid comparison with neighbouring authorities treasury structures.

The use of benchmarks for investments may be inappropriate for those Local Authorities with small cash balances as they may only be able to put money out for short periods and often at weaker rates.

4.0 THE PROSPECT FOR INTEREST RATES FOR 2008/09

Section 4.0 is reproduced from the Treasury Management Strategy approved by the Executive Board Sub-Committee on 20th March 2008.

See Appendix A

5.0 CAPITAL BORROWINGS AND THE BORROWING PORTFOLIO STRATEGY

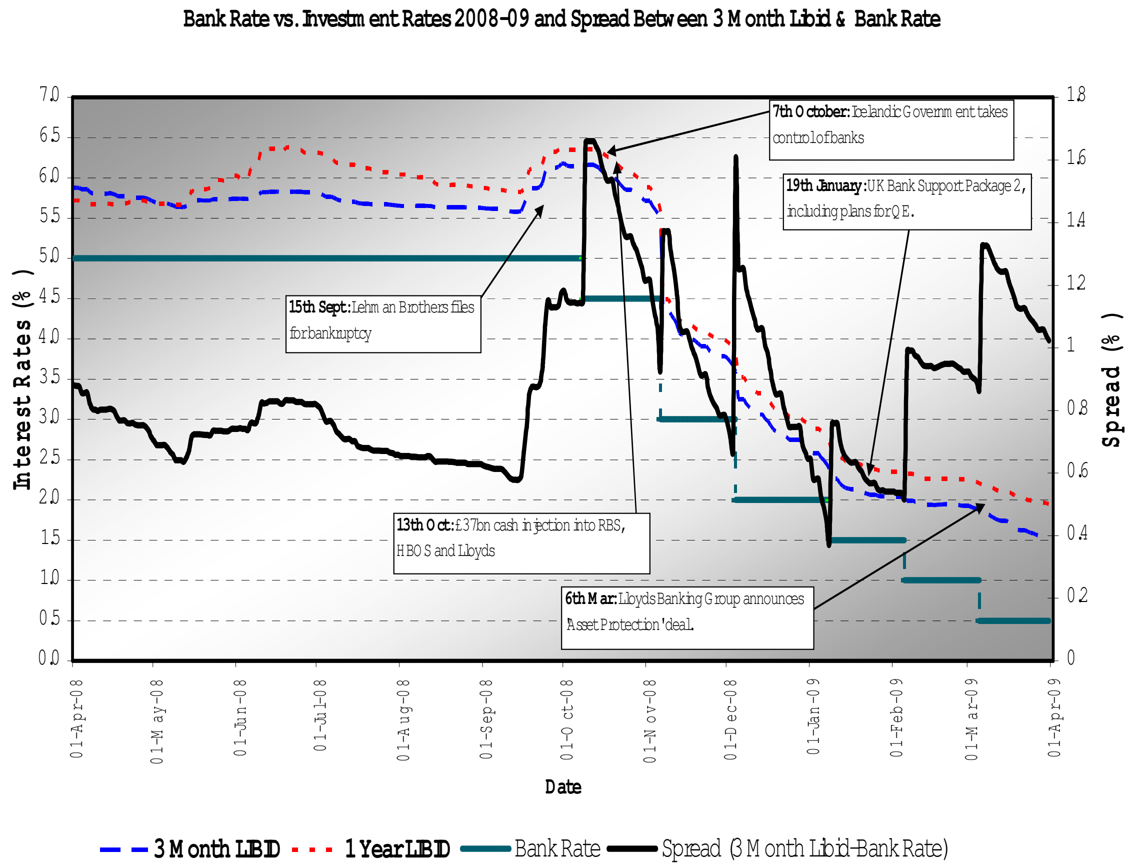
Section 5.0 is reproduced from the Treasury Management Strategy approved by the Executive Board Sub-Committee on 20th March 2008.

