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**MEETING:** RESOURCE AND PERFORMANCE SCRUTINY PANEL  
THE EXECUTIVE  
COUNCIL

**DATE:** 14 February 2006  
15 February 2006  
22 February 2006

**SUBJECT:** TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL  
INDICATORS 2006/07

**REPORT FROM:** Executive Member for Quality Council (Resource &  
Performance)

**CONTACT OFFICER:** M Owen – Director of Finance and E-Government

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**TYPE OF DECISION:** Council

**REPORT STATUS:** FOR PUBLICATION

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**PURPOSE/SUMMARY:**

The report sets out the suggested Strategy for 2006/07 in respect of the following aspects of the Treasury Management function. It is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The Strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators
- the current treasury position;
- the borrowing requirement
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy;

The primary objective of the Council's treasury management function will continue to be the minimisation of financing costs whilst ensuring the stability of the authority's long term financial position by borrowing at the lowest rates of interest and by investing surplus cash to earn maximum interest, all at an acceptable level of risk.

The previous Strategy, of running down investments in lieu of borrowing will no longer be viable after March 2006 and it will be necessary to resume borrowing to fund capital expenditure.

The authority's view of interest rates is that it expects short-term rates to fall slightly during 2006 and then rise in 2007 and that long-term rates will remain steady until the last quarter of 2006 at which time they will begin to increase and continue to increase in 2007.

The overall strategy for 2006/07 will to take advantage of historically low rated long term external debt for capital financing purposes at around 4% and invest at rates which are expected also to be around 4% in accordance with cashflow needs.

This will mean locking in long-term borrowing during the first 9 months of 2006 before rates rise whilst at the same time locking in any investments before base rates begin to fall and timing the maturity of the investments so that it is linked to the time at which we expect base rates to be rising.

#### **OPTIONS AND RECOMMENDED OPTION:**

It is RECOMMENDED that the Executive approves, for onward submission to Council, the:

- Prudential Indicators forecast for 3 years
- Treasury Management Strategy 2006/07
- Scheme of Delegation and Responsibility attached at Appendix B

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#### **IMPLICATIONS -**

##### **Financial Implications and Risk Considerations**

See Statement by Director of Finance & E-Government

##### **Corporate Aims/Policy Framework:**

Do the proposals accord with the Policy Framework?      Yes

Are there any legal implications?      No

**Considered by Monitoring Officer:**      Yes

##### **Statement by Director of Finance and E-Government:**

Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy adopted is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.

##### **Staffing/ICT/Property:**

There are no direct staffing, ICT or property implications arising from this report

##### **Wards Affected:**

All Wards/Area Boards will be affected by the schemes within the approved Capital Programme.

##### **Scrutiny Interest:**

Resource and Performance Scrutiny Panel

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<b>Chief Executive/ Management Board</b>	<b>Executive Member/ Chair</b>	<b>Ward Members</b>	<b>Partners</b>
Chief Executive	Leader Executive Member		
<b>Scrutiny Panel</b>	<b>Executive</b>	<b>Committee</b>	<b>Council</b>

## 1.0 BACKGROUND

- 1.1 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.
- 1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (included at paragraph 9); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.3 The suggested strategy for 2006/07 in respect of the following aspects of the treasury management function is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:
- treasury limits in force which will limit the treasury risk and activities of the Council;
  - Prudential Indicators
  - the current treasury position;
  - the borrowing requirement
  - prospects for interest rates;
  - the borrowing strategy;
  - debt rescheduling;
  - the investment strategy;

## 2.0 TREASURY LIMITS FOR 2006/07 TO 2008/09

- 2.1 It is a statutory duty under s3 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.
- 2.2 The Council must have regard to the Prudential Code when setting the 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 and council rent levels is 'acceptable'.
- 2.3 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 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 2006/07 – 2008/09

