BURY METRO

REPORT FOR DECISION

Agenda Item	

MEETING:	**RESOURCE AND PERFORMANCE SCRUTINY PANEL** **THE EXECUTIVE** **COUNCIL**
DATE:	**13 February 2007** **14 February 2007** **28 February 2007**
SUBJECT:	**DRAFT TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2007/08**
REPORT FROM:	**Executive Member for Quality Council (Resource & Performance)**
CONTACT OFFICER:	**M Owen – Director of Finance and E-Government**

TYPE OF DECISION:	**COUNCIL - KEY DECISION**
FREEDOM OF INFORMATION/ STATUS:	**FOR PUBLICATION - This paper is within the public domain**

PURPOSE/SUMMARY:

The report sets out the suggested Strategy for 2007/08 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;
- prospects for interest rates;
- the borrowing strategy;
- the borrowing requirement
- 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 in 2006/07 to resume borrowing to fund capital expenditure will continue and in a time of historically favourable low borrowing rates, further borrowing will be consider taking advantage of low rates so that when rates are unfavourable it will not be necessary to borrow.

The authority's view of interest rates is that it expects short-term rates to be higher than long term rates for the foreseeable future and that long-term rates will remain at historically low levels in 2007/08 and out to 2010.

The overall strategy for 2007/08 will be to take advantage of historically low rated long term external debt for capital financing purposes at around 4.25% and invest at rates which are expected to be around 5%.

This will mean locking in long-term borrowing at a trigger rate of 4.25%, whilst at the same time locking in investments for cash flow needs and the longer term before base rates begin to fall in 2009 and timing the maturity of the investments so that it is linked to the time at which we expect base rates to again rise in 2010.

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 2007/08
- Scheme of Delegation and Responsibility attached at Appendix B

IMPLICATIONS -

Corporate Aims/Policy Framework:	Do the proposals accord with the Policy Framework? Yes
Financial Implications and Risk Considerations	See Statement by Director of Finance & E-Government and paragraph 7.5
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 is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Equality/Diversity implications	No, see paragraph 11.1
Considered by Monitoring Officer: Are there any legal implications?	
Staffing/ICT/Property:	No implications
Wards Affected:	All
Scrutiny Interest:	Primarily Resource and Performance

TRACKING/PROCESS **DIRECTOR:**

Chief Executive/ Management Board	Executive Member/ Chair	Ward Members	Partners
	Executive Member		
Scrutiny Commission	Executive	Committee	Council

1.0 BACKGROUND

1.1 The Local Government Act 2003, and supporting regulations, 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 (as required by Investment Guidance issued subsequent to the Act included at paragraph 10); 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 2007/08 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 2007/08 TO 2009/10

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 2007/08 – 2009/10

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

PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10	
(1). AFFORDABILITY PRUDENTIAL INDICATORS	**probable outturn**	**estimate**	**estimate**	**estimate**	
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	
Non - HRA	40,840	31,003	20,545	12,347	
HRA (applies only to housing authorities)	12,438	12,670	12,680	7,280	
TOTAL	**53,278**	**43,673**	**33,225**	**19,627**	1
Capital Financing Requirement	**£'000**	**£'000**	**£'000**	**£'000**	
Non - HRA	118,091	122,265	122,578	122,648	
HRA (applies only to housing authorities)	22,507	30,253	38,183	40,713	
TOTAL	**140,598**	**152,517**	**160,761**	**163,361**	2
Affordable Borrowing Limit					
Estimate of incremental impact of capital investment decisions	**£**	**£**	**£**	**£**	
Increase in council tax (band D, per annum)	0.0	32.34	14.45	1.62	3
Increase in housing rent per week	0.0	0.0	0.0	0.0	4
Ratio of financing costs to net revenue stream					
Non - HRA	2.85%	3.88%	3.86%	3.78%	5
HRA (applies only to housing authorities)	3.13%	4.52%	6.18%	6.93%	5
Net External Borrowing only to support the CFR in Medium Term		**£'000**			
Net External borrowing over medium term		156,010			
Total CFR over Medium Term		163,361			
Net External Borrowing < Total CFR		TRUE			6

PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10	
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**probable outturn**	**estimate**	**estimate**	**estimate**	
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	
borrowing	199,300	203,200	211,500	214,100	
other long term liabilities	9,700	9,400	9,400	9,000	
TOTAL	209,000	212,600	220,900	223,100	7
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	
borrowing	124,400	168,600	177,600	179,000	
other long term liabilities	9,700	9,400	9,400	9,000	
TOTAL	134,100	178,000	187,000	188,000	7
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	132%	140%	140%	140%	8
Upper limit for variable rate exposure					

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

Maturity structure of new fixed rate borrowing during 2005/06	upper limit	lower limit
under 12 months	40%	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.

3.3 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 stay constant. 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 2007/08 the Council's current treasury portfolio position is detailed below:

	31-Mar-06			**Forecast 31-Mar-07**		
	Principal		**Avg. Rate**	**Principal**		**Avg. Rate**
	£000	**£000**		**£000**	**£000**	
Fixed rate funding						
PWLB Bury	47,309			83,432		
PWLB Airport	9,089			8,829		
Market Bury	29,000	85,398		39,000	131,261	
Variable rate funding						
PWLB Bury	0			0		
Market Bury	0	0		0	0	
Other Loans / Bonds	3	3		3	3	
Long Debt		**85,401**	**5.85%**		**131,264**	**5.12%**
Total Investments		**6,600**	**4.68%**		**31,600**	**5.00%**

4.2 The long term debt at 31 March 2007 has been estimated to increase by £45.9m from 31 March 2006 to £131.3m.

4.3 The capital programme determines the amount of required borrowing which will have been approved in the 2006/07 Treasury Management Strategy. At that time it was anticipated to borrow £13.5m to cover the capital programme. However due to the favourable interest rates on the market it has been considered in line with Sector Treasury Services (The authority's Treasury Management Advisors) to increase the amount borrowed during 06/07 to an additional £30 million. The requirement to borrow £30 million is confirmed by calculating the difference between the Capital Financing Requirement (CFR) and the actual total debt. The Capital Financing Requirement is the cumulative amount of debt required to cover the capital programme.

4.4 In the past, long term rates have not been as attractive as they are at present and therefore the authority's surplus funds have been used to support the capital programme rather than increase the debt portfolio.

4.5 Currently PWLB loan rates are at historically low levels and it is therefore beneficial to increase the level of debt to the Capital Financing Requirement. This strategy aims to keep the average rate of the debt portfolio as low as possible as the authority choose to borrow when rates are low, rather than having to take debt when necessary possibly in an unfavourable interest rate environment.

4.6 Currently in 06/07 £30m of external debt has been borrowed and £2m repaid due to natural fallout of debt, the maturity date being reached. It is anticipated that by 31 March 2007 an additional £17.9m will be taken. This is as explained above and also takes in to account the additional approved borrowing in April 06 for the Invest to Save scheme at Bradley Fold also the borrowing for the corporate ICT systems. This is in line with the Prudential Indicators for the Capital Financing Requirement and also the authorised and operational limits and the affordable borrowing limit.

4.7 The average interest on borrowing is therefore estimated to be 5.12%.

4.8 If Borrowing is taken at these historical low levels this will increase the amount of investment portfolio by approximately the amount borrowed between the CFR and Debt level which previously had been covered by internal balances. The investment portfolio after the Capital programme has been spent during 06/07 is estimated to be around £31.6 million and the estimated rate of interest 4.9%.

4.9 It should be noted that the further borrowing will only be taken if long term rates remain favourable at the target rate of 4.25%.