See Appendix B

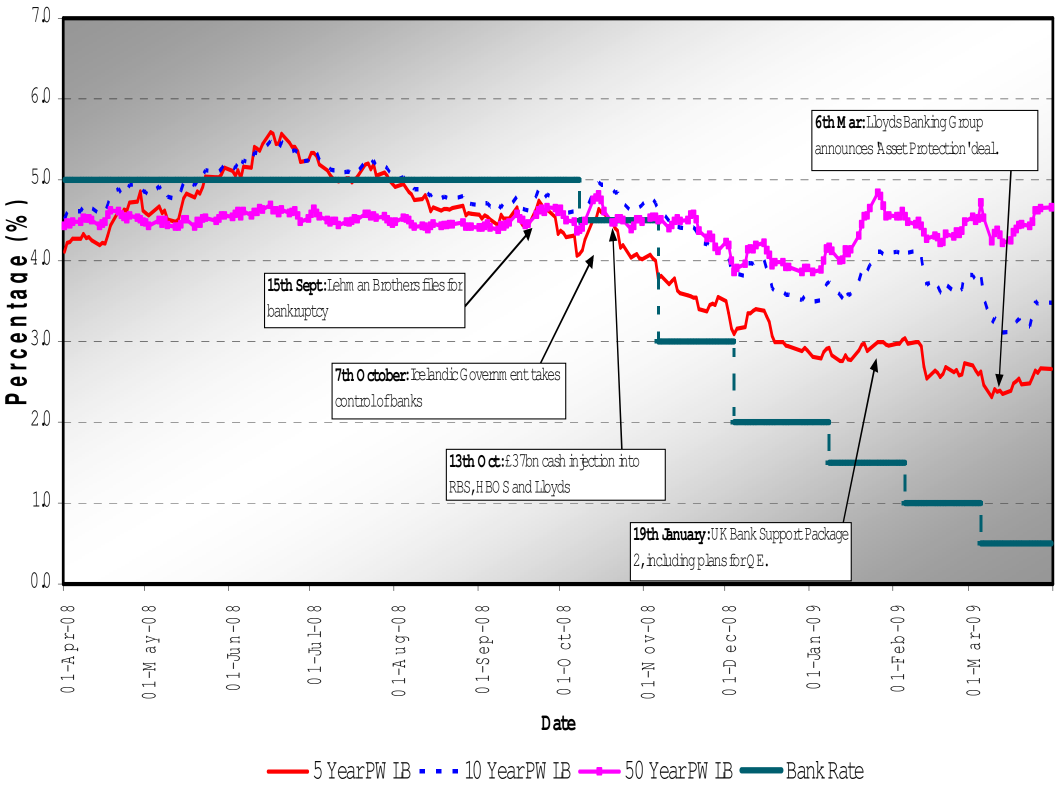
6.0 OUTTURN FOR 2008/09

6.1 The Economy and Interest Rates

In a year that can only be described as unparalleled and extraordinary the Annual Treasury Report for 2008/09 is summarised in the graphs below. These graphs show the major events of the financial year and the impact they had on both PWLB and investment rates. The financial crisis, commonly known as the 'credit crunch', had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England.



PWLB Borrowing Rates vs. Bank Rate 2008-09



On 1st April 2008 Bank Rate was 5% and the Bank of England was focused on fighting inflation. Market fears were that rates were going to be raised as CPI, the Government's preferred inflation target, was well above the 2% target (two years ahead). The money market yield curve reflected these concerns with one year deposits trading well above the 6% level. PWLB rates in both 5 and 10 years edged above Bank Rate during the summer as markets maintained the belief that inflation was the major concern of the monetary authorities. The money markets were reflecting some concerns about liquidity at this time and, as shown in the graph, the spread between Bank Rate and 3 month LIBOR was greater than had historically been the case.

This phase continued throughout the summer until the 15th September when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. As can be seen from the charts this also led to an immediate spike up in investment rates as markets grappled with the implications this might have on other financial institutions, their credit standing and indeed their viability. On 7th October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping a massive £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. The Monetary Policy Committee meantime had reduced interest rates by 50bp on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out. On the other hand the short end of the PWLB fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower.

Market focus now shifted from inflation concerns to concerns about recession, depression and deflation. Although CPI was still well above target it was seen as no barrier to interest rates being cut further. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities across the curve, at the front end because of credit concerns and the longer end because of the economic consequences reducing inflation, driving yields in 10 year PWLB temporarily below 4% and 5 years to around 3.5%. In December as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates to 2%-a drop this time of 1%. The whole interbank yield curve shifted downwards but the 'disconnect' at the short end remained very wide, negating to some degree the impact of the cuts in Bank Rate. 50 year PWLB rates dropped below 4% at the turn of the year, marking the low point, as it turned out, in this maturity.

The New Year of 2009 brought little relief to the prevailing sense of crisis and on 8th January the MPC reduced rates by 0.5% to 1.5%, a record low. More Government support for the banking sector was announced on 19th January 2009. The debt markets had a sharp sell-off at this stage as they took fright at the amount of gilt issuance likely to be needed to finance the help provided to the banks. There was also discussion about further measures that could be introduced to kick start lending and economic activity. These included quantitative easing by the Bank of England, effectively printing money.

