

## **TREASURY MANAGEMENT STATEMENT**

### **1. Introduction**

- 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); this details 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 Council's Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's external treasury advisor. This strategy covers:
- treasury limits for 2008/09 to 2010/11, which will limit the treasury risk and activities of the Council;
  - prudential indicators;
  - the current treasury position and borrowing requirement;
  - prospects for interest rates;
  - the borrowing strategy;
  - the extent of debt rescheduling opportunities;
  - the annual investment strategy including the treasury management policy.
- 1.4 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.

## 2. Treasury Limits for 2008/09 to 2010/11

- 2.1 It is a statutory duty under S.3 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" (also referred to as "Authorised Limit").
- 2.2 The Council must have regard to the Prudential Code when setting the Authorised 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 "Authorised 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 Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

## 3. Prudential Indicators for 2008/09 – 2010/11

- 3.1 The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.
- 3.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted in May 2002 by the Council.
- 3.3 The actual capital expenditure that was incurred in 2006/07 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

	Capital Expenditure					
	2006/07 Actual £'000	2007/08 Estimate £'000	2007/08 Revised Estimate £'000	2008/09 Estimate £'000	2009/10 Estimate £'000	2010/11 Estimate £'000
General Fund						
HRA	86,770	78,806	90,548	88,302	105,970	71,697
<b>Total</b>	<b>18,075</b>	<b>19,278</b>	<b>19,819</b>	<b>58,093</b>	<b>81,351</b>	<b>81,797</b>
	<b>104,845</b>	<b>98,084</b>	<b>110,367</b>	<b>146,395</b>	<b>187,321</b>	<b>153,494</b>
<b>Funded by</b>						
Credit						
approvals/supported						
borrowing	22,135	23,666	23,713	48,817	72,625	74,580
Unsupported						
borrowing	276	592	910	962	1,234	0
Capital receipts	12,377	10,216	14,121	18,167	10,628	12,107
Government grants	42,910	42,144	50,669	57,143	77,463	48,494
Major Repairs						
Allowance (MRA)	12,272	11,991	11,991	11,855	11,581	11,813
Revenue and other						
contributions	14,875	9,475	8,963	9,451	13,790	6,500

<b>Total</b>	<b>104,845</b>	<b>98,084</b>	<b>110,367</b>	<b>146,395</b>	<b>187,321</b>	<b>153,494</b>
--------------	----------------	---------------	----------------	----------------	----------------	----------------

- 3.4 Estimates of the ratio of financing costs to net revenue stream for the current and future years and the actual figures for 2006/07 are:

	<b>Ratio of Financing Costs to Net Revenue Stream</b>					
	<b>2006/07 Actual £'000</b>	<b>2007/08 Estimate £'000</b>	<b>2007/08 Revised Estimate £'000</b>	<b>2008/09 Estimate £'000</b>	<b>2009/10 Estimate £'000</b>	<b>2010/11 Estimate £'000</b>
GF	6.48%	7.04%	6.19%	5.93%	5.77%	5.62%
HRA	26.13%	33.41%	33.45%	32.94%	34.48%	36.47%
Combined	5.08%	5.55%	4.87%	4.65%	4.52%	4.42%

The estimates of financing costs include current commitments and the proposals in this budget report and elsewhere on the agenda.

- 3.5 The actual capital financing requirement for 2006/07 and estimates of the capital financing requirement for the council for the current and future years are:

<b>Capital Financing Requirement</b>						
	<b>2006/07 Actual £'000</b>	<b>2007/08 Estimate £'000</b>	<b>2007/08 Revised Estimate £'000</b>	<b>2008/09 Estimate £'000</b>	<b>2009/10 Estimate £'000</b>	<b>2010/11 Estimate £'000</b>
GF	238,840	258,103	240,723	236,404	232,837	229,920
HRA	364,812	371,147	371,045	413,383	481,353	549,537
<b>Total</b>	<b>603,652</b>	<b>629,250</b>	<b>611,768</b>	<b>649,787</b>	<b>714,190</b>	<b>779,457</b>

- 3.6 The capital financing requirement (CFR) measures the authority's underlying need to borrow for a capital purpose. The Council has, at any point in time, a number of cash flows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices.
- 3.7 The CFR is planned to increase significantly from 2008/09 onwards primarily because of the additional supported investment in respect of decent homes that will be funded by supported borrowing.
- 3.8 CIPFA's *Prudential Code for Capital Finance in Local Authorities* includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing

does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.”