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

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09	
<b>(1). AFFORDABILITY PRUDENTIAL INDICATORS</b>	<b>probable</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>	
	<b>outturn</b>				
<b>Capital Expenditure</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
Non - HRA	37,469	29,744	24,227	13,311	
HRA (applies only to housing authorities)	7,902	11,270	12,670	12,680	
<b>TOTAL</b>	<b>45,371</b>	<b>41,014</b>	<b>36,897</b>	<b>25,991</b>	<b>1</b>
<b>Capital Financing Requirement</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
Non - HRA	107,691	113,226	116,843	117,957	
HRA (applies only to housing authorities)	16,062	22,582	30,502	38,432	
<b>TOTAL</b>	<b>123,753</b>	<b>135,808</b>	<b>147,345</b>	<b>156,389</b>	<b>2</b>
<b>Affordable Borrowing Limit</b>					
Estimate of incremental impact of capital investment decisions	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>	
Increase in council tax (band D, per annum)	£15.10	£14.72	£8.33	£1.32	3
Increase in housing rent per week	£0.00	£0.00	£0.00	£0.00	4
<b>Ratio of financing costs to net revenue stream</b>					
Non - HRA	2.99%	3.58%	3.66%	3.65%	5
HRA (applies only to housing authorities)	2.86%	3.58%	5.02%	6.61%	5
<b>Net External Borrowing only to support the CFR in Medium Term</b>		<b>£'000</b>			
Net External borrowing over medium term		115,540			
Total CFR over Medium Term		156,389			
Net External Borrowing < Total CFR		<u>TRUE</u>			6

PRUDENTIAL INDICATOR	2005/06	2006/07	2007/08	2008/09	
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	<b>probable</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>	
	<b>outturn</b>				
<b>Authorised limit for external debt - borrowing</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
other long term liabilities	165,400	199,300	210,600	219,600	
<b>TOTAL</b>	<b>175,400</b>	<b>209,000</b>	<b>220,000</b>	<b>229,000</b>	<b>7</b>
<b>Operational boundary for external debt - borrowing</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
other long term liabilities	112,200	124,400	133,700	146,800	
<b>TOTAL</b>	<b>122,200</b>	<b>134,100</b>	<b>143,100</b>	<b>156,200</b>	<b>7</b>
<b>Upper limit for fixed interest rate exposure</b>					
Net principal re fixed rate borrowing / investments	110%	132%	140%	140%	8

<b>Upper limit for variable rate exposure</b> Net principal re variable rate borrowing / investments	-10%	-32%	-40%	-40%	8
<b>Upper limit for total principal sums invested for over 364 days</b> (per maturity date)	<b>£'000</b> 10,000	<b>£'000</b> 10,000	<b>£'000</b> 10,000	<b>£'000</b> 10,000	9

<b>Maturity structure of new fixed rate borrowing during 2005/06</b>	upper limit	lower limit
under 12 months	10%	0%
12 months and within 24 months	35%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	90%	30%

3.2 In addition to the tabled prudential indicators, the Council is also required to formally adopt the CIPFA Code of Practice on Treasury Management. This is also in accordance with the Council's Standing Orders (56h) and it was last adopted on 23 February 2005 by the full Council. It is recommended that the Council re-affirms its adoption of the Code for the coming year.

Notes to the indicators:

1. Capital expenditure is derived from the Capital Programme forecast. Capital expenditure decreases over the 3 year forecast as further external funding is to be identified.
2. Capital Financing Requirement relates to all capital expenditure – i.e. it includes relevant capital expenditure incurred in previous years. The Capital financing requirement reflects the authority's underlying need to borrow.
3. The finance costs related to the increases in capital expenditure impact Council tax. The costs over the three year forecast fall as the estimated capital expenditure in the third year is lower therefore finance costs fall as loan interest falls and investment balances increase. The incremental impact of capital investment decisions on Council tax is explained in further detail in the body of the report, paragraph 8 - Capital Borrowing Requirement.
4. There is no direct impact of capital expenditure on housing rents as the housing rent is set according to Government formula.
5. The General Fund finance costs to net revenue streams remains stable throughout the 3 year forecast. The finance costs in the HRA increase due to the impact of the increased Capital programme in Six Town Housing.
6. To ensure that borrowing is only for a capital purpose and therefore show that the authority is being prudent this indicator compares the level of borrowing and capital financing requirement (CFR) over the medium term. The level of borrowing will always be below the CFR.
7. The authorised limit and operational boundary are consistent with the authority's plans for capital expenditure and financing. The authorised limit is the maximum amount that the authority can borrow. There is headroom within this limit to borrow the following 3 years capital financing requirement.