In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Interbank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The MPC cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. This scheme would focus on buying up to £75bn of gilts in the 5-25 year maturity periods and £10 -15bn of corporate bonds. This led to a substantial rally in the gilt market, particularly in the 5 and 10 year parts of the curve, and PWLB rates fell accordingly. Finally at the end of March it was announced that the Dunfermline Building Society had run into difficulties and its depositors and good mortgages were taken over by Nationwide whilst the Treasury took on its doubtful loans.

The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place. Investment income returns have been badly hit but lower borrowing rates in short to medium periods had allowed indebted local authorities to benefit.

7.0 BORROWING AND INVESTMENT RATES IN 2008/09

12-month bid rates: One year LIBID fluctuated between around 5.7% to 6.4% with two peaks driven by credit crunch fears in June and September. Bank Rate had been held at 5.0% until October 9 when the first of a series of major cuts caused 12 month LIBID in 2008-09 to be on a rapidly falling trend to the end of the financial year, reaching 1.85% at the end.

5 (and 10 year) gilt yields: ***(this paragraph will be relevant to those authorities with externally managed investments).*** These yields have been very volatile during the year. In April, they started at around 4.1% (4.4%) and peaked at around 5.5% (5.2%) during June before edging down again to around 4.4% (4.5%) in mid September. After Lehman's then collapsed, yields were on a generally falling trend although volatility was again pronounced with a mini peak in late January around 2.9% (3.0%) before finishing the year at around 2.3% (2.4%).

Longer-term interest rates – The PWLB 45-50 year rate started the year at 4.43% (25 year at 4.62%) and was then generally within a band of 4.3 - 4.6% (4.6% - 5.0%) until mid October when there was a spike up to 4.84% (5.08%) followed by a plunge down to 3.86% (4.03% late December) in early December. Further spikes of 4.84% (4.86%) and 4.72% (4.69%) occurred in late January and early February with the year closing out at 4.58% (4.28%). It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year.

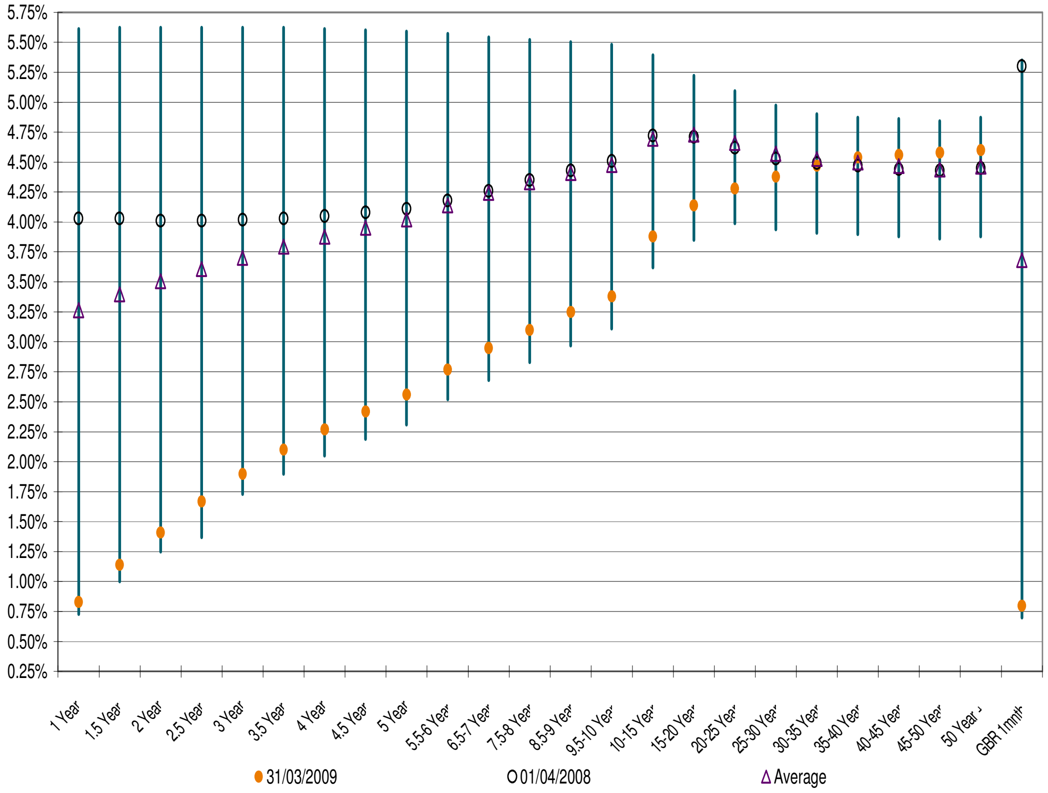
8.0 BORROWING OUTTURN 2008/09

As comparative performance indicators, average PWLB maturity loan interest rates for 2008/09 were:

1 year	3.264%
9.5 - 10 year	4.477%
24.5 - 25 year	4.570%
49.5 - 50 year	4.438%
1 month GBR variable	3.682%

The graph below shows the range (high and low points) in rates for each maturity period during the year, and individual rates at the start and end of the financial year:

PWLB rates 2008/09



8.1 Debt Performance

As highlighted in section 2.1, above the average debt portfolio interest rate has moved over the course of the year from 4.38% to 2.90% (although the long term core rate stayed the same at 4.06%). The strategy for the year was to fund borrowing from surplus cash unless rates were particularly attractive when the Council would draw longer term fixed rate debt.

8.2 There was no new long term borrowing transactions in the year. The possibility of undertaking new long term borrowing was looked at several times during the year. However, with falling interest rates and the difficulty of finding a secure home for the cash pending it's use it was decided to defer any borrowing. This decision minimised the council's exposure to capital loss and interest rate movements in the short term. It is hoped that long term rates will not move up too quickly and that any new borrowing can be undertaken in the near future at competitive rates.

9.0 COMPLIANCE WITH TREASURY LIMITS

8. During the financial year the Council operated within the treasury limits set out in the Council's Treasury Policy Statement and Treasury Strategy Statement.

10.0 TEMPORARY INVESTMENTS STRATEGY

Section 9.0 is reproduced from the Treasury Management Strategy approved by the Executive Board Sub-Committee on 20th March 2008.

See Appendix C

11.0 INVESTMENTS OUTTURN FOR 2008/09

11.1 Internally Managed Investments – The authority manages its investments in-house and invests within the institutions listed in the authority's approved lending list. The authority invests for a range of periods from overnight to 3 years, dependent on the authority's cash flows counterparty limits and the interest rates on offer.

11.2 Investment Outturn – Detailed below is the result of the investment strategy undertaken by the Council.

	Average Investment Level	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return*
Internally Managed	£46.783m	5.98%	5.98%	3.69%

*The benchmark for internally managed funds is the average 7-day LIBID rate (uncompounded) sourced from the Financial Times. The benchmark for externally managed funds is the 7 day LIBID rate, averaged for the week, and compounded weekly.

NB: The 3 month LIBID benchmark rate was 4.49%.

11.3 No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

12.0 DEBT RESCHEDULING

12.1 The post housing stock transfer debt situation has left the council in a unique situation. It has a low level of external debt at £20m, £10m of which is locked into an excellent rate of 3.70% for a long period. It is unlikely that this debt would be rescheduled as it provides a cornerstone of the debt portfolio for future years.

13.0 OTHER ISSUES

13.1 Counterparty Limits

Due to the high level of uncertainty in the money markets during the year, the authority was particularly careful in monitoring the suitability of the organisations on its approved investment counterparty list. A supplementary report was presented to members in January to update them on how the various credit rating downgradings had affected the authorities ability to invest cash. With the protection of capital as the most important parameter the authorities limits have been refined to reduce exposure wherever possible albeit at the loss of potential extra income. Although the investment return for 2008/9 was very good, the declining rate of return on investments will be felt more in 2009/10 as various fixed rate deals unwind. The authority has never had the Icelandic Banks on its counterparty list and was therefore unaffected by their default in October 2008.

Appendix A

4.0 PROSPECTS FOR INTEREST RATES

4.1 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.

4.2 Sector View: Interest rate forecast – 1st February 2008

	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	Q4 2010	Q1 2011	Q2 2011
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Bank Rate	5.25	5.00	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00
5 yr Gilt Yield	4.55	4.55	4.50	4.50	4.55	4.65	4.70	4.75	4.80	4.85	4.85	4.85	4.85	4.85
10 yr PWLB Rate	4.60	4.55	4.50	4.55	4.55	4.55	4.65	4.70	4.75	4.80	4.85	4.85	4.85	4.80
25 yr PWLB Rate	4.55	4.50	4.50	4.50	4.50	4.55	4.60	4.65	4.70	4.70	4.75	4.75	4.75	4.75
50 yr PWLB Rate	4.50	4.45	4.45	4.45	4.45	4.50	4.55	4.60	4.60	4.65	4.65	4.65	4.65	4.60