- 3.9 The Council will meet this requirement. This view takes into account current commitments, existing plans, and the proposals in this budget report and elsewhere on the agenda. Borrowing is within the requirements of the capital programme.

	<b>Net borrowing and Capital Financing Requirement</b>				
	<b>2007/08 Estimate £'000</b>	<b>2007/08 Revised Estimate £'000</b>	<b>2008/09 Estimate £'000</b>	<b>2009/10 Estimate £'000</b>	<b>2010/11 Estimate £'000</b>
Gross borrowing	635,291	644,026	659,787	724,190	789,457
Investments	(30,000)	(60,000)	(60,000)	(60,000)	(60,000)
<b>Net Borrowing</b>	<b>605,291</b>	<b>584,026</b>	<b>599,787</b>	<b>664,190</b>	<b>729,457</b>
<b>Capital Financing Requirement</b>	<b>629,250</b>	<b>611,768</b>	<b>649,787</b>	<b>714,190</b>	<b>779,457</b>

- 3.10 The operational boundary is the Council's estimate of the most likely and prudent level of external debt needed to fund capital expenditure. The starting point is the actual gross debt as at 31 March 2007 and this is then adjusted for the element of the capital programme each year to be funded by external borrowing, an allowance for the possibility of needing to borrow temporarily on the last evening of the financial year, other long term liabilities and a small amount of headroom (contingency) to give the operational boundary. The authorised limit provides over and above the operational boundary for unusual cash movements. It would not be normal to exceed the operational boundary and if this was required then this would be reported to Cabinet and Council. We would similarly report any issues with keeping within the authorised limit for approval.
- 3.11 It is recommended that the Council approve the following operational and authorised limits for its total external debt for the next three financial years. These limits separately identify borrowing from other long-term liabilities such as leases. The operational boundary represents a key management tool for in year monitoring by the Chief Financial Officer. The operational boundary excludes the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate.
- 3.12 The Council is asked to approve the following limits and to delegate authority to the Chief Financial Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and

other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Council at its next meeting following the change.

	<b>Operational Boundary for External Debt</b>		
	<b>2008/09 Estimate £'000</b>	<b>2009/10 Estimate £'000</b>	<b>2010/11 Estimate £'000</b>
Gross borrowing	659,787	724,190	789,457
Headroom	4,013	4,075	4,274
Other long term liabilities	7,200	6,735	6,269
<b>Total</b>	<b>671,000</b>	<b>735,000</b>	<b>800,000</b>

	<b>Authorised Limit for External Debt</b>		
	<b>2008/09 Estimate £'000</b>	<b>2009/10 Estimate £'000</b>	<b>2010/11 Estimate £'000</b>
Gross borrowing	659,787	724,190	789,457
Headroom	29,013	29,075	29,274
Other long term liabilities	7,200	6,735	6,269
<b>Total</b>	<b>696,000</b>	<b>760,000</b>	<b>825,000</b>

- 3.13 The proposed authorised and operational limits for external debt in 2008/09 to 2010/11 are consistent with the authority's current commitments, existing plans and the proposals in this budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. They are based on the estimate of the most likely forecast position, but with sufficient headroom over and above this to allow for operational cash flow management.
- 3.14 The Council's actual external debt at 31 March 2007 was £634 million. This is well below our operational boundary and authorised limits for external debt.
- 3.15 In taking its decisions on this budget report, the Council is asked to note that the authorised limit determined for 2008/09 (see paragraph 3.11 above) will be the statutory limit determined under Part 1 s.3 (1) of the Local Government Act 2003.
- 3.16 The Band D Council Tax that would result for the Council for 2008/09 from the totality of the capital and revenue plans recommended in this budget report and elsewhere on the agenda is £1,161.66.
- 3.17 Forward estimates for the Band D Council Tax for 2009/10 and 2010/11 are £1,196.51 and £1,232.41 respectively. These forward estimates are not fixed and do not commit the Council. They are based on the Council's

existing commitments, current plans and the totality of the approved capital and revenue plans.

- 3.18 With respect to the HRA, the average weekly rent that would result for 2008/09 from the totality of the capital and revenue plans is £79.52.
- 3.19 Forward estimates for housing rents for 2009/10 and 2010/11 are £83.50 and £87.67 respectively. Again, these forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the totality of the approved capital and revenue plans.

