



## **ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2008/09**

### **Treasury Management Strategy 2008/09 – 2010/11**

1. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy which require approval.
2. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management, and as a result adopted a Treasury Management Policy Statement on 21 August 2003. This adoption meets the requirements of the first of the treasury prudential indicators.
3. The policy require an annual strategy to be reported to Cabinet outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year.
4. This strategy covers:
  - The Council's debt and investment projections;
  - The expected movement in interest rates;
  - The Council's borrowing and investment strategies;
  - Treasury performance indicators;
  - Specific limits on treasury activities;

### Debt and Investment Projections 2008/09 – 2010/11

5. The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances.

External Debt	2007/08 Revised £m	2008/09 Estimated £m	2009/10 Estimated £m	2010/11 Estimated £m
Debt at 1 April	22.6	30.6	30.6	34.6
Expected change in debt	8.0	0	4.0	0
Debt at 31 March	30.6	30.6	34.6	34.6
Operational Boundary	31.6	35.6	35.6	35.6
<b>Investments</b>				
Total Investments at 31 March	15.0	10.0	9.0	8.0
Investment change	4.1	(5.0)	(1.0)	(1.0)

6. The related impact of the above movements on the revenue budget are:

Revenue Budgets	2007/08 Revised £m	2008/09 Estimated £m	2009/10 Estimated £m	2010/11 Estimated £m
Interest on Borrowing	2.028	2.331	2.210	1.811
Related HRA Charge	1.408	1.454	1.477	1.290
Net General Fund Borrowing Cost	0.620	0.877	0.738	0.521
Investment income	0.850	0.720	0.700	0.713

### Expected Movement in Interest Rates

#### Medium-Term Rate Forecasts (averages)

	Bank Rate	1-year LIBOR	5-year Gilt	20-yr Gilt	50-yr Gilt
2006/07	4.8	5.3	4.9	4.4	4.0
2007/08	5.6	6.0	5.3	4.9	4.5
2008/09	4.8	4.7	4.7	4.8	4.6
2009/10	4.8	4.8	4.8	4.7	4.6
2010/11	5.0	5.3	4.9	4.8	4.8
2011/12	5.2	5.5	5.3	5.2	5.1

7. **Short Term Interest Rates** - While the December cut in Bank Rate ultimately came as no great surprise to the financial markets it did reflect the Monetary Policy Committee's growing unease about the state of the domestic economy.
8. The November Inflation Report highlighted the threat of a comparatively steep decline in economic activity in 2008. However, until then there had been few decisive signals that this process had commenced in earnest. More recently,

the economic data has been transmitting an increasing amount of evidence that this may indeed be the case.

9. The cooling in the housing market has been noted for some time although it is only in the past few months that the two key indicators on this front (the Nationwide & Halifax Indices) have moved down in unison. The deciding factors behind the MPC's decision were probably the November Chartered Institute of Purchasing and Supply (CIPS) surveys of the manufacturing and service sectors.
10. Both these indicators pointed towards a marked deceleration in activity on a broad front and may well have been interpreted by the more optimistic economists as a sure sign that the effects of the credit squeeze is beginning to spread beyond the confines of the financial markets.
11. The squeeze on credit represents a sharp and involuntary tightening of domestic monetary policy. The fact that it is likely to take some time to evaporate suggests that consumers' expenditure (which has still to see the full effects of the adjustment of discounted, fixed-rate mortgages) will eventually respond through a marked contraction.

This, along with an easing of capacity constraints as the economy slows down, is expected to reduce inflation pressures and ensure Consumer Price Index (CPI) growth reverts to the 2% central target rate over the medium term.

Nevertheless, the Bank of England does note that the upside risks to inflation remain. Many of the current pressures are externally generated (oil, food, commodity prices etc) and will not respond to UK interest rate policy.

Hopes rest upon the anticipated deceleration in international activity reversing at least some of these trends. In the mean time, the MPC is hoping that domestic inflation expectations do not deteriorate and that weakening household consumption prevents companies passing cost increases on to the retail level. The outcome of this "central case" scenario will not be known for some time.

12. **Longer Term Interest Rates** – Bond markets (which underpin the Council's borrowing rates) will remain aware of the risks policy makers are taking with inflation for the sake of engineering a gradual and moderate dip in economic activity. Concerns about the health of the financial sector will persist for some time and these will maintain the downward bias to bond yields in the near term.

However, investors may be unsettled by the risks central banks are taking with long-term inflation control in their attempts to shore up faltering activity. Worries about inflation prospects in the medium to long term are expected drive yields higher through 2008/09 and beyond.

