# REPORT FOR DECISION

| Agenda Item | |
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| **MEETING:** | **RESOURCE AND PERFORMANCE SCRUTINY COMMISSION**<br>**THE EXECUTIVE**<br>**COUNCIL** |
| **DATE:** | **12 February 2008**<br>**13 February 2008**<br>**20 February 2008** |
| **SUBJECT:** | **TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2008/09** |
| **REPORT FROM:** | **Executive Member for Resource & Performance** |
| **CONTACT OFFICER:** | **M Owen – Director of Finance and E-Government** |

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| **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 2008/09 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 2007/08 to resume borrowing to fund capital expenditure will continue and in a time of historically favourable low borrowing rates, further borrowing will be considered 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 2008/09 and out to 2011/2012.

The overall strategy for 2008/09 will be to take advantage of historically low rated long term external debt for capital financing purposes at around 4.45% and invest at rates which are expected to be around 5%.

This will mean locking in long-term borrowing at a trigger rate of 4.45%, whilst at the same time locking in investments for cash flow needs and the longer term before base rates begin to fall in 2008 and 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 2008/09
- Scheme of Delegation and Responsibility attached at Appendix B

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**IMPLICATIONS -**

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| **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 |
| **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:**<br>Are there any legal implications? | Yes<br>No |
| **Staffing/ICT/Property:** | No implications |
| **Wards Affected:** | All |
| **Scrutiny Interest:** | Resource and Performance Scrutiny Commission |

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**TRACKING/PROCESS** **DIRECTOR:** Mike Owen

| 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 2008/09 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 2008/09 TO 2010/11

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 2008/09 – 2010/11

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

| PRUDENTIAL INDICATOR | 2007/08 | 2008/09 | 2009/10 | 2010/11 | |
|---|---|---|---|---|---|
| **(1). AFFORDABILITY PRUDENTIAL INDICATORS** | **probable outturn** | **estimate** | **estimate** | **estimate** | |
| **Capital Expenditure** | **£'000** | **£'000** | **£'000** | **£'000** | |
| Non – HRA | 27,911 | 24,120 | 22,591 | 28,763 | |
| HRA (applies only to housing authorities) | 11,738 | 12,754 | 7,426 | 4,497 | |
| TOTAL | **39,649** | **36,874** | **30,017** | **33,260** | 1 |
| **Capital Financing Requirement** | **£'000** | **£'000** | **£'000** | **£'000** | |
| Non – HRA | 114,941 | 115,117 | 112,340 | 112,564 | |
| HRA (applies only to housing authorities) | 30,253 | 38,183 | 40,713 | 40,713 | |
| TOTAL | **145,194** | **153,300** | **153,053** | **153,277** | 2 |
| **Affordable Borrowing Limit** | | | | | |
| Estimate of incremental impact of capital investment decisions | **£** | **£** | **£** | **£** | |
| Increase in council tax (band D, per annum) | 0.0 | 7.47 | 6.85 | 0.0 | 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 | 2.42% | 2.52% | 2.61% | 2.53% | 5 |
| HRA (applies only to housing authorities) | 4.52% | 6.18% | 6.93% | 6.93% | 5 |
| **Net External Borrowing only to support the CFR in Medium Term** | | **£'000** | | | |
| Net External borrowing over medium term | | 133,141 | | | |
| Total CFR over Medium Term | | 153,277 | | | |
| Net External Borrowing < Total CFR | | TRUE | | | 6 |

| PRUDENTIAL INDICATOR | 2007/08 | 2008/09 | 2009/10 | 2010/11 | |
|---|---|---|---|---|---|
| **(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS** | **probable outturn** | **estimate** | **estimate** | **estimate** | |
| **Authorised limit for external debt -** | **£'000** | **£'000** | **£'000** | **£'000** | |
| Borrowing | 203,200 | 211,500 | 214,100 | 214,500 | |
| other long term liabilities | 9,400 | 9,400 | 9,000 | 8,600 | |
| TOTAL | 212,600 | 220,900 | 223,100 | 223,100 | 7 |
| **Operational boundary for external debt -** | **£'000** | **£'000** | **£'000** | **£'000** | |
| Borrowing | 168,600 | 177,600 | 179,000 | 179,400 | |
| other long term liabilities | 9,400 | 9,400 | 9,000 | 8,600 | |
| TOTAL | 178,000 | 187,000 | 188,000 | 188,000 | 7 |
| **Upper limit for fixed interest rate exposure** | | | | | |
| Net principal re fixed rate borrowing / investments | 140% | 140% | 140% | 140% | 8 |
| **Upper limit for variable rate exposure** | | | | | |
| Net principal re variable rate borrowing / investments | -40% | -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 2007/08** | 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 2008/09 the Council's current treasury portfolio position is detailed below:

| | **31-Mar-07** | | | **Forecast 31-Mar-08** | | |
|---|---|---|---|---|---|---|
| | **Principal** | | **Avg. Rate** | **Principal** | | **Avg. Rate** |
| | **£000** | **£000** | | **£000** | **£000** | |
| Fixed rate funding | | | | | | |
| PWLB Bury | 65,309 | | | 75,282 | | |
| PWLB Airport | 8,829 | | | 8,569 | | |
| Market Bury | 39,000 | 113,138 | | 39,000 | 122,851 | |
| Variable rate funding | | | | | | |
| PWLB Bury | 0 | | | 0 | | |
| Market Bury | 0 | 0 | | 0 | 0 | |
| Other Loans / Bonds | 3 | 3 | | 3 | 3 | |
| **Long Debt** | | **113,141** | **5.50%** | | **122,854** | **5.50%** |
| **Total Investments** | | **35,350** | **4.92%** | | **60,000** | **5.64%** |

4.2 The long term debt at 31 March 2008 has been estimated to increase by £9.7m from 31 March 2007 to £122.9m.

4.3 The capital financing requirement for 2007/08 is £13.1m of which the Authority plans to borrow £10m before the end of the financial year to take advantage of favourable interest rates. The Authority has the right to borrow a further £20m if required and will take advice from its Treasury Management Advisors.

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 can borrow when rates are low, rather than having to take debt when necessary possibly in an unfavourable interest rate environment.

4.6 The average interest on borrowing is estimated to be 5.50% for 2007/08.

4.7 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 2007/08 is estimated to be around £60 million and the estimated rate of interest is 5.64% for 2007/08.

4.8 It should be noted that the further borrowing will only be taken if long term rates remain favourable at the target rate of 4.45%.

## 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 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Bank rate** | 5.25% | 5.00% | 4.75% | 4.75% | 4.75% | 4.75% | 4.75% | 5.00% | 5.00% | 5.00% |
| **5yr PWLB rate** | 4.55% | 4.55% | 4.50% | 4.50% | 4.55% | 4.65% | 4.70% | 4.75% | 4.80% | 4.85% |
| **10yr PWLB rate** | 4.60% | 4.55% | 4.50% | 4.50% | 4.55% | 4.55% | 4.65% | 4.70% | 4.75% | 4.80% |
| **25yr PWLB rate** | 4.55% | 4.50% | 4.50% | 4.50% | 4.50% | 4.55% | 4.60% | 4.65% | 4.70% | 4.70% |
| **50yr PWLB rate** | 4.50% | 4.45% | 4.45% | 4.45% | 4.45% | 4.50% | 4.55% | 4.60% | 4.60% | 4.65% |

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

- started on a downward trend from 5.75% to 5.50% in December 2007.
- will be followed by further cuts in Q1 2008 to 5.25%, to 5.00% in Q2 and to 4.75% in Q3 2008
- will then remain unchanged for most of the following year with an increase to 5% in Q4 2009.
- however, there is downside risk to this forecast if inflation concerns subside and so open the way for the MPC to be able to make further cuts in Bank Rate

5.4 Economic Background

**International**

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

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

§ In an attempt to try to stimulate the economy and to ameliorate the extent of the downturn the Fed. has cut its rate on a number of occasions, to 4.5% in October 2007, to 4.25% in December and to 3.0% in January 2008. More cuts may be required to stimulate the economy, however, the speed and extent of these cuts will be inhibited by inflationary pressures arising from oil prices, the falling dollar increasing the costs of imports, etc. The US could well be heading into stagflation in 2008 – a combination of inflation and a static economy (but the economy could even tip into recession if the housing downturn becomes severe enough).

§ The major feature of the US economy is a steepening downturn in the housing market which is being undermined by an excess stock of unsold houses stoked by defaulting sub prime borrowers pushed into forced sales. Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure. Petrol prices have trebled since 2003 and, with similar increases in the price of home heating oil, this will also depress consumer spending with knock on effects on house building, employment etc.

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

§ EU growth has been strong during 2006 and 2007 but is expected to be caught by the general downturn in world growth in 2008.

