BURY METRO

REPORT FOR DECISION

Agenda Item	

MEETING:	**RESOURCE AND PERFORMANCE SCRUTINY COMMISSION** **THE EXECUTIVE** **COUNCIL**
DATE:	**10 February 2009** **18 February 2009** **25 February 2009**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2009/10**
REPORT FROM:	**Executive Member for Resource**
CONTACT OFFICER:	**Mike 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 2009/10 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, for 2008/09, which was 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 overall strategy for 2009/10 will be to take advantage of historically low rated short term external debt for capital financing purposes at around 2.25% or below (1 to 5 years) and invest at rates which are expected to yield 2% to 2.25% for the year 2009/10.

This will mean locking in short-term borrowing at a trigger rate of 2.25% or below, 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 cash flow needs of the authority.

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 2009/10
- 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
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?	Yes No
Staffing/ICT/Property:	No implications
Wards Affected:	All
Scrutiny Interest:	Resource and Performance Scrutiny Commission

---

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 2009/10 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 2009/10 TO 2011/12

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 2009/10 – 2011/12

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

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12	
(1). AFFORDABILITY PRUDENTIAL INDICATORS	**probable outturn**	**estimate**	**estimate**	**estimate**	
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	
Non – HRA	35,975	26,052	30,329	2,338	
HRA (applies only to housing authorities)	18,476	7,426	4,497	0	
TOTAL	**54,451**	**33,478**	**34,826**	**2,338**	1
Capital Financing Requirement (CFR)	**£'000**	**£'000**	**£'000**	**£'000**	
Non – HRA	118,101	121,403	119,193	115,438	
HRA (applies only to housing authorities)	38,541	41,071	45,568	45,568	
TOTAL	**156,642**	**162,474**	**164,781**	**161,026**	2
Affordable Borrowing Limit					
Estimate of incremental impact of capital investment decisions	**£**	**£**	**£**	**£**	
Increase in council tax (band D, per annum)	7.0	12.45	4.75	1.88	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	2.61%	2.83%	2.86%	2.81%	5
HRA (applies only to housing authorities)	5.66%	5.72%	5.83%	5.66%	5
Net External Borrowing only to support the CFR in Medium Term		**£'000**			
Net External borrowing over medium term		145,285			
Total CFR over Medium Term		161,026			
Net External Borrowing < Total CFR		TRUE			6

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12	
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**probable outturn**	**estimate**	**estimate**	**estimate**	
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	
Borrowing	211,500	214,100	214,500	214,500	
other long term liabilities	8,300	8,000	7,700	7,400	
TOTAL	219,800	222,100	222,200	221,900	7
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	
Borrowing	177,600	179,000	179,400	179,800	
other long term liabilities	8,300	8,000	7,700	7,400	
TOTAL	185,900	187,000	187,100	187,200	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	**£'000**	**£'000**	**£'000**	**£'000**	

invested for over 364 days (per maturity date)	10,000	10,000	10,000	10,000	9

Maturity structure of new fixed rate borrowing during 2009/10	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 upon 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. Both General Fund and HRA finance costs to net revenue streams remain stable throughout the 3 year forecast.

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 2009/10 the Council's current treasury portfolio position (at nominal value) is detailed below:

	31-Mar-08			Forecast 31-Mar-09		
	Principal		Avg. Rate	Principal		Avg. Rate
	£000	£000		£000	£000	
Fixed rate funding						
PWLB Bury	65,309			84,309		
PWLB Airport	8,542			8,181		
Market Bury	39,000	112,851		39,000	131,490	
Variable rate funding						
PWLB Bury	0			0		
Market Bury	0	0		0	0	
Other Loans / Bonds	3	3		3	3	
Long Debt		**112,854**	**5.40%**		**131,490**	**5.23%**
Total Investments		**36,294**	**5.83%**		**50,000**	**5.00%**

4.2 The capital financing requirement for 2008/09 is £15.3m of which the Authority plans to borrow £10m before the end of the financial year (or early in the next 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.