### **Consideration of options for the capital programme**

- 3.20 In considering its programme for capital investment, the Council is required within the Prudential Code to have regard to:
- Affordability, e.g. implications for Council Tax;
  - Prudence and sustainability, e.g. implications for external borrowing;
  - Value for money, e.g. option appraisal;
  - Stewardship of assets, e.g. asset management planning;
  - Service objectives, e.g. strategic planning for the authority;
  - Practicality, e.g. achievability of the forward plan.
- 3.21 A key measure of affordability is the impact on the Council Tax, and the Council could consider different options for its capital investment programme in relation to their differential impact on the Council Tax. The Council considers future capital investment options through its business planning process including the pre-business plan reviews.

### **Treasury management**

- 3.22 It is recommended that the Council set upper limits on its fixed interest rate exposures as follows: 2008/09 £660 million, 2009/10 £725 million and 2010/11 £790 million.
- 3.23 It is recommended that the Council set upper limits on its variable interest rate exposures as follows; 2008/09 £66 million, 2009/10 £73 million and 2010/11 £79 million.
- 3.24 It is recommended that the Council set upper and lower limits for the maturity structure of its borrowings during 2008/09 as follows:  
Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period.

	Upper limit	Lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

3.25 Following advice received from our external advisors, Sector, it is proposed to broaden our investment strategy (see section 8) to permit investing some sums for periods longer than 364 days.

3.26 The capital finance regulations contained in the Local Government Act 2003 do not deal with investments and this has been dealt with through guidance from the ODPM.

#### 4. The Current Treasury Position and Borrowing Requirement

4.1 The Council's treasury portfolio position at 31 March 2007 comprised:

		Principal sum	Average rate
<b>Debt</b>		<b>£m</b>	<b>%</b>
Fixed Rate Funding	PWLB	509.0	
	Market	125.0	
		<b>634.0</b>	
Other long term liabilities		6.3	
<b>Total Debt</b>		<b>640.3</b>	7.26%
<b>Total Investments</b>		<b>100.7</b>	5.44%
<b>Current net borrowing</b>		<b>539.6</b>	

4.2 The capital financing requirement (CFR) is planned to increase in 2008/09 by £38m as a consequence of the capital programme proposed.

4.3 CFR is planned to increase significantly from 2008/09 onwards primarily because of the anticipated additional supported investment in respect of **decent homes** – potentially up to £160m of capital investment in housing stock from 2008/09 to 2010/11. This will be financed by supported borrowing. Homes for Haringey have now successfully achieved the two star inspection, which was a pre-requisite for the release of decent homes funding. The bid for investment funding was £231m above existing funding streams and the DCLG are in dialogue with all local authorities about the timing and scale of the final approval. There is pressure from government to release the funding over a longer time than the current CSR period.

4.4 For **children's services**, the Building Schools for Future (BSF) programme (including the new 6<sup>th</sup> form centre) is the main scheme. A total of £199m is planned to be spent on BSF (made up of £179m of central government resources, £10m from the Learning Skills Council contributing towards the

cost of the new 6<sup>th</sup> form centre, a specific capital receipt and revenue contributions from the DSG).

4.5 In the Council's 2008/09 to 2010/11 budget plans the capital programme is mainly based on the amount of supported borrowing and grant from central government and a projection of potential capital receipts. However there is one new unsupported borrowing scheme and further phased spend on an existing prudential scheme with spend totalling £2.2m. These are in addition to the existing approval in relation to the investment in Leisure facilities and IT investment. In all cases the proposals need to meet the approved Council's policy on passing the affordability test where the cost of borrowing is being met by additional revenue income and or expenditure savings. Therefore there is no increase in council tax or housing rent to fund a higher level of spend above the level of resources available.

4.6 Council's estimated borrowing requirement in future years as set out in the prudential limits is as set out in the table below.

	2008/09	2009/10	2010/11
	£m	£m	£m
New borrowing	15.8	64.4	65.3
Alternative financing arrangements	0	0	0
Replacement borrowing	0	0	0
<b>Totals</b>	<b>15.8</b>	<b>64.4</b>	<b>65.3</b>

4.7 Although there is no scheduled replacement borrowing in the period as shown above, there are some LOBO option start date reviews on existing borrowing in 2008/09 to 2010/11 where replacement borrowing may be required depending on the outcome of those reviews.