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 (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

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

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

- peak at 5.50% in quarter 1 2007
- fall to 5.25% in Q3 2007 and then to 5.00% in Q4 2007
- fall to 4.75% in Q3 2008 and then to 4.50% in Q1 2009 before rising back to 4.75% in Q1 2010

5.4 Economic Background

International

- The US, UK and EU economies have all been on the upswing of the economic cycle in 2005 and 2006 and so have been raising interest rates in order to cool their economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices which could feed through into increases in wage inflation, producer prices etc.
- The US is ahead of the UK and EU in the business cycle and it looks as if the Fed. rate has probably already peaked at 5.25% whereas there is still an expectation in the financial markets of further increases in the EU and UK.
- The major feature of the US economy is a still steepening downturn in the housing market which is likely to drag consumer spending, and so the wider economy, down with it (e.g. house building, employment etc.). Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure.
- The Fed. may be reluctant and tardy to respond to the aforementioned downturn in the economy if inflationary pressures remain stubbornly high. This could exacerbate the downturn both in the US and the world economies.
- EU growth picked up strongly in the first half of 2006 and remained healthy in the second half. Growth is expected to slow moderately in 2007 due to weaker US and global demand.
- Despite sharply increased energy prices, disinflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3% and will fall as the energy effects go into reverse.

- **UK**
- GDP: the UK is on the upswing of the economic cycle from a low point reached in June 2005. Robust growth is expected to continue for a little longer but a modest cooling is expected in 2007 (2006 2.7%, 2007 2.2%) and then to edge up to 2.5% in 2008.
- Recovery in consumer spending and retail sales has underpinned this upswing in GDP.
- The housing market has proved more robust than expected; house price inflation over 8% p.a.
- Higher than expected immigration from Eastern Europe has strengthened growth and dampened wage inflation.
- The MPC's decisions to raise Bank Rate in November 2006 and January 2007 were needed to bring CPI inflation down to the 2% target level two years ahead. The MPC has been concerned that short term price increases (CPI has been significantly above target since June 2006) could feed through into wage settlements in the current pay round and anchor inflation expectations at a higher level.
- Household income growth to recover in 2007 as inflation falls and pay rises. But extra income likely to go into a recovery of the savings rate, pension saving and servicing debt costs (as rates rise) rather than consumer expenditure.
- Public sector real increase in expenditure per annum to weaken to 2.5% over the next few years from 3% average over 2000-2005.
- The three increases in Bank Rate in August and November 2006 and then January 2007, are expected to dampen the housing market and increases in unsecured borrowing although one more increase in Bank Rate is forecast.
- World slowdown in growth in 2007 will dampen UK exports.

5.4 OUTLOOK: Once inflation is contained, the Bank Rate will switch to a falling trend in the second half of 2007 to counter the above negative effects on the economy and growth.

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 2007/08 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 (Resource & Performance). The Scheme of Delegation is attached at Appendix B

7.0 BORROWING STRATEGY

7.1 The Sector forecast is as follows: -

- The 50 year PWLB rate is expected to remain flat at 4.25%. As the Sector forecast is in 25bp segments there is obviously scope for the rate to move around the central forecast by +/- 25bp without affecting this overall forecast.
- The 25-30 year PWLB rate is expected to stay at 4.50% for the foreseeable future.
- The 10 year PWLB rate will fall from 5.00% to 4.75% in Q3 2007 and then fall again to 4.50% in Q1 2008 and remain at that rate for the foreseeable future.
- 5 year PWLB rate will fall from 5.50% to 5.25% in Q2 2007 and continue falling until reaching 4.5% in Q1 2008 when it will remain at that rate for the foreseeable future.

7.2 This forecast indicates, therefore, that the borrowing strategy for 2007/08 should be set to take very long dated borrowing at any time in the financial year. Variable rate borrowing and borrowing in the five year area are expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to taking long term borrowing.