8. The variable and fixed limits together look at the whole portfolio and will therefore together always show 100% exposure. Variable interest rate limit can be positive or negative as investments under 364 days are classed as variable and are credit balances which are offset against debit variable loans. The smaller the balance of investments, the more likely the variable limit will be positive as the variable loan debit balance will be higher than the credit investment balance offset against it.
9. Principal sums invested for periods longer than 364 days has been set at £10 million. The investment balance is estimated to be cash flow driven, however if the opportunity arises that surplus investment balances are available then advantage will be taken of favourable rates.

#### 4.0 CURRENT PORTFOLIO POSITION

- 4.1 Treasury Management is a very dynamic area of the Council's financial management and involves forecasting trends in the market and matching these to the Council's overall financial objectives, both short-term and long-term. To assist Members in agreeing a strategy for 2006/07 the Council's current treasury portfolio position is detailed below:

		31-Mar-05		Forecast 31-Mar-06		Avg. Rate
		Principal		Principal		
		£000	£000	£000	£000	
Fixed	PWLB Bury	39,309		42,309		
	PWLB Airport	9,597		9,089		
	Market Bury	29,000	77,906	34,000	85,398	
Variable	PWLB Bury	0		0		
	Market Bury	0	0	0	0	
Other Loans / Bonds		3	3	3	3	
<b>Long Debt</b>			<b>77,909</b>		<b>85,401</b>	<b>6.21%</b>
<b>Total Investments</b>			<b>5,650</b>		<b>4,000</b>	<b>4.65%</b>

- 4.2 During 2005/06 the increase in debt has been kept to a minimum in line with the strategy for 2005/06 to maintain the Council's long term external debt at the lowest level possible, keeping costs to a minimum. This approach in the first instance used surplus funds to support the increase in capital expenditure and then the level of debt was increase.
- 4.3 Interest rates for long term debt have been at an all time historical low. Therefore, early redemption of £20m higher rated market loans have been replaced with lower rated £20 million market loans. This has the effect of reducing the amount of interest paid on the loans portfolio. The overall interest rate of the portfolio has fallen by 0.36%.
- 4.4 Surplus cash for investment has been reduced in accordance with the Strategy for 05/06 and is mainly cash flow driven.
- 4.5 During 06/07, interest rates for borrowing and investments are both expected to be around 4%. Borrowing will be taken in accordance with the capital financing requirement and investments will be mainly cash flow driven.

## 5.0 PROSPECTS FOR INTEREST RATES

5.1 The Council has appointed Sector Treasury Services as its treasury adviser and part of their service is to assist the Council to formulate a view on interest rates.

5.2 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. The following table gives the Sector central view.

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	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
Base rate	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
5yr Gilt Yield	4.00%	4.00%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
10yr PW LB Rate	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	4.75%	4.50%
25yr PW LB Rate	4.25%	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	4.75%	4.50%
50yr PW LB Rate	4.00%	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.50%	4.25%

5.3 Sector's current interest rate view is that the base rate will:

- remain on hold at 4.5% until the end of Q1 2006
- fall to 4% by the end of Q4 2006
- edge up by 0.25% in Q1, Q2 and Q3 of 2007 to end the year at 4.75%

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

### 5.5 Economic background and Interest Rate forecast

#### UK

- § GDP growth weakened from 3.2% in 2004 to 1.7% in 2005 under the impact of monetary and fiscal tightening and the oil price shock depressing household spending. Growth expected to recover weakly to about 2.0% in 2006 and then return to the long term trend rate of 2.5% in 2007.
- § House price inflation has fallen to low levels and may now stabilise
- § Inflation forecast to stay around target despite hike in oil prices. MPC on alert for pipeline cost pressures, primarily from oil price increases, feeding through into output prices and then into retail prices.
- § Public sector deficit to decline steadily over next few years as the Government cuts back on the rate of growth of its expenditure.