4.3 Currently Public Works Loan Board (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.

4.4 The average interest on borrowing is estimated to be 5.23% for 2008/09.

4.5 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 2008/09 is estimated to be around £50 million and the estimated rate of interest is 5.00% for 2008/09.

4.6 It should be noted that the further borrowing will only be taken if short term rates (1 to 5 years) remain favourable at the target rate of 2.25% or below.

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.

Sector Interest rate forecast – 6th December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

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

- will fall from current levels because of the intensifying global recession
- Starting 2009 at 1.50%, Bank Rate is forecast to fall to 0.5% in Q1 2009
- It is then expected to remain there until starting to rise gently up from Q2 2010 till it reaches 4.0% in Q1 2012.
- There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

5.4 Economic Background

Introduction

§ The sub prime crisis of early 2008 was supplanted by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50bp took place on 8th October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession hove into view.

International

§ Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The European Central Bank (ECB) was very concerned about rising inflation and less about the state of the economy.

§ The second quarter of 2008/9 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.

§ In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions that had invested in these issues.

§ In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.

§ Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.

§ After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the International Monetary Fund (IMF) for support.

§ The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the US Federal Reserve (Fed), ECB and the Monetary Policy Committee (MPC) all cutting rates by 50bp on 8th October. The Fed subsequently cut rates again by 50bp to 1% on 29th October and again on 16 December to a band of 0.0% to 0.25% in an attempt to stave off the oncoming recession. Inflation was yesterday's problem.

§ The ECB reduced rates again on 6th November by 50bp and by its biggest ever cut of 75bp on 4 December to reach 2.5%.

UK

§ Gross Domestic Product (GDP): growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in the autumn the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.

§ Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.

§ Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.

§ Notwithstanding the pressures on household finances consumer spending still continued at a reasonable clip although the trend was slowing as the year progressed.

§ Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.

§ The Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer inter-bank lending.

§ The Government took action in September to either supply finance itself to recapitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was so that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.

§ The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.

§ Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.

§ U.K. equity prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.

§ The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though

the storm had been weathered. The MPC had been very concerned about CPI inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 50bp on October 8th in concert with the Federal Reserve, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 150bps on 6 November, 100bps on 4 December and 50 bps on 8 January 2009, and by a further 50bps on the 5th February 2009.

§ The London Inter Bank Offer Rate (LIBOR) spread over Bank Rate has also been a feature, and a concern, of 2008/9. Because of the credit fears and the reluctance of lenders to place cash for long periods 3 month LIBOR (the rate at which banks will lend to one another) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 150 bps Bank Rate cut in November on some borrowing rates.

§ The Government has abandoned its 'golden rule'. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short term designed to help stimulate economic growth to counter the recession.

6.0 BORROWING STRATEGY

6.1 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 remain around current levels of about 3.80 - 3.90% until Q2 2010 when it is forecast to rise to 4.00%. The rate then edges up gradually to reach 5.00% at the end of the forecast period.

- The 25 year PWLB rate is expected to drop to 3.95% in Q1 2009 and stay around there until starting to rise in Q1 2010 and then to eventually reach 5.05% at the end of the forecast period.

- The 10 year PWLB rate is expected to drop to 2.55% in Q3 2009 but then to start rising again in Q2 2010 to eventually reach 4.85% at the end of the forecast period.

- The 5 year PWLB rate is expected to fall to a floor of 2.15% during Q3 2009. The rate then starts rising in Q2 2010 to eventually reach 4.60% at the end of the forecast period.

6.2 This forecast indicates, therefore, that there is a range of options available for borrowing strategy for 2009/10. Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to simply taking long term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates so this will 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. Rates are expected to

be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.

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

- For authorities wanting to focus on the very cheapest PWLB borrowing, the under 10 year rates will provide significantly cheaper rates than longer term borrowing. Under 5 year rates are also expected to be significantly lower than 5-10 year rates. Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.
- For authorities wanting to lock into historically low long term rates, there is expected to be little difference between 25 year and 50 year rates. However, despite the minimally more expensive new borrowing rates expected in the 25 – 30 year period later in the year, these could be seen as being much more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.
- This strategy would also mean that after some years of focusing on borrowing at or near the 50 year period, local authorities would be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.
- When long term PWLB rates fall back to the central forecast rate of about 3.95%, borrowing should be made at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 3.95%. 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 if they become available again.