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

- started on a downward trend from 5.75% to 5.50% in December 2007
- to be followed by further cuts in Q1 2008 to 5.25%, to 5.00% in Q2 2008 and to 4.75% in Q3 2008
- then unchanged until an increase in Q4 2009 to 5.0%
- unchanged then for the rest of the forecast period
- there is downside risk to this forecast if inflation concerns subside and therefore opens the way for the MPC to be able to make further cuts in the Bank Rate

4.3 Economic background

International

- The US, UK and EU economies have all been on the upswing of the economic cycle during 2005 and 2006 and so interest rates were successively raised in order to cool their economies and to counter the build up of inflationary pressures.
- The US is ahead of both the UK and EU in the business cycle and started on the downswing of the economic cycle during

2007. The Fed. rate peaked at 5.25% and was first cut in September by 0.5% to 4.75%. This was a response to the rapidly deteriorating prospects for the economy in the face of the downturn in the housing market, the sub prime mortgage crisis and the ensuing liquidity crisis which started in August 2007 and has subsequently resulted in banks making some major write offs of losses on debt instruments containing sub prime mortgages. Banks have also tightened their lending criteria which has hit hard those consumers with poor credit standing.

- The Fed cut its rate again, to 4.5% in October 2007 and to 4.25% in December. A steep plunge in equity markets around the world in January precipitated by widespread concerns as to recession in the US, the financial viability of bond insurers in the US as a result of the sub-prime crisis and the unwinding of huge unauthorised positions taken by a rogue trader at the French bank SocGen, triggered an emergency between meetings cut of 0.75% by the Fed followed by another cut of 0.50% at its regular meeting a few days later on 30 January.

- More cuts may be required to try to further stimulate the economy and to ameliorate the extent of the expected downturn. However, the speed and extent of these cuts may be inhibited by inflationary pressures arising from oil prices, the falling dollar increasing the costs of imports, etc. The US could be heading into stagflation in 2008 – a combination of inflation and a static economy (but the economy could even tip into recession if the housing downturn becomes severe enough).

- The major feature of the US economy is a steepening downturn in the housing market which is being undermined by an excess stock of unsold houses stoked by defaulting sub prime borrowers pushed into forced sales. 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. Petrol prices have trebled since 2003 and, with similar increases in the price of home heating oil, this will also depress consumer spending with knock on effects on house building, employment etc.

- The downturn in economic growth in the US in 2008 will depress world growth, (especially in the western economies), which will also suffer directly under the impact of high oil prices. However strong growth in China and India will partially counteract some of this negative pressure.

- EU growth has been strong during 2006 and 2007 but will be caught by the general downturn in world growth in 2008.

United Kingdom

- GDP: growth has been strong during 2007 and hit 3.3% year on year in Q3. Growth is expected to cool from 3.0% in 2007 as a whole to 2.0% in 2008.

- Higher than expected immigration from Eastern Europe has underpinned strong growth and dampened wage inflation.

- House prices started on the downswing in Q3 2007 and this is expected to continue into 2008.

- The combination of increases in Bank Rate and hence mortgage rates, short term mortgage fixes expiring and being renewed at higher rates, food prices rising at their fastest rate since 1993 and increases in petrol prices, have all put consumer spending power under major pressure.

- Banks have also tightened their lending criteria since the sub prime crisis started and that will also dampen consumer expenditure via credit cards and on buying houses through obtaining mortgages.

- Government expenditure will be held under a tight reign for the next few years, undermining one of the main props of strong growth during this decade.

The MPC is very concerned at the build up of inflationary pressures, especially the rise in the oil price to reach $90 – 100 per barrel from time to time (was $30 in 2003) and the consequent likely knock on effects on general prices. The prices of UK manufactured goods have risen at the fastest rate in 16 years in December 2007 – 5.0%. Food prices have also risen at their fastest rate for fourteen years (7.4% annual increase) driven by strong demand from China and India. Consequently, the MPC is going to be much more cautious about cutting rates compared to the Fed in the face of these very visible inflationary pressures. In addition, UK growth was still strong in Q4 (despite expectations of a significant cooling off). The downward trend in Bank Rate is now expected to be faster than at first thought after the initial cut in December 2007 to 5.50% in view of the MPC minutes which showed a unanimous MPC vote for a cut and the consideration given to a half per cent cut. This demonstrated how concerned the MPC is at the potential impact of the credit crunch on the economies of the western world. However, the MPC's room for cutting rates is currently limited by concerns over inflationary pressures. If those pressures subside, then there is further downward risk to the Sector forecast which currently only allows for 0.25% cuts to reach 4.75% in Q3 2008.