7.3 Therefore, the authority's borrowing strategy in order to minimise debt interest costs is as follows:

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

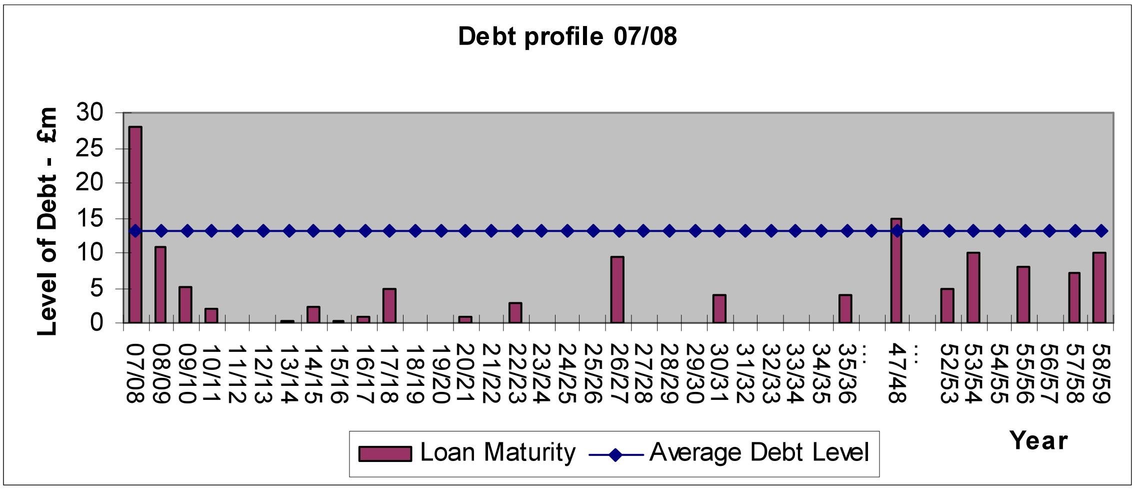
7.4 Against this background caution will be adopted with the 2007/08 treasury operations. The Director of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Executive at the next available opportunity.

7.5 **Sensitivity of the forecast** - The main sensitivities of the forecast are likely to be the two scenarios below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- ***if it were felt that there was a significant risk of a sharp rise in long and short term rates,*** perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

- ***if it were felt that there was a significant risk of a sharp fall in long and short term rates****,* due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

7.6 The debt profile below shows the estimated fall out of debt at 31 March 2007 for 2007/08. 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 at the first option 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 be called at the first option date.



7.7 The profile shows that on average, the maximum percentage of total debt due to fall out in any one year is less than 10% or £13.3m, except in the short term where the LOBO loans have the option to be called semi annually. The limited concentration of debt maturity in any one year enables good control of the debt portfolio, thereby reducing the risk of being dependent on a specific years interest rates.

7.8 The strategy for 2007/08 is to take advantage of historically low rated long term external debt for capital financing purposes at a trigger rate of 4.25% and to invest at rates which will produce an investment return for the year around 5%. Overall costs will be maintained at a minimum.

8.0 CAPITAL BORROWING REQUIREMENT

8.1 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

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.

	2007/08 £'000 estimate	**2008/09 £'000 estimate**	**2009/10 £'000 estimate**
New borrowing	17,126	13,564	7,988
Known replacement borrowing	0	1,000	0
Less MRP	(4,550)	(4,720)	(4,739)
Total gross borrowing	**12,576**	**9,844**	**3,249**
Non-HRA borrowing	4,656	1,914	719
Six Town Housing borrowing	7,920	7,930	2,530

8.3 Borrowing for the authority is estimated at £4.7m and for Six Town Housing (the ALMO) is will be £7.9 m. 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.

Affordable Borrowing Limit	**2007/08 estimate**	**2008/09 estimate**	**2009/10 estimate**
Increase in Council tax	£32.34	£14.45	£1.62

8.5 The increase in 2007/08 at £32.34 is due to change in regulation with regards to the minimum amount set aside to repay debt, a higher cost now being incurred and also the affect of the HRA having higher balances and therefore less investment interest earned is maintained by the general Fund. 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 As the first fall in Bank Rate is expected in Q3 2007, there will be a sharp difference between higher shorter term rates and cheaper long term rates in quarters 2 to 3 of 2007. Later on in 2007/08, this advantage will gradually diminish once Bank Rate, and short term rates generally, start falling. There will therefore be opportunity during quarters 2 to 3 of 2007 to restructure shorter term debt into long term in order to optimise the potential savings achievable in the financial year 2007/08. Any positions taken via rescheduling will be in accordance with the strategy position outlined in paragraph 7 above.