**UK**

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

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

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

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

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

§ The MPC is very concerned at the build up of inflationary pressures especially the rise in the oil price to $90 – $100 per barrel (was $30 in 2003) and the consequent likely knock on effects on general prices. The prices of UK manufactured goods have risen at the fastest rate in 16 years in November 2007 – 4.5%. Food prices have also risen at their fastest rate for fourteen years (6.6% annual increase) driven by strong demand from China and India. Consequently, the MPC is going to be much more cautious about cutting rates compared to the Fed. in the face of these very visible inflationary pressures. In addition, UK growth was still exceptionally strong in Q3, as has also been the growth in the money supply. The downward trend in Bank Rate is now expected to be faster than at first thought after the initial cut in December 2007 to 5.50% in view of the MPC minutes which showed a unanimous MPC vote for a cut and the consideration given to a half per cent cut. This demonstrated how concerned the MPC is at the potential impact of the credit crunch on the economies of the western world. However, the MPC's room for cutting rates is currently limited by concerns over inflationary pressures. However, if those pressures subside, then there is further downward risk to the Sector forecast which currently only allows for 0.25% cuts to reach 4.75% in Q3 2008.

## 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 2008/09 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
- 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 Resource & Performance. The Scheme of Delegation is attached at Appendix B

## 7.0 BORROWING STRATEGY

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

- The 50 year PWLB rate is expected to fall marginally from 4.50% in Q1 2008 to 4.45% in Q2 2008 before rising back again to 4.50% in Q2 2009 to eventually reach 4.65% in Q2 2010.

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

- The 10 year PWLB rate is expected to fall from 4.60% in Q1 2008 to 4.55% in Q2 and to 4.5% in Q3 2008 and to then gradually rise from Q1 2009 to reach 4.85% in Q3 2010.

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

7.2 This forecast indicates, therefore, that there is a range of options available for borrowing strategy for 2008/09. Variable rate borrowing is expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to taking fixed rate borrowing. There is expected to be little difference between 5 – 50 year PWLB rates so this may open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long dated debt. There is also expected to be little variation in rates during the year so borrowing could be undertaken at any time in the year.

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

- Focus on undertaking new borrowing in or near the 25 – 30 year period so as to minimise the spread between the PWLB new borrowing and early repayment rates as there is little, or no difference in the new borrowing rate between rates in these periods and the 50 year rate. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.
- This strategy also means that after some years of focusing on borrowing at or near the 50 year period, local authorities will be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.
- When the 25-30 year PWLB rates fall back to the central forecast rate of about 4.50%, borrowing should be made in this area of the market at any time in the financial year. This rate is likely to be lower than the forecast rates for shorter maturities in the 5 year and 10 year area. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4.50%. However, if shorter period loans become available around this rate, these will also be considered.
- The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.
- Consideration will also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate.

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

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

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

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

## 8.0 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.

| | **2008/09 £'000 Estimate** | **2009/10 £'000 estimate** | **2010/11 £'000 estimate** |
|---|---|---|---|
| New borrowing | 12,704 | 4,358 | 4,718 |
| Known replacement borrowing | 1,000 | 55 | 1,882 |
| Less MRP | (4,598) | (4,605) | (4,494) |
| Total gross borrowing | **9,106** | **(192)** | **2,106** |
| Non-HRA borrowing | 1,176 | (2,722) | 2,106 |
| Six Town Housing borrowing | 7,930 | 2,530 | 0 |

8.3 Borrowing for the authority is estimated at £1.1m and for Six Town Housing (the ALMO) will be £7.9m for 2008/09. 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** | **2008/09 estimate** | **2009/10 estimate** | **2010/11 estimate** |
|---|---|---|---|
| Increase in Council tax | £7.47 | £6.85 | 0 |

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 The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings will still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans.

9.2 As average PWLB rates are expected to be minimally higher at the start of the financial year than later on in the year, and as Bank Rate is expected to fall more than longer term borrowing rates during the year, this will mean that the differential between long and short rates will narrow during the year and that there should therefore be greater potential for making interest rate savings on debt by doing debt restructuring earlier on in the year. Any positions taken via rescheduling will be in accordance with the strategy position outlined in paragraph 7 above.

9.3 The reasons for any rescheduling to take place will include:
- the generation of cash savings and / or discounted cash flow savings;
- 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 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 Guidance on Local Government Investments ("the Guidance") issued by the ODPM (now DCLG) 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.