#### International

- § Boom in world commodity prices driven by strong growth in China and India; potential for further increases in prices but supply side increases and improvements in technology are likely to reduce prices in the medium term
- § Inability of oil producers to spend their huge cash surpluses and reluctance of Asian economies to run current account deficits will suppress world demand and dampen world growth
- § US – Fed nearing the end of its phase of measured rate raising. Fed rate may now peak at 4.5%.
- § US GDP growth expected to weaken from 4.2% 2004 to 3.5% 2005 and 3.0% 2006

- § ECB had held repo rate at 2.00% since June 2003; increase in December to 2.25% and further increases expected as the economic outlook has improved.
- § Eurozone GDP growth expected to rise weakly and to continue to under perform the UK and US economies.

## **6.0 TREASURY MANAGEMENT STRATEGY**

6.1 The primary objective of the Council's treasury management function is to minimise financing costs ensuring the stability of the authority's long term financial position by borrowing at the lowest rates of interest and by investing surplus cash to earn maximum interest, all at an acceptable level of risk.

6.2 The objective is achieved by a range of policies formulated, implemented, reviewed and monitored by the Director of Finance and E-Government as s151 officer.

6.3 The detailed Treasury Management Objectives recommended to Council for 2006/07 are:

- To successfully identify, assess, monitor and control the elements of risk (financial return and security of lender)
- To maintain a low average interest rate in the top quartile of metropolitan Councils (Bury is currently in the top three with the lowest interest rate)
- To ensure that treasury management supports the achievement of the Council's business and service objectives.
- To anticipate changes in the Council's business that will impact on Treasury Management decisions in the short and long term
- To take advantage of debt rescheduling opportunities
- To maintain an efficient, manageable and cost effective debt profile
- To apply the principles of achieving best value in treasury management, and employ suitable performance techniques, within the context of effective risk management.

6.4 The objectives are not necessarily mutually exclusive and individual Treasury Management decisions will be made taking into account the short term financial needs of the Council while maintaining a longer term debt profile and assessing risks.

6.5 Treasury Management activities will be reported to the Executive at the end of the year. In order to maximise Treasury Management opportunities and achieve the objective during the year, there maybe a need for 'immediate' decisions to be made and the Strategy therefore recommends the continuation of the current policy that Treasury Management decisions are delegated to the Director of Finance and E-Government in consultation with the Executive Member for Quality Council. The Scheme of Delegation is attached at Appendix B