## 5. Prospects for interest rates

5.1 The Council 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. The following table gives the forecast, which is Sector's central view.

5.2 **Sector View as at 24 December 2007:** Current interest rate view is that Bank Rate:

- Started on a downward trend from 5.75% to 5.50% in December 2007;
- To be followed by further cuts in Q1 2008 to 5.25% and to 5.00% in Q2 2008;
- Then unchanged for the following two years.
- There is a downside risk to this forecast if inflation concerns subside and so open the way for the Monetary Policy Committee (MPC) to be able to make further cuts in Bank Rate.

	Q/E 4 2007 %	Q/E 1 2008 %	Q/E 2 2008 %	Q/E 3 2008 %	Q/E 4 2008 %	Q/E 1 2009 %	Q/E 2 2009 %	Q/E 3 2009 %	Q/E 4 2009 %	Q/E 1 2010 %	Q/E 2 2010 %	Q/E 3 2010 %	Q/E 4 2010 %
Bank rate	5.50	5.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
5yr PWLB rate	4.80	4.70	4.65	4.55	4.55	4.60	4.70	4.75	4.80	4.80	4.80	4.85	4.85
10yr PWLB rate	4.80	4.70	4.60	4.55	4.55	4.55	4.55	4.60	4.70	4.75	4.75	4.80	4.80
25yr PWLB rate	4.65	4.60	4.55	4.55	4.50	4.55	4.55	4.60	4.65	4.70	4.70	4.70	4.70
50yr PWLB rate	4.55	4.50	4.45	4.45	4.45	4.45	4.45	4.50	4.50	4.55	4.55	4.55	4.55

5.3 Sector's reviews of economic background during 2007 and looking forward through 2008 and into 2009 for UK, US and EU are as follows.

#### 5.4 UK economic background

5.4.1 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% in 2007 as a whole to 2% in 2008.

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

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

5.4.4 The combination of increases in Bank Rate and hence mortgage rates, short term mortgage fixes expiring and being renewed at higher rates, food prices rising at their fastest rate since 1993 and increases in petrol prices, have all put consumer spending power under major pressure.

5.4.5 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.

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

5.4.7 The MPC is very concerned at the build up of inflationary pressures especially the rise in the oil price and the consequent likely knock on effects on general prices. The prices of UK manufactured goods has risen at the fastest rate in 16 years in November 2007 at 4.5%. Food prices have also risen at their fastest rate for 14 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 further compared to USA taking account 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.

- 5.4.8 The downward trend in Bank Rate is now expected to be faster than as 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 in Q1 and Q2 2008 before Bank Rate stabilises at 5.00% for the next two years.
- 5.4.9 US and EU economic positions and outlooks have also been reviewed and taken into account in formulating a view on interest rates.
- 5.4.10 The forecast within this strategy statement has also taken account of data from a variety of forecasts published by a number of institutions.

## **6 Borrowing Strategy**

- 6.1 The Sector forecast is as follows: -

- 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 Q4 2009 and to 4.55% in Q2 2010. As the Sector forecast is in 25bp segments there is scope for the rate to move around the central forecast by +/- 25 basis points without affecting this overall forecast;
- The 25 year PWLB rate is expected to fall progressively from 4.65% to reach 4.50% in Q4 2008 and to then be on the rise from Q1 2009 to reach 4.70% in Q1 2010 and 4.75% in Q1 2011;
- The 10 year PWLB rate is expected to fall from 4.70% in Q1 2008 to 4.55% in Q3 2009 and to then gradually rise to reach 4.80% in Q3 2010;
- 5 year PWLB rate is expected to fall from 4.70% in Q1 2008 to reach 4.55% in Q3 2008 and to then gradually rise starting in Q1 2009 to reach 4.85% in Q3 2010;

- 6.2 This forecast indicates that the borrowing strategy for 2008/09 should be set to take 25 to 30 year borrowing towards the end of the financial year but as little variation is expected in average quarterly rates, this is likely to mean that attractive rates could be available at any time in the year when there is a dip down in rates. Variable rate borrowing and borrowing in the five year area are expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to taking long term borrowing.