Appendix B

5.0 CAPITAL BORROWINGS AND THE BORROWING PORTFOLIO STRATEGY

5.1 The Sector forecast is as follows:

(These forecasts are based around an expectation that there will normally be variations of +/- 25bp during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur if should there be any unexpected shocks to financial and/or political systems.) These forecasts are for the PWLB new borrowing rate: -

- 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 Q2 2009 to eventually reach 4.65% in Q2 2010.

- The 25 year PWLB rate is expected to fall from 4.55% to 4.50% in Q2 2008 and then to rise in gradual steps from Q2 2009 to reach 4.75% in Q3 2010.

- The 10 year PWLB rate is expected to fall from 4.60% in Q1 2008 to 4.55% in Q2 and to 4.50% in Q3 2008 and to then gradually rise from Q1 2009 to reach 4.85% in Q3 2010.

- The 5 year PWLB rate is expected to fall from 4.55% in Q2 2008 to 4.50% in Q3 2008 and to then gradually rise starting in Q1 2009 to reach 4.85% in Q2 2010.

This forecast indicates, therefore, that the borrowing strategy for 2008/09 should be set to take 25 – 30 year borrowing 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.

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 so as to minimise the spread between the PWLB new borrowing and early repayment rates as there is little, or no difference in the new borrowing rate between rates in these periods and the 50 year rate. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.

- This strategy also means that after some years of focusing on borrowing at or near the 50 year period, local authorities will be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.

- 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. This rate is likely to 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 4.60%. However, if shorter period loans become available around this rate, these will also be considered.

- The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.

- Consideration will also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate.

5.4 Against this background caution will be adopted with the 2008/09 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.

5.5 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.

Appendix C

9.0 ANNUAL INVESTMENT STRATEGY

9.1 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 v non specified investments

There has been an increasing number of innovative investment products being marketed over the past few years. The have arisen due to the relatively low interest rate environment which has prevailed during this period. The initial guidance from the ODPM focused on high security and more particularly credit risk. This approach however does not deal with market risk, which is the sudden adverse movement in interest rates. In some products this could lead to a significant diminution of the maturity value below that of the original sum invested.

Because of this it has been suggested that if any investment other than a straight cash deposit is envisaged the following tests are applied ;-

1. the working of the product is fully understood;

2. the degree of risk exposure the product carries is identified;

3. the level of risk fits within the parameters set by the authority;

4. the product complies with the CIPFA Code of Practice on Treasury Management (prime focus on security and best value applied to optimise returns).

The Council has in the main used straightforward cash deposits, with both fixed and variable rates, but always with options to repay if the counterparty wanted to change the terms and agreement couldn't be reached. The issue therefore still boils down to credit risk and this is handled through the counterparty weighted rankings and prudential indicators which limit the amount that can be placed with non rated organisations at any one time.

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 (i.e. credit rated counterparties).

	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. This group is to include non credit rated organisations.

	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.

9.2 Investment Strategy

In-house funds: The Council's in-house managed funds have during the past twelve months (January to December) been in the value range of £27.30m to £51.35m with a core balance of around £20m which is available for investment over a longer (say) 2-3 year period. The current balance is £55.25m. 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 (%)
Derbyshire BS	2,500	25/04/2008	5.57
West Bromwich BS	2,500	30/04/2008	6.31
Cumberland BS	1,000	15/05/2008	6.36
Bank of Ireland Plc	2,500	23/05/2008	6.09
Newcastle BS	2,500	05/06/2008	5.00
Northern Rock	2,500	05/06/2008	5.13
Northern Rock	2,500	30/06/2008	5.96
Norwich & Peterborough BS	2,500	02/07/2008	6.25
Nottingham BS	2,500	25/07/2008	5.55
Coventry BS	2,500	14/08/2008	5.95
Derbyshire BS	2,500	30/09/2008	6.23
Stroud & Swindon BS	2,500	17/11/2008	6.15
Kent Reliance BS	2,500	18/12/2008	5.53
Coventry BS	2,500	23/01/2009	6.46
Progressive BS	2,500	26/02/2009	5.95
Cheshire BS	2,500	02/11/2009	6.15
Northern Rock	2,500	23/07/2010	6.41

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

The interest rate outlook is particularly relevant to the performance of the Council's investment portfolio. Appendix 'A' shows quite clearly that all economic forecasters are predicting further rate cuts in the next financial year. The timing and severity of the cuts may be different but the trend is the same. It is difficult to argue against this message as the pressure of a recession in the USA will impact on Europe and our own economy will come under pressure. The Council has already placed as much of it's current portfolio into fixed rate, fixed period deals as it feels it can do within it's current risk spread policy and will adopt a policy of running down it's investments as they mature during 2008/9 whilst waiting for the opportune time to borrow to fund it's long term capital projects. This policy should minimise the impact of falling investment rates.