## **7.0 BORROWING STRATEGY**

7.1 The Sector Treasury Management Advisor's forecast is as follows: -

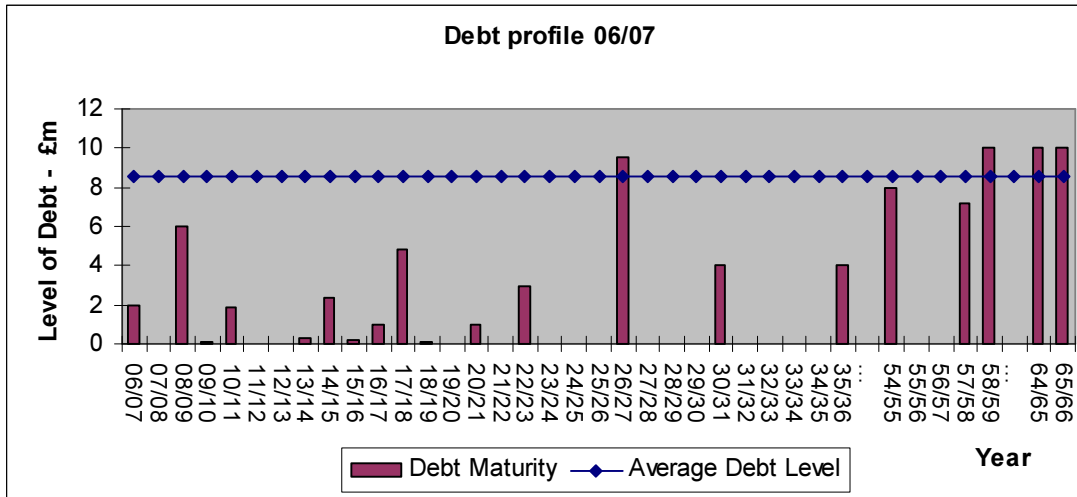
- The new 50 year PWLB rate will remain flat at 4% until Q4 2006 when it will rise to 4.25% with a further increase to 4.5% in Q2 2007. As the Sector forecast is in 25bp segments there is obviously scope for the rate to move away slightly from 4.0% without affecting this overall forecast.
- Similarly the 25-30 year PWLB rate will remain flat at 4.25% until Q4 2006 when it will rise to 4.50% with a further increase to 4.75% in Q2 2007.



- The 10 year PWLB rate will stay at 4.25% in the first two quarters of 2006 but will then rise to reach 4.50% in Q3 2006 and then 4.75% in Q1 2007.
  - 5 year gilt yields will follow base rate down and trough by the end of Q3 2006 at 4.00%. Yields will then rise to 4.25% in Q4 2006, 4.5% in Q1 2007 and to 4.75% in Q2 2007 as the interest rate cycle turns up again.
- 7.2 This forecast indicates that the borrowing strategy for 2006/07 should be set to take long dated borrowings in the second and third quarters of the calendar year before PWLB rates rise. This applies particularly to the 50 year area where we forecast the rate to remain at 4.00% until Q3 2006. Variable rate borrowing and borrowing in the five year area will also be attractive in the second and third quarter of the calendar year while the base rate is on a falling trend.
- 7.3 These interest rate expectations provide the following option:
- with 50 year PWLB rates at 4% borrowing should be made in this area of the market in Q2 and Q3 of the calendar 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 4.0%.
  - Consideration will also be given to borrowing short term fixed and variable borrowing to ensure that a suitable maturity profile is maintained and this should be undertaken in the second and third quarters of the financial year as the base rate declines.
- 7.4 The authority will borrow longer term fixed funding as it is believed that there is a risk that the average variable rate over the budget forecast period is going to be higher than the longer term fixed rate. However, over the longer term there may be periods where short term/variable rates are lower than longer term fixed rates.
- 7.5 Against this background caution will be adopted with the 2006/07 treasury operations. The Director of Finance and E-Government will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Executive at the next available opportunity.

**Sensitivity of the forecast** - The main sensitivities of the forecast are likely to be the two scenarios below. The Council's 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 in 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 remaining low or weakening, then long term borrowings will be postponed, and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.
- 7.6 The debt profile below shows the estimated fall out of debt at 31 March 2006 for 2006/07. All variable rated debt is recorded as being repayable in the short term. Market LOBO (Lenders Option Borrower's Option loans) loans are recorded as maturing on the loan maturity date. This view is based on the uncertainty about whether a lender will actually seek an interest rate change, and whether an authority would accept any change in rate. As there is such ambiguity around the exercising of an option, it is reasonable to assume that the LOBO will run its full term.



- 7.7 The profile shows that on average, the maximum percentage of total debt due to fall out in any one year is around 10%. This enables good control of the debt portfolio, so there is limited concentration of debt maturity in any one year thereby reducing the risk of being dependent on a specific years interest rates.
- 7.8 The strategy for 2006/07 is to take advantage of historically low rated long term external debt for capital financing purposes at around 4% and invest at rates which are expected also to be around 4% in accordance with cashflow needs. Overall costs will be maintained at a minimum.