- 6.3 The main strategy to minimise debt interest costs is as follows:

- Focus on undertaking new borrowing in or near the 25 to 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 the 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 means that after some years of focusing on borrowing at or near the 50 year period, local authorities will be able to borrow in a markedly different period and so achieve a better spread in their debt maturity profile;
- When the 25 to 30 year PWLB rates fall back to the forecast of 4.60%, 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 4.60%. However, if shorter period loans become available around this rate, these will also be considered;
- The forecast will be reviewed on an ongoing basis;
- Consideration will be given to borrowing fixed rate market loans at 25 to 50 basis points below the PWLB target rate.

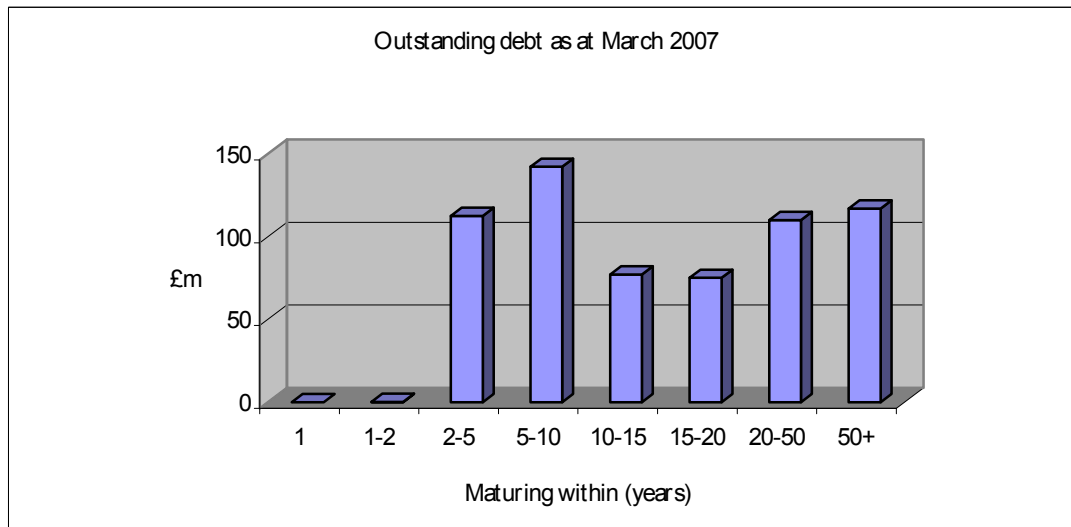
6.4 Against this background caution will be adopted with the 2008/09 treasury operations. The Chief Financial Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions as required by the policy.

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

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap;
- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

## **7. Debt Rescheduling and restructuring**

- 7.1 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 to 50 basis points for the longest period loans narrowing down to 25 to 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 could still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans.
- 7.2 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 section 6 earlier in the report.
- 7.3 The reasons for any rescheduling to take place will include:
- the generation of cash savings and/or discounted cash flow savings;
  - in order to help fulfil the strategy outlined in section 6; and
  - enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 7.4 All rescheduling will be reported as required by the policy.
- 7.5 Profile of long term debt maturity as at 31 March 2007 is as follows. Currently debt maturing within 5 to 10 years is relatively high. This is monitored as part of our continual review of our debt profile with our advisors to ensure that a balanced portfolio is maintained that takes due account of risk.



## 8. Annual investment strategy

### 8.1 Investment Policy

8.1.1 The Council will have regard to the ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities are: -

- the security of capital and
- the liquidity of its investments.

8.1.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

8.1.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

#### **Developing our investment strategy**

8.1.4 Our external advisors, Sector, have advised that we consider developing our investment strategy.

8.1.5 The Council's current policy is not to deal in non-specified investments. i.e. investments longer than one year and specific investments below one year that are also regarded as non-specified investments. e.g. Certificates of Deposits issued by banks and building societies.

8.1.6 Sector advise that there would appear to be no value in using external fund managers in the current market conditions and therefore suggest we consider an approach using our in-house team.

8.1.7 It is suggested that we could invest some of our portfolio over one year and up to three years ahead to achieve greater value and to protect the Council against any future interest rate falls. Benefit would be if interest rates then fell and we were locked into higher interest rates. The risk would be if interest rates went up and we were locked into lower interest rates for a period of time. If we invest in liquid investments we could sell early although the risk would be the prevailing market price on the day of sale. If we invest in an illiquid investment we would need to hold.

8.1.8 Liquidity requirements will be driven by our long term cash flow forecasts. It is prudently estimated that there is a core balance available of £30m that is available for investment for up to three years ahead.