External v. internal borrowing

- The next financial year is expected to be a time of historically abnormally low Bank Rate. This opens up an opportunity for authorities to fundamentally review their strategy of undertaking external borrowing.
- For those authorities with investments in excess of their borrowing requirement over the next year and access to the cash from maturing investments within the financial year, then consideration also needs to be given to the potential merits of internal borrowing.
- As long term borrowing rates are expected to be higher than rates on the loss of investment income and look likely to be so for the next couple of years or so, authorities may prefer to avoid all new external borrowing in the next financial year in order to maximise savings in the short term.
- The running down of investments also has benefits of reducing exposure to interest rate and credit risk.

6.4 Against this background caution will be adopted with the 2009/10 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 Council as appropriate.

Sensitivity of the forecast – In normal times 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.

6.5 However, after the freezing of some local authority investments by Icelandic banks now in receivership, many local authorities are currently concerned about the safety of investments and the ability of authorities to rely on credit ratings as a basis for ensuring that investments can be undertaken safely, especially for longer periods of time. The approach of this authority is therefore to continue to invest safely and prudently yet seek opportunities to repay and reschedule debt where the circumstances and results are favourable to Bury Council.

7.0 CAPITAL BORROWING REQUIREMENT

7.1 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.

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

	2009/10	**2010/11**	**2011/12**
	£'000	**£'000**	**£'000**
	Estimate	**estimate**	**estimate**
New borrowing	5,832	2,307	2,307
Known replacement borrowing	4,000	10,000	0
Less MRP and VRP	(5,129)	(5,279)	(5,209)
Total gross borrowing	**4,703**	**7,028**	**(2,902)**
Non-HRA borrowing	2,173	7,028	(2,506)
Six Town Housing borrowing	2,530	0	0

7.3 Borrowing for the authority is estimated at £2.2m and for Six Town Housing (the ALMO) will be £2.5m for 2009/10. This increase in the borrowing requirement will increase the finance costs of the authority, and have been included in the draft Revenue Budget.

7.4 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	2009/10 Estimate	2010/11 estimate	2011/12 estimate
Increase in Council tax	£12.45	£4.75	£1.88

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

8.0 DEBT RESCHEDULING

8.1 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 may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans if these become available after the drying up of their supply during autumn 2008.

8.2 Due to short term borrowing rates being expected to be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a rebalancing of an authority's debt maturities towards a flattening of the maturity profile as in recent years there has been a skew towards longer dated PWLB.

8.3 Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action and other financial considerations.

As average PWLB rates in some maturity periods are expected to be minimally higher earlier on in the financial year than later on, there should therefore be greater potential for making marginally higher 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.

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).

All rescheduling will be reported to the Council as appropriate.

9.0 ANNUAL INVESTMENT STRATEGY

9.1 Investment Policy

9.1.1 The Council will have regard to the Guidance on Local Government Investments ("the Guidance") issued by the Office of the Deputy Prime Minister (ODPM) (now Department for Communities and Local Government) 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.

9.1.2 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.

9.1.3 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.

9.1.4 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.

9.1.5 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.

9.1.6 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.

9.1.7 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:

9.1.8 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

Sector have informed Bury Council that since the credit crunch crisis there have been a number of developments which require separate consideration and approval for use: -

Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, they have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these

institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

Blanket guarantees on all deposits. Some countries have supported their banking system by giving a blanket guarantee on ALL deposits e.g. Ireland. Authorities may view that the sovereign rating of that country then takes precedence over the individual credit ratings for the banks covered by that guarantee. Clients need to decide if they wish to rely on these blanket guarantees to authorise lending to banks covered by these guarantees and for which countries they are prepared to do so.