## 8.0 CAPITAL BORROWING REQUIREMENT

8.1 It is a statutory duty under s3 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. This therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. 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.

8.2 Based on a current forecast for the capital financing requirement plus the known fallout of existing debt, less the minimum revenue provision (MRP), the net borrowing requirement for the next three years is estimated to be as follows.

	<b>2006/07</b>	<b>2007/08</b>	<b>2008/09</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>
New borrowing	14,911	15,519	15,930
Known replacement borrowing	2,270	0	1,000
Less MRP	(3,435)	(3,981)	(4,073)
<b>Total gross borrowing</b>	<b>13,746</b>	<b>11,538</b>	<b>12,857</b>
Non-HRA borrowing	7,227	3,617	4,927
Six Town Housing borrowing	6,520	7,920	7,930

- 8.3 Borrowing for the authority is estimated at £7.3 million and for Six Town Housing (the ALMO) is will be £6.5 million. This increase in the borrowing requirement will increase the finance costs of the authority, and have been included in the draft Revenue Budget.
- 8.4 The overall effect of the finance costs on the General Fund for the next three years is detailed in the Affordable Borrowing Limit prudential indicator. This ultimately shows the effect of the proposed capital investment decision on the council tax compared to a situation with the same level of capital investment as occurred in the previous year. Changes in the capital investment decision affects the movement in new borrowing for capital purposes, resulting in a change in the finance costs which impacts council tax.

	2006/07	2007/08	2008/09
Affordable Borrowing Limit	£	£	£
	estimate	estimate	estimate
Increase in Council tax	£14.72	£8.33	£1.32

- 8.5 The effect of increased finance costs on housing rents is zero as housing rents are determined by a government formula.

## 9.0 DEBT RESCHEDULING

- 9.1 Opportunities may exist for restructuring long term debt into short term variable rate debt to produce savings later in the year, particularly once base rate has fallen to 4.25%. With variable rate borrowing rates likely to fall significantly during 2006/07, it will be best to avoid restructuring into fixed borrowing for short periods (e.g. one year). Long term fixed rates, 25-30 years, are not expected to rise back above 4.75% during 2006 and 2007. Consequently long term, 25-30 years, debt rates at or around 4.75% would warrant reviewing the potential for undertaking debt restructuring. Any positions taken via rescheduling will be in accordance with the strategy position outlined in section 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 re-borrowing 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;
  - in order to help fulfil the strategy outlined in paragraph 7 above; and
  - In order to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 9.4 All rescheduling will be reported to the Executive in the next quarterly monitoring report following any action taken under delegated powers.

## 10.0 ANNUAL INVESTMENT STRATEGY

### 10.1 Investment Policy

- 10.1.1 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.

10.1.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. However, the Council recognises that the borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

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

**Specified Investments:**

All such investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum ‘high’ rating criteria where applicable. The table below details the different investment categories available.

	<b>Minimum ‘High’ Credit Criteria</b>	<b>Use</b>
Debt Management Agency Deposit Facility	N/A	In-house
Term deposits – UK government	N/A	In-house
Term deposits – other LAs	N/A	In-house
Term deposits – banks and building societies	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house
Certificates of deposits issued by banks and building societies	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house after advice from Sector Treasury Services
Money Market Funds	AAA	In-house
UK Government Gilts	AAA	In-house after advice from Sector Treasury Services
Gilt Funds and Bond Funds	Govt-backed	In-house after advice from Sector Treasury Services
Bonds issued by multilateral development banks	AAA	In-house on a ‘buy-and-hold’ basis after advice from Sector Treasury Services
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house on a ‘buy-and-hold’ basis after advice from Sector Treasury Services
Sovereign bond issues (i.e. other	AAA	In-house on a

than the UK govt)		'buy-and-hold' basis after advice from Sector Treasury Services
Treasury Bills	Govt-backed	In-house after advice from Sector Treasury Services

### Non-Specified Investments:

A maximum of 100% can be held in aggregate in non-specified investments during the year. Non-specified investments are surplus funds that are invested for periods greater than one year or surplus funds placed with counterparties in the short term but do not meet the high credit rating described in specified investments.