### **Borrowing Strategy 2008/09 – 2010/11**

13. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.
14. Long-term fixed interest rates are expected to be higher over the medium term. The Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. Interest rates are now considered to be favourable and a sum of £4m is planned to be borrowed during 2008/09 for cash flow purposes.

15. The Section 151 Officer and treasury consultants will monitor prevailing interest to consider debt restructuring, but the penalties that would be incurred for early repayment of debt currently are currently too severe to make this a viable option.
16. A key change in the options for borrowing and rescheduling occurred on 1 November 2007 when the PWLB changed its interest rate structure to a more sensitive pricing method and also increased the relative cost of repaying debt. This will prompt a more cautionary approach to both borrowing and rescheduling.

### **Investment Counterparty and Liquidity Framework**

17. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
  - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
18. The Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counterparties the Council will choose rather than defining what its investments are.

**Banks** – the Council will use banks which have at least the following Fitch ratings (or equivalent):

<b>Investment Type</b>	<b>Fitch Rating (or equivalent)</b>
Short Term	F1
Long Term	A
Individual / Financial Strength	C (Fitch / Moody's only)
Support	3 (Fitch only)
Bank Subsidiary and Treasury Operations	the Council will use these where the parent bank has the necessary ratings outlined above.
Building Societies	the Council will use all Societies that meet the ratings for banks outlined above.

19. The time limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	<b>Fitch</b>	<b>Moody</b>	<b>Standard &amp; Poor</b>	<b>Money Limit</b>	<b>Time Limit</b>
Upper Limit	F1+	P1	A1+	£4m	364 days
Middle Limit	F1	P1	A1	£3m	6 mths

20. The proposed criteria for Specified and Non-Specified investments are shown on the final 2 pages of this annex, for approval.
21. In the normal course of the Council's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short term investments.
22. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator below.

### **Investment Strategy 2008/09 – 2010/11**

23. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and its advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise, subject to over riding credit counterparty security. The Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

### **Treasury Management Prudential Indicators and Limits on Activity**

24. There are four further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:
  - **Upper limits on variable interest rate exposure** – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments
  - **Upper limits on fixed interest rate exposure** – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
  - **Maturity structures of borrowing** – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
  - **Total principal funds invested for greater than 364 days** – These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

25. The Council is asked to approve the following prudential indicators:

	<b>2008/09</b> £m	<b>2009/10</b> £m	<b>2010/11</b> £m
<b>Interest rate Exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
<b>Maturity Structure of fixed interest rate borrowing 2008/09</b>			
		<b>Lower</b>	<b>Upper</b>
Under 12 months		0%	20%
12 months to 2 years		0%	25%
2 years to 5 years		0%	80%
5 years to 10 years		0%	90%
10 years and above		0%	95%
<b>Maximum principal sums invested &gt; 364 days</b>			
Principal sums invested > 364 days	£2m	£2m	£2m

### Performance Indicators

26. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

The results of these indicators will be reported in the Treasury Annual Report for 2007/08.

## **Treasury Management Practice (TMP) 1 (5) – Credit and Counterparty Risk**

### **Management**

*(The comprehensive set of TMPs were approved at Cabinet Feb 2007. The list is not reproduced in this report as annual approval is not required).*

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12<sup>th</sup> March 2004, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code will apply its principles to all investment activity. In accordance with the Code, the Section 151 Officer has produced its treasury management practices. This part, TMP 1(5), covering investment counterparty policy requires approval each year.

**Annual Investment Strategy** - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for decision making on investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

This strategy is to be approved by full Council.

The investment policy proposed for the Council is:

**Strategy Guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

**Specified Investments** – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:

1. An investment scheme that has been awarded a high credit rating by a credit rating agency
2. A body that has been awarded a high credit rating by a credit rating agency

For category 1 this covers a money market fund rated by Standard and Poor's, Moody's or Fitch rating agencies.

For category 2 this covers bodies with a minimum rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

**Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	<b>Non Specified Investment Category</b>	<b>Limit</b>
a.	<b>Building societies not meeting the basic security requirements under the specified investments.</b> The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such Building Societies which have a minimum asset size of £500m, but will restrict these type of investments to <i>six months</i> .	5% of gross investments
b.	Any <b>bank or building society</b> that has a minimum long-term credit rating of AA, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	10% of gross investments
c.	Any <b>non-rated subsidiary</b> of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to guarantee from the parent company and the maximum period of investment will be restricted to three months.	15% of gross investments

**The Monitoring of Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its advisers, Butlers, on a daily basis and as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the

criteria will be removed from the list immediately by the Section 151 Officer, and if required new counterparties which meet the criteria will be added to the list.

### **Use of External Fund Managers**

The Council do not currently use external fund managers. However, consideration will be given to their use where gains could reasonably be expected.