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

9.3 The reasons for rescheduling to take place will include:

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

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

9.5 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. 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 The guidance primarily focuses on high security and investing with bodies with high credit ratings. However, this focus only deals with credit risk i.e. the potential for default by a counterparty, as occurred with BCCI in 1991, which could result in the loss of the principal sum invested.

10.1.4 However, this approach does not deal with market risk i.e. an adverse movement in interest rates which, with some investment products, could lead to a diminution of the maturity value below that of the original principal sum invested. There is for example, potential for this to occur with investments in pooled investments i.e. collective investment schemes where an investment of cash is translated into the purchase of units in the fund. The value of these units is NOT guaranteed to remain unchanged between the date of investment and the maturity date. However, pooled vehicles do use rigorous methods to control their risk exposure and so consequently, they do have high credit ratings. But higher rates of return can usually only be achieved by taking on greater exposure to risk.

10.1.5 Therefore the categories of investments listed below are split between Specified and non-specified investments dependent on the level of credit & market risk the authority believes is associated with the investment categories.

10.1.6 In para. 20 of the commentary in the March 2004 guidance, specified investments are identified by the ODPM as requiring "minimal procedural formalities". Specified investments are therefore categorised of investment which are more risk averse.

10.1.7 The spirit of the guidance is that investment products which take on greater risk and therefore should be subject to greater scrutiny, should be subject to more rigorous justification and agreement of their use in the Annual Investment Strategy and so should fall into the non specified category; this would apply regardless of whether they are under one year investments and have high credit ratings.

<u>Specified Investments</u>:

10.1.8 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.

Investment Category	**Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	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
Fixed term Deposits with variable rate & variable maturities:-		
1. Callable Deposits	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 buy & hold after advice from Sector Treasury Services
UK Government Gilts	AAA	In-house buy & hold after advice from Sector Treasury

		Services
Bonds issued by multilateral development banks	AAA	In-house buy & hold after advice from Sector Treasury Services
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house buy & hold after advice from Sector Treasury Services
Sovereign bond issues (i.e. other than the UK govt)	AAA	In-house buy & hold after advice from Sector Treasury Services
Treasury Bills	Govt-backed	In-house buy & hold after advice from Sector Treasury Services
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):		
Money Market Funds	AAA	In-house

<u>Non-Specified Investments</u>:

10.1.9 A maximum of 100% can be held in aggregate in non-specified investments during the year. Non-specified investments for this Local Authority are surplus funds

- placed with counterparties for less than one year but do not meet the high credit rating described in specified investments
- placed in investment structures or pooled investments that have a slightly higher level of risk
- that are invested for periods greater than one year

10.1.10 During 2007/08 it is forecast that advantage will be taken of market rates for investments greater than 1 year. This is in line with the investment strategy and forecast of interest rates. The limit for investments to be placed for more than one year is 20%. The table shows the limits given to the different investment categories:

Non-Specified Investments Less than 1 year				
	***Minimum Credit Criteria**	**Use**	**Max % of total investments**	**Max. maturity period**
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
Fixed term Deposits with variable rate & variable maturities :-				
1. Range Trades	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house	10%	Not greater than 1 year
2. Snowballs	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house	10%	Not greater than 1 year
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):-				
1. Enhanced cash funds	Short-term F1+, Long-term AA-,	In-house	10%	Not greater than 1 year
2. Short term funds	Short-term F1+, Long-term AA-,	In-house	10%	Not greater than 1 year
3. Bond funds	Short-term F1+, Long-term AA-,	In-house	10%	Not greater than 1 year
4. Guilt funds	Short-term F1+, Long-term AA-,	In-house	10%	Not greater than 1 year

Non-Specified Investments in excess of 1 year				
	***Minimum Credit Criteria**	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – other LAs	N/A	In-house	10%	5 years
Term deposits – banks and building societies	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2	In-house	10%	5 years
Fixed term Deposits with variable rate & variable maturities :-				
1. Callable Deposits	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house	10%	5 years
2. Range Trades	Short-term F1+,	In-house	10%	5 years