It is unlikely during 06/07 that investments will be placed for greater than one year however an aggregate 10% limit has been set to give flexibility. The table shows the limits given to the different investment categories:

	<b>*Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Term deposits – UK government (with maturities in excess of 1 year)	N/A	In-house	10%	5 years
Term deposits – other Las (with maturities in excess of 1 year)	N/A	In-house	10%	5 years
Term deposits – banks and building societies (with maturities in excess of 1 year)	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2	In-house	10%	5 years
Term deposits – banks and building societies - with lower ratings than specified investments : any maturity not greater than one year	Short-term F1, Long-term A, Individual B/C, Support 1,2,3	In-house	100%	Not greater than 1 year
Certificates of deposits issued by banks and building societies with maturities in excess of 1 year	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2	Fund managers	10%	5 years
UK Government Gilts with maturities in excess of 1 year	AAA	Fund Managers	10%	5 years
Bonds issued by multilateral development banks with maturities in excess of 1 year	AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers	10%	5 years
Bonds issued by a financial institution which is guaranteed by the UK	AAA / government guaranteed	In-house on a 'buy-and-hold' basis. Also for	10%	5 years

government with maturities in excess of 1 year		use by fund managers		
Sovereign bond issues (i.e. other than the UK govt) with maturities in excess of 1 year	AAA (or state your criteria if different)	Fund Managers	10%	5 years

- 10.1.4 In addition to listing the Investment Categories that the Council can use overall, it is necessary to determine detailed limits for investment categories that are used on a daily basis for short term investments. This incorporates the high credit criteria detailed for specified investments and also the credit criteria detailed for non-specified investments.
- 10.1.5 The Council uses Fitch ratings to derive its criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's or Standard and Poors rating will be used. All credit ratings will be monitored monthly. 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. If a Counterparty / investment scheme meets the Council's minimum criteria, consideration will be given to its inclusion for investment purpose.
- 10.1.5 Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules. The institutions included on the counterparty list satisfy the selected credit criteria detailed in the "investment category" tables above.
- 10.1.6 Where a counterparty / Investment scheme meets the specified investment criteria money can be invested for longer periods of time – around 364 days and the maximum amount allocated to anyone Counterparty / Investment Scheme is a limit of £7.5 million. For those that meet the lower credit criteria, a short time period is allocated and an amount below the maximum.
- 10.1.7 The report approved by Council on 3 November 2004 details the selected credit criteria and gives an example of the Counterparty 's used for short term investments.

## 10.2 Investment Strategy

- 10.2.1 During 2006/07, it is expected that the borrowing requirement will match the capital expenditure requirement and therefore the Council's funds will be mainly cash-flow driven. However, it is possible that there may be a small balance of around £2-3 million which is a core balance available for longer term investment.
- 10.2.2 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).
- 10.2.3 Sector Treasury Management advisers are forecasting base rates to be on a falling trend from 4.50% to reach 4.00% in Q4 2006 but to rise again to end Q1 2007 at 4.25%. The Council will 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. Some investments will be aimed to mature during Q1 2007 when the interest rate cycle turns up and the market yield curve should have turned positive. This will enable us to lock into higher yielding investments with the maturing deposits. For 2006/7 it is estimated that the average investment return will be 4.0%.