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.

Appendix D

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.

Sector interest rate forecast – 1 February 2008

	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	Q/E4 2010	Q/E1 2011	Q/E2 2011
Bank Rate	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.55%	4.55%	4.50%	4.50%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.85%	4.85%
10yr PWLB rate	4.60%	4.55%	4.50%	4.50%	4.55%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.80%
25yr PWLB rate	4.55%	4.50%	4.50%	4.50%	4.50%	4.55%	4.60%	4.65%	4.70%	4.70%	4.75%	4.75%	4.75%	4.75%
50yr PWLB rate	4.50%	4.45%	4.45%	4.45%	4.45%	4.50%	4.55%	4.60%	4.60%	4.65%	4.65%	4.65%	4.65%	4.60%

Capital Economics interest rate forecast – 12 December 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
Bank rate	5.50%	5.25%	5.00%	4.75%	4.50%	4.25%	4.00%	4.00%	4.00%
5yr PWLB rate	4.65%	4.45%	4.35%	4.05%	3.95%	4.05%	4.25%	4.35%	4.75%
10yr PWLB rate	4.65%	4.45%	4.25%	4.15%	4.15%	4.25%	4.45%	4.65%	4.85%
25yr PWLB rate	4.65%	4.55%	4.45%	4.45%	4.35%	4.45%	4.55%	4.75%	4.95%
50yr PWLB rate	4.55%	4.55%	4.45%	4.35%	4.25%	4.35%	4.55%	4.65%	4.75%

UBS interest rate forecast (for quarter ends) – 25 January 2008

	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
Bank Rate	5.25%	5.00%	4.75%	4.25%	4.25%	4.25%	4.25%	4.25%
10yr PWLB rate	4.65%	4.60%	4.55%	4.55%	4.55%	4.55%	4.65%	4.75%
25yr PWLB rate	4.50%	4.50%	4.50%	4.45%	4.45%	4.45%	4.55%	4.65%
50yr PWLB rate	4.43%	4.40%	4.45%	4.45%	4.50%	4.55%	4.65%	4.75%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – January 2008 summary of forecasts of 24 City and 13 academic analysts for Q4 2007 and 2008. (2009 – 2011 are based on 21 forecasts)

BANK RATE FORECASTS		quarter ended		annual average Bank Rate		
	actual	Q4 2007	Q4 2008	ave. 2009	ave. 2010	ave. 2011
Median	5.50%	5.50%	4.88%	5.20%	5.24%	5.27%
Highest	5.50%	5.75%	6.25%	6.25%	6.25%	6.25%
Lowest	5.50%	5.00%	4.25%	4.80%	4.50%	4.50%

Appendix E

INTEREST RATE MOVEMENTS DURING 2008/9

	MPC	Market	PWLB New Loan Maturity Rates			
Date	Base Rate	7 Day Libid	1 Year	10 Year	25 Year	50 Year
	%	%	%	%	%	%
April 7, 2008	5.25	5.33	4.14	4.61	4.67	4.48
April 14, 2008	5.00	5.14	4.08	4.58	4.64	4.43
April 21, 2008	5.00	5.09	4.51	4.89	4.86	4.61
April 28, 2008	5.00	5.07	4.67	4.95	4.84	4.53
May 5, 2008	5.00	5.04	4.60	4.92	4.82	4.50
May 12, 2008	5.00	5.03	4.49	4.77	4.74	4.42
May 19, 2008	5.00	5.02	4.85	4.93	4.79	4.42
May 26, 2008	5.00	5.02	5.07	5.10	4.87	4.49
June 2, 2008	5.00	5.02	5.14	5.16	4.91	4.54
June 9, 2008	5.00	5.02	5.17	5.19	4.93	4.56
June 16, 2008	5.00	5.01	5.61	5.48	5.09	4.69
June 23, 2008	5.00	5.02	5.46	5.37	5.00	4.59
June 30, 2008	5.00	5.02	5.19	5.20	4.94	4.56
July 7, 2008	5.00	5.01	5.01	5.13	4.89	4.47
July 14, 2008	5.00	5.01	5.03	5.10	4.88	4.48
July 21, 2008	5.00	5.01	5.23	5.23	4.99	4.58
July 28, 2008	5.00	5.01	5.12	5.18	4.93	4.55
August 4, 2008	5.00	5.01	5.06	5.03	4.87	4.53
August 11, 2008	5.00	5.00	4.95	4.88	4.75	4.43
August 18, 2008	5.00	5.00	4.82	4.77	4.73	4.43
August 25, 2008	5.00	5.02	4.90	4.80	4.75	4.47
September 1, 2008	5.00	5.00	4.78	4.69	4.67	4.41
September 8, 2008	5.00	5.00	4.60	4.60	4.60	4.38
September 15, 2008	5.00	5.01	4.47	4.62	4.64	4.46
September 22, 2008	5.00	5.02	4.30	4.80	4.76	4.57
September 29, 2008	5.00	5.04	4.22	4.76	4.80	4.65
October 6, 2008	5.00	5.05	3.99	4.61	4.62	4.48
October 13, 2008	4.50	5.07	3.46	4.84	4.99	4.75
October 20, 2008	4.50	5.07	3.51	4.89	4.86	4.47
October 27, 2008	4.50	5.05	3.13	4.61	4.69	4.39
November 3, 2008	4.50	5.02	2.96	4.79	4.89	4.53
November 10, 2008	3.00	4.98	2.51	4.49	4.86	4.44
November 17, 2008	3.00	4.91	2.11	4.39	4.79	4.50
November 24, 2008	3.00	4.88	1.92	4.20	4.57	4.28
December 1, 2008	3.00	4.82	1.98	4.12	4.52	4.23
December 8, 2008	2.00	4.82	1.64	3.81	4.23	3.96
December 15, 2008	2.00	4.66	1.53	4.01	4.46	4.22
December 22, 2008	2.00	4.56	1.14	3.62	4.16	3.98