8.1.9 There are three new types of instruments and Forward Deals that Sector recommend we should consider investing a proportion of our portfolio in as set out below:

- Certificates of Deposits;
- Callable Deposits;
- Term Deposits greater than one year;
- Forward Deals.

8.1.10 The main features of each proposed new type of investment including their benefits and risks are set out in the following table.

	<b>Main features</b>	<b>Benefits</b>	<b>Risks</b>
Certificates of Deposits	<p>Issued by organisations with the same credit risk as banks and building societies that we currently make term deposits with.</p> <p>Investments would be with banks, building societies and local authorities.</p>	<p>Real advantage is if there were a change in interest rates or liquidity circumstances we could sell the investment.</p> <p>Useful for investing some of our core funds to minimise risk of some being required.</p> <p>Yields are a couple of basis points below those available from a comparable term deposit.</p>	Any sale of an investment before its natural maturity date will be subject to market risk at the date of sale.

Callable Deposits	<p>Money Market deals where the deposit taker has an option to repay the loan at intervals between the start date and the maturity date, these options to repay are typically quarterly or annually.</p> <p>Investments would be with banks, building societies and local authorities.</p>	<p>Enhanced return available with the margin over the cash rate for the same investment duration reflecting the value of the options to repay that the borrower has.</p> <p>Can help provide marginal improvements in yield.</p>	<p>Risk of early repayment by the borrower, the paying of premium interest rate compensates for this.</p>
Term Deposits greater than one year	<p>Investment for a fixed period of time and at a fixed rate of interest.</p> <p>Investments would be with banks, building societies and local authorities.</p>	<p>Lock into higher interest rates for a longer period of time.</p> <p>Preserves capital values as would only lend to highly credit-rated institutions.</p>	<p>Mis-timing a deposit could expose the Council to a potential revenue shortfall in an environment of rising interest rates.</p> <p>In most cases, a lender is unable to force liquidation of a deposit prior to its maturity date and any success in achieving this could attract a penalty.</p> <p>The longer the term deposit, the higher is the relative liquidity risk.</p>
Forward Deals	<p>If Sector or the Council believes that there has been a spike in interest rates and the Council does not have the necessary cash available to take advantage of the higher rate, the Council can undertake a forward deal which fixes the price today, for transfer of monies at some point in the future.</p> <p>Would invest in forward deals issued by banks and building societies.</p>	<p>Ensures that the Council does not miss out on an opportunity due to liquidity reasons.</p> <p>Can be used to protect investments that are maturing when it is believed that lower interest rates will prevail. The Council could protect itself by fixing a higher price today, for the transfer of monies when the original investment matures hence preventing the reinvestment of the matured investment at lower levels.</p>	<p>View taken on interest rates could be incorrect. In the future even better investments could be available but would be committed to the forward deal made.</p>

8.1.11 Sector recommend that the Council should inject an element of liquidity into the portfolio strategy using Certificates of Deposits issued by highly credit rated institutions. This will enable the Council to effectively manage the portfolio with Sector's advice, even though a 'buy and hold' strategy is envisaged, enabling the Council to terminate investment quickly and switch investments should the need arise during the course of the investment period.

- 8.1.12 Within any portfolio there is an element of cash which is invested for relatively short periods because of uncertainty over its future use but does have the tendency to be available for a long period of time. The uncertainty clouds the investment decision. By using liquid instruments, the investment decision can still be made in the comfort of knowing that should the cash be required sooner than the maturity of the investment, the investment could be considered for selling to realise the appropriate funds. Any such sale of an investment before its natural maturity date will be subject to market risk at the date of sale.
- 8.1.13 The above approach will enable the Council to manage its own portfolio to achieve the desired level of certainty and volatility in relation to our return objectives in a diversified manner which will deliver better value than the perceived future returns available from using fund managers.
- 8.1.14 As part of the above strategy **it is recommended** that we permit investments in Certificates of Deposits, Callable Deposits and Term Deposits with highly credit rated banks, building societies and local authorities and allow Forward Deals up to a duration of three years and up to a limit of £30m (our core funds based upon our cash flow).
- 8.1.15 It is proposed that we review the above approach in one year's time to determine if this strategy needs further revision.