- 10.2.4 The Council has identified 100 % as an attractive trigger rate for 1-year lending and 10% for 2-3 year lending. This gives the flexibility if the Council's funds are totally cashflow driven that all funds can be invested for 1 year only. The 'trigger points' will be kept under review and discussed with Sector so that investments can be made at the appropriate time.
- 10.2.5 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.
- 10.2.6 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

**COUNCILLOR MIKE CONNOLLY**  
**EXECUTIVE MEMBER FOR QUALITY COUNCIL (RESOURCE AND PERFORMANCE)**

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**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 View interest rate forecast – 13.1.06**

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	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
<b>Base rate</b>	4.50%	4.25%	4.25%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
<b>5yrGilt Yield</b>	4.00%	4.00%	4.00%	4.25%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%
<b>10yrPW IB Rate</b>	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	4.75%	4.50%
<b>25yrPW IB Rate</b>	4.25%	4.25%	4.25%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	4.75%	4.50%
<b>50yrPW IB Rate</b>	4.00%	4.00%	4.00%	4.25%	4.25%	4.50%	4.50%	4.50%	4.75%	4.75%	4.75%	4.75%	4.50%	4.25%

**Capital Economics interest rate forecast - 13.1.06**

	Q /E1 2006	Q /E2 2006	Q /E3 2006	Q /E4 2006	Q /E1 2007	Q /E2 2007	Q /E3 2007	Q /E4 2007
<b>Base Rate</b>	4.25%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
<b>5yr gilt yield</b>	4.10%	4.00%	3.90%	3.80%	4.00%	4.10%	4.30%	4.40%
<b>10 yr PW IB rate</b>	4.25%	4.15%	4.25%	4.35%	4.55%	4.75%	4.85%	4.75%
<b>25 yr PW IB rate</b>	4.25%	4.25%	4.35%	4.45%	4.45%	4.55%	4.65%	4.65%
<b>50 yr PW IB rate</b>	3.95%	3.95%	4.05%	4.15%	4.15%	4.25%	4.35%	4.35%

**UBS Economic interest rate forecast (for quarter ends) – 13.1.06**



	Q/E1 2006	Q/E2 2006	Q/E3 2006	Q/E4 2006	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007
<b>Base Rate</b>	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
<b>10 yr PWLB rate</b>	4.25%	4.35%	4.45%	4.55%	4.60%	4.60%	4.65%	4.65%
<b>25 yr PWLB rate</b>	4.15%	4.45%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%
<b>50 yr PWLB rate</b>	4.05%	4.45%	4.61%	4.74%	4.80%	4.86%	4.91%	4.97%

## **2. SURVEY OF ECONOMIC FORECASTS**

**HM Treasury** – December 2005 summary of forecasts of 26 City and 14 academic analysts for Q4 2005 and 2006. (2007 – 2009 are as at November 2005 but are based on 18 forecasts)

	Repo	Quarter ended		annual average repo rate		
		Q 4 2005	Q 4 2006	ave. 2007	ave. 2008	ave. 2009
<b>Indep. forecasters BoE Base Rate</b>	4.50%	4.49%	4.29%	4.39%	4.54%	4.60%
<b>Highest base rate</b>	4.50%	4.55%	5.00%	5.40%	5.90%	6.20%
<b>Low est base rate</b>	4.50%	4.20%	3.50%	3.75%	3.75%	3.75%

## Appendix B

### DELEGATION AND RESPONSIBILITY

The following personnel are involved on a regular basis in Treasury Management: -

Director of Finance and E-Government (Mike Owen)	Overall supervision of Treasury Management function and cashflow. Regular reviews of Treasury Management Strategy.
Head of Financial Management (Andrew Baldwin)	Deputise for the Director of Finance and E-Government. Direct supervision of Treasury Management function. Assist in reviews of Treasury Management Strategy and monitor performance. Deputise in allocation of short-term business via brokers as required.
Group Accountant (Treasury Management) (Louise Branford-White)	Manage and undertake day to day Treasury Management Activities in accordance with Treasury Policy Statement.
Senior Accountancy Assistant Chris Peel	Deputise for Group Accountant in her duties as required.
Accountancy Assistant Joanne McIntyre	Deputise for Group Accountant in her duties as required.
Principal Accountant – Financial Accounting (Lewis Magid)	Standby for allocation of short term business via brokers
Acting Senior Accountant - Capital (Angela Sozansky)	Standby for allocation of short term business via brokers.
Senior Accountancy Assistants/ Management Support officer	Standby for allocation of short term business via brokers