**Specified Investments**:

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 |

| Non-Specified Investments Less than 1 year | | | | |
|---|---|---|---|---|
| | *Minimum Credit Criteria | Use | Max % of total | Max. maturity |

**Non-Specified Investments**:

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 2008/09 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:

| | | | investments | 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+, Long-term AA-, Individual B/C, Support 1,2,3 or equivalent | In-house | 10% | 5 years |

| | | | | |
|---|---|---|---|---|
| 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 does not have any investments that span the financial year 2008/09.

10.2.3 Interest rate outlook: Sector is forecasting that the Bank Rate has now started on a downward trend with the first cut to 5.50% in December 2007. This is forecast to continue with further cuts to 5.25% in Q1 2008, 5.00% in Q2 and 4.75% in Q3. It is then expected to rise back to 5.0% in Q4 2009 and stabilise there for the foreseeable future.

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. For 2008/09 an investment return of 4.9% - 5.00% on investments placed in 2008/09 should be attainable.

10.2.5 The Authority has identified the following Minimum Investment Levels points for investments as follows:-

| | |
|---|---|
| 5.20% | for 1 year lending |
| 5.30% | for 2 year lending |
| 5.35% | for 3 year lending |
| 5.50% | for 4 year lending |
| 5.60% | for 5 year lending |

The Minimum Investment Levels will be kept under review and discussed with Sector so that investments can be made at the appropriate time.

10.2.6 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.

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

## 11.0 EQUALITY & DIVERSITY

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

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**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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## INTEREST RATE FORECASTS

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

### 1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 31 January 2008

| | Q/E1 2008 | Q/E2 2008 | Q/E3 2008 | Q/E4 2008 | Q/E1 2009 | Q/E2 2009 | Q/E3 2009 | Q/E4 2009 | Q/E1 2010 | Q/E2 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Bank rate** | 5.25% | 5.00% | 4.75% | 4.75% | 4.75% | 4.75% | 4.75% | 5.00% | 5.00% | 5.00% |
| **5yr PWLB rate** | 4.55% | 4.55% | 4.50% | 4.50% | 4.55% | 4.65% | 4.70% | 4.75% | 4.80% | 4.85% |
| **10yr PWLB rate** | 4.60% | 4.55% | 4.50% | 4.50% | 4.55% | 4.55% | 4.65% | 4.70% | 4.75% | 4.80% |
| **25yr PWLB rate** | 4.55% | 4.50% | 4.50% | 4.50% | 4.50% | 4.55% | 4.60% | 4.65% | 4.70% | 4.70% |
| **50yr PWLB rate** | 4.50% | 4.45% | 4.45% | 4.45% | 4.45% | 4.50% | 4.55% | 4.60% | 4.60% | 4.65% |

Capital Economics interest rate forecast – 12 December 2007

| | Q/E4 2007 | Q/E1 2008 | Q/E2 2008 | Q/E3 2008 | Q/E4 2008 | Q/E1 2009 | Q/E2 2009 | Q/E3 2009 | Q/E4 2009 |
|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 5.50% | 5.25% | 5.00% | 4.75% | 4.50% | 4.25% | 4.00% | 4.00% | 4.00% |
| 5yr PWLB rate | 4.65% | 4.45% | 4.35% | 4.05% | 3.95% | 4.05% | 4.25% | 4.35% | 4.75% |
| 10yr PWLB rate | 4.65% | 4.45% | 4.25% | 4.15% | 4.15% | 4.25% | 4.45% | 4.65% | 4.85% |
| 25yr PWLB rate | 4.65% | 4.55% | 4.45% | 4.45% | 4.35% | 4.45% | 4.55% | 4.75% | 4.95% |
| 50yr PWLB rate | 4.55% | 4.55% | 4.45% | 4.35% | 4.25% | 4.35% | 4.55% | 4.65% | 4.75% |

**UBS** interest rate forecast (for quarter ends) – 12 December 2007

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

## 2. SURVEY OF ECONOMIC FORECASTS

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

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

## 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) (Peter Harrington) | Manage and undertake day to day Treasury Management Activities in accordance with Treasury Strategy and Policy Statement. |
| Senior Accountancy Assistant (Stephen Blake) | Deputise for Group Accountant in his duties as required. |
| Senior Accountant – Capital & External Funding (Angela Sozansky) | Deputise for Group Accountant in his 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. |