### **Specified investments**

- 8.1.16 All such investments will be sterling denominated, with maturities up to a maximum of one year. Investment is permitted with the following organisations registered in the UK, European Union or North America, up to the following investment limits. **It is recommended** that we increase our counterparty limits to reflect current sums available for investment. These have been set at a prudent level and the table below compares the current limits with those proposed. The previous limits per counterparty were put in place a number of years ago when the Council did not have the current level of money to invest and therefore tends to restrict our dealing unduly.

	<b>Current counterparty limits £m</b>	<b>Proposed counterparty limits £m</b>
All banks authorised under the Banking Act 1987 which have an acceptable rating in the rating matrix	10	20
The Council's banker (currently Co-operative Bank PLC but changing to Natwest from 1 April 2008)	7	10
All building societies which have an acceptable rating in the rating matrix	10	20
Local Authorities	10	15
HM Government	20	20
Money Market Funds	10	10

## Non-specified investments

8.1.17 A maximum of £30m will be held in aggregate in non-specified investments and be invested for periods of up to a maximum duration of three years.

	Counterparty limits £m
Term deposits – local authorities, banks and building societies that have an acceptable rating in the rating matrix.	10
Certificates of Deposits issued by banks and building societies that have an acceptable rating in the rating matrix.	10
Callable deposits issued by banks and building societies that have an acceptable rating in the rating matrix.	10
Forward deals issued by banks and building societies that have an acceptable rating in the rating matrix.	10

8.1.18 The ratings matrix referred to in the above tables is prepared by the Council's treasury advisors. The Council uses Fitch ratings to derive its criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's (*or other rating agency if applicable*) rating will be used. All credit ratings will be monitored on an ongoing basis. 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.

8.1.19 The Treasury Management Policy document is included at Section 9.

## 8.2 Investment Strategy

### In-house funds

8.2.1 Based on its cash flow forecasts, the Council anticipates its fund balances in 2008/09 to range between £50m and £125m, however, cashflow variations can sometimes occur where this may vary.

8.2.2 Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for interest rates (i.e. rates for investments up to 12 months and beyond 12 months).

8.2.3 Giving due consideration to the Council's balances over the next 3 years, the need for liquidity, its spending commitments and provisioning for

contingencies, the Council has determined that some of its overall fund balances could possibly be prudently committed to longer term investments (i.e. those with a maturity exceeding a year). It is prudently estimated that there is a core balance available of £30m that is available for investment over a 2 to 3 year period.

- 8.2.4 The purpose of our strategy is to maximise our investment returns but only by taking a prudent level of risk. Our **proposal** to investment up to £30m using new instruments and forward deals for between one and three years is to achieve greater value and to protect the Council against any future interest rate falls.

### **Interest Rate Outlook**

- 8.2.5 Sector is forecasting that Bank Rate has now started on a downward trend from 5.75% to 5.50% in December 2007. This will continue with further cuts forecast to 5.25% in Q1 2008 and again to 5% in Q2 2008. It will then expected to remain unchanged for the next two years. We are advised to lock in longer period investments at higher rates before this fall starts for some element of our investment portfolio which represents our core balances. For 2008/09 we are advised to budget for an investment return of 5% on investments placed in 2008/09.
- 8.2.6 Attractive trigger rates for lending will be kept under review in consultation with Sector. 5.45% is identified as the current attractive rate for one year, and 5.55% for two and three years.
- 8.2.7 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to 3 months) in order to benefit from the compounding of interest.

### **End of year Investment Report**

- 8.2.8 At the end of the financial year, the Council will report on its investment activity as part of its outturn report.

## **9. Treasury Management Policy**

### **Introduction**

- 9.1 This policy is prepared in accordance with the Code of Practice on Treasury Management in Local Authorities, published by CIPFA ('the Code'). In adopting the Code, the following policies have been agreed.
- 9.2 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 4 of that Code.
- 9.3 Accordingly, the Council has created and will maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies and objectives of its treasury management activities
  - suitable treasury management practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how those activities will be managed and controlled.
- 9.4 The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 and 7 of the code subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the code's key recommendations.
- 9.5 The Council receives reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, and an annual report after its close, in the form prescribed in its TMP's.
- 9.6 The Council delegates responsibility for the monitoring of the implementation of its treasury management policies and practices to the Cabinet Member for Resources. The Council delegates the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the organisation's statement and TMP and CIPFA's Standard of Professional Practice on Treasury Management.

### **Definitions**

- 9.7 The Code defines treasury management as:
- “the management of the local authority’s cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks”.
- 9.8 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
- 9.9 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employ suitable performance measurement techniques, within the context of effective risk management.