UK banking system support package. Please note that the UK Government has NOT given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system by supporting eight named banks with a £500bn support package. Again, clients need to decide if they wish to authorise lending to those named banks on the basis of that implicit guarantee on local authority deposits placed with these eight banks or to rely on the credit ratings of the individual banks.

Other countries. Clients will also need to decide if they wish to rely on this implicit guarantee for the banking systems of other countries. The US, countries within the EU and Switzerland (and other countries) are currently providing major support packages to their banking systems .

Please note that Sector does not provide an information service to clients on what countries other than the UK are doing to support their banking systems.

	*** Minimum Credit Criteria**	**Use**	***** Max % of total investments**	**Max. maturity period**
Banks nationalised by high credit rated (sovereign rating) countries	* Sovereign AAA, Short-term F1+, Long-term AA-, Individual B/C, Support 1,2,3	In-house and fund managers	100%	As advised by Sector
Government guarantee on ALL deposits by high credit rated (sovereign rating) countries*	Sovereign rating AAA	In-house and fund managers	100%	As advised by Sector
UK Government support to the banking sector**	Sovereign rating AAA	In-house and fund managers	100%	As advised by Sector

* e.g. Ireland (AAA), Australia (AA+), Singapore (AAA), Hong Kong (AA)

**Banks supported by the UK bail-out package: -

- Abbey
- Barclays
- HBOS
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Non-Specified Investments:

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

9.1.9 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

9.1.10 During 2009/10 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:

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 (investments with fixed and variable elements)	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. Gilt 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 (investments with fixed and variable	Short-term F1+, Long-term AA-,	In-house	10%	5 years

elements)	Individual B/C, Support 1,2,3 or equivalent			
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. Gilt Funds (UK Government Bonds)	Short-term F1+, Long-term AA-	In-house	10%	5 years

9.1.11 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.

9.1.12 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.

9.1.13 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.

9.2 Investment Strategy

9.2.1 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).

9.2.2 The Authority has one investment that spans the financial year 2009/10.

Royal Bank of Scotland £5 Million
Maturity: May 2011
Rate 4.75%

9.2.3 Interest rate outlook: Sector is forecasting that Bank Rate will fall to 0.50% in Q1 2009 and stay flat until Q2 2010 when it will rise to 0.75% with further gradual increases until it reaches 4.00% in Q1 2012.

9.2.4 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 2009/10 an investment return of 1.5% on investments placed in 2009/10 should be attainable. Including investments already made in 2008/09 at higher rates but which relate in part to 2009/10, the overall investment return for 2009/10 should be in the range 2.00% to 2.25%.

9.2.5 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.

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

10.0 EQUALITY & DIVERSITY

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

COUNCILLOR PETER REDSTONE
EXECUTIVE MEMBER FOR RESOURCE

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

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 – 6 December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

Capital Economics interest rate forecast –18 December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010
Bank Rate	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
5yr PWLB rate	1.65%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%
10yr PWLB rate	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
25yr PWLB rate	4.15%	4.00%	3.80%	3.65%	3.65%	3.65%	3.65%	3.65%
50yr PWLB rate	4.05%	3.95%	3.85%	3.75%	3.75%	3.75%	3.75%	3.75%

UBS interest rate forecast (for quarter ends) – 12 December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
Bank rate	0.50%	0.50%	0.50%	0.75%
10yr PWLB rate	3.75%	4.15%	4.35%	4.65%
25yr PWLB rate	4.25%	4.55%	4.85%	5.05%
50yr PWLB rate	4.30%	4.65%	5.00%	5.25%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – December 2008 summary of forecasts of 23 City and 12 academic analysts for Q4 2008 and 2009. Forecasts for 2010 – 2012 are based on 21 forecasts in the last quarterly forecast – November 2008.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate		
	actual	Q4 2008	Q4 2009	ave. 2010	ave. 2011	ave. 2012
Median	2.00%	2.00%	1.00%	3.11%	3.97%	4.49%
Highest	2.00%	4.50%	4.00%	4.70%	5.00%	5.25%
Lowest	2.00%	2.00%	0.50%	1.00%	2.25%	3.00%

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.

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.