December 29, 2008	2.00	4.50	1.04	3.51	4.03	3.86
January 5, 2009	2.00	4.46	1.00	3.51	4.06	3.89
January 12, 2009	1.50	4.39	1.00	3.58	4.14	4.00
January 19, 2009	1.50	4.32	1.08	3.74	4.39	4.31
January 26, 2009	1.50	4.25	0.92	4.11	4.86	4.84
February 2, 2009	1.50	4.19	1.03	4.11	4.65	4.55
February 9, 2009	1.00	4.12	1.17	4.12	4.56	4.45
February 16, 2009	1.00	4.05	0.86	3.77	4.38	4.31
February 23, 2009	1.00	3.99	1.03	3.62	4.38	4.30
March 2, 2009	1.00	3.88	0.93	3.82	4.60	4.54
March 9, 2009	0.50	3.83	0.85	3.22	4.07	4.24
March 16, 2009	0.50	3.77	0.99	3.12	4.00	4.25
March 23, 2009	0.50	3.73	0.91	3.19	4.11	4.43
March 30, 2009	0.50	3.71	0.83	3.38	4.28	4.58
Maximum	5.25	5.33	5.61	5.48	5.09	4.69
Minimum	0.50	3.71	0.83	3.12	4.00	3.86
Spread	4.75	1.62	4.78	2.36	1.09	0.83
Average	3.60	4.75	3.25	4.46	4.64	4.42

Appendix F

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

No.	Prudential Indicator	2008/09 Estimate £	2008/09 Actual £
	(1) Extract from Budget		
7	Capital Financing Requirement (as at 31 March)	£m	£m
	Non-HRA	70.30	62.883

No.	Prudential Indicator	2008/09 Estimate £m	2008/09 Actual £m
	(2) Treasury Management Prudential Indicators		
10	Authorised Limit for External Debt		
	Borrowing	58.10	40.70
	Other Long Term Liabilities	0.00	0.00
	TOTAL	58.10	40.70
11	Operational Boundary for External Debt		
	Borrowing	53.10	40.70
	Other Long Term Liabilities	0.00	0.00
	TOTAL	53.10	40.70
12	Upper Limit for Fixed Interest Rate Exposure		
	Expressed as		
	Net Principal re Fixed Borrowing/ Investments	39.82 (75%)	20.00 (50%)
13	Upper Limit for Variable Rate Exposure		
	Expressed as		
	Net Principal re Variable Borrowing/ Investments	39.82	20.70
	Net Interest re Variable Rate Borrowing/ Investments	(75%)	(51%)
14	Maturity Structure of New Fixed Rate Borrowing during 2008/09	Upper	Upper
	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%
	None taken in 2008/09		

No.	Prudential Indicator		
		%	%
15	Upper Limit for Total Principal Sums invested for over		
	Up to 1 year (per maturity date)	100	78
	Up to 2 years (per maturity date)	60	22
	2 Years+ (per maturity date)	30	5

No.	Prudential Indicator
16	Maturity Structure of New Fixed Rate Borrowing in Previous year
	None taken in 2007/08