	Long-term AA-, Individual B/C, Support 1,2,3 or equivalent			
3. Snowballs	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent	In-house	10%	5 years
Certificates of deposits issued by banks and building societies	Short-term F1+, Long-term AA-, Individual B/C, Support 1,2	Fund managers	10%	5 years
UK Government Gilts	AAA	Fund Managers	10%	5 years
Bonds issued by multilateral development banks	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 government	AAA / government guaranteed	In-house on a 'buy-and-hold' basis. Also for use by fund managers	10%	5 years
Sovereign bond issues (i.e. other than the UK govt) with maturities in excess of 1 year	AAA	Fund Managers	10%	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):-				
1. Bond Funds	Short-term F1+, Long-term AA-	In-house	10%	5 years
2. Guilt Funds	Short-term F1+, Long-term AA-	In-house	10%	5 years

10.1.11 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.

10.1.12 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.

10.1.13 The reports approved by Council on 3 November 2004 and Executive on 24 January 2007 detail the selected credit criteria and the latter report gives an example of the institutions currently used for investments.

10.2 Investment Strategy

10.2.1 Investments will be made with reference to the core cash balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

10.2.2 The Authority currently has one investment that spans the financial year 2007/08 which takes advantage of the favourable market interest rates in accordance with the forecast.

	Amount	Maturity	Rate
Clydesdale Bank	2.5m	17 Nov 08	5.51%

10.2.3 Interest rate outlook: Sector is forecasting Bank Rate to peak at 5.5% in Q1 2007 before falling to 5.25% in Q3 2007, to 5.00% in Q4 2007, to 4.75% in Q3 2008 and then to trough at 4.50% in Q1 2009, remaining at that level before rising again to 4.75% in Q1 2010.

10.2.4 The strategy is therefore to seek to lock in longer period investments at higher rates before this fall starts for some element of the investment portfolio which represents the core balances.

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

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

11.0 EQUALITY & DIVERSITY

11.1 An initial input assessment has been undertaken & it is concluded that there will be no negative impact from this report.

For further information on the contents of this report, please contact:
Mike Owen, Director of Finance and E-Government
Tel: 0161 253 5002
e-mail: M.A.Owen@bury.gov.uk

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NTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.
The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 29.1.2007

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

Capital Economics interest rate forecast – 15.1.2007

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

UBS interest rate forecast (for quarter ends) – 15.1.2007

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008
Bank rate	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%
10yr PWLB rate	4.85%	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%	4.90%
25yr PWLB rate	4.25%	4.25%	4.25%	4.30%	4.35%	4.40%	4.45%	4.55%
50yr PWLB rate	4.15%	4.15%	4.25%	4.35%	4.40%	4.45%	4.55%	4.65%

2. SURVEY OF ECONOMIC FORECASTS

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

	bank rate	Quarter ended		annual average bank rate		
	actual	Q4 2006	Q4 2007	ave. 2008	ave. 2009	ave. 2010
Indep. forecasters BoE Bank Rate	5.00%	4.96%	4.89%	4.86%	4.88%	4.85%
Highest bank rate	5.00%	5.00%	6.00%	5.90%	5.60%	6.10%
Lowest bank rate	5.00%	4.50%	4.00%	3.75%	4.00%	4.00%

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.
Group Accountant (Treasury Management) (Louise Branford-White)	Manage and undertake day to day Treasury Management Activities in accordance with Treasury Strategy and Policy Statement.
Senior Accountancy Assistant (Peter Harrington)	Deputise for Group Accountant in her duties as required.
Senior Accountant – Capital & External Funding (Angela Sozansky)	Deputise for Group Accountant in her duties as required
Accountancy Assistant (Joanne McIntyre)	Standby for allocation of short term business via brokers.
Senior Accountancy Assistant (Chris Peel)	Standby for allocation of short term business via brokers
Accountancy Assistant (Linda Hughes)	Standby for allocation of short term business via brokers.