### **Approved activities**

- 9.10 The approved activities for the treasury management function are:
- borrowing;

- lending;
- debt repayment and rescheduling;
- consideration, approval and use of financial instruments and treasury management techniques;
- managing the underlying risk associated with the Council's capital financing and cash flows;
- leasing.

### **Strategy**

- 9.11 An annual strategy report will be presented to Council. The report will set out projections of treasury management activity for the year and for subsequent years and propose actions to be taken.
- 9.12 The strategy will consider:
- interest rate prospects;
  - borrowing strategy;
  - annual investment strategy;
  - debt rescheduling;
  - any other treasury management activity.
- 9.13 The strategy will further set out:
- the Council's Prudential Indicators for the following 3 financial years;
  - the Council's current portfolio position and borrowing requirement.

### **Approved methods and sources of funding**

- 9.14 Borrowing is raised in accordance with the Local Government and Housing Act (1989) and is permitted via the following instruments:

- overdraft;
- short term loans;
- Public Works Loan Board loans;
- other loan instruments.

### Investment Policy

9.15 The Council will have regard to the ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities are: -

- the security of capital; and
- the liquidity of its investments.

9.16 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

9.17 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

9.18 Specified Investments. (All such investments will be sterling denominated, with maturities up to maximum of 1 year). Investment is permitted with the following organisations registered in the UK, European Union or North America, up to the following investment limits. **It is recommended** that we increase our counterparty limits to reflect current sums available for investment. These have been set at a prudent level and the table below compares the current limits with those proposed. The previous limits per counterparty were put in place a number of years ago when the Council did not have the current level of money to invest and therefore tends to restrict our dealing unduly.

	Current counterparty limits £m	Proposed counterparty limits £m
All banks authorised under the Banking Act 1987 which have an acceptable rating in the rating matrix	10	20
The Council's banker (currently Co-operative Bank PLC but changing to Natwest from 1 April 2008)	7	10
All building societies which have an acceptable rating in the rating matrix	10	20
Local Authorities	10	15

HM Government	20	20
Money Market Funds	10	10

- 9.19 Non-specified investments. A maximum of £30m will be held in aggregate in non-specified investments and be invested for periods of up to a maximum duration of three years.

	Counterparty limits £m
Term deposits – local authorities, banks and building societies that have an acceptable rating in the rating matrix.	10
Certificates of Deposits issued by banks and building societies that have an acceptable rating in the rating matrix.	10
Callable deposits issued by banks and building societies that have an acceptable rating in the rating matrix.	10
Forward deals issued by banks and building societies that have an acceptable rating in the rating matrix.	10

- 9.20 The ratings matrix referred to in the above table is prepared by the Council's treasury advisors. The Council uses Fitch ratings to derive its criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's (*or other rating agency if applicable*) rating will be used. All credit ratings will be monitored on an ongoing basis. 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.

### **Investment Strategy**

- 9.21 Investments will be made with reference to the core balance and cash flow requirements and the outlook for interest rates (i.e. rates for investments up to 12 months and beyond 12 months).
- 9.22 Attractive trigger rates for one year, two year and three year lending will be kept under review in consultation with Sector.
- 9.23 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest.

### **Brokers and advisors**

9.24 The following brokers are approved for open market transactions:

- ICAP PLC;
- Prebon Marshall Yamane (UK) Ltd;
- Tradition UK Ltd;
- Sterling Brokers Ltd;
- The Co-operative Bank PLC (Natwest from 1 April 2008);
- Martins Brokers (UK) PLC.

9.25 The following broker is approved for leasing transactions:

- Sector Leasing Services Ltd

9.26 The Chief Financial Officer is authorised to deal with other brokers or agents, from time to time, when the Chief Financial Officer considers it to be beneficial to the Council.

9.27 The Council's treasury management advisor is Sector.

### **External managers**

9.28 The use of external managers is not permitted.

### **Delegation**

9.29 The following delegations will apply for treasury management:

#### Cabinet

Annual review of policy

Consideration of the strategy

#### Chief Financial Officer

Implementation of the policy and strategy, including the authority to raise loans, enter into leases and make investments. In each case this will be in accordance with procedures determined by the Chief Financial Officer as set out in the Treasury Management Practices.

Any decision to invest in specified investments not currently used or in non-specified investments will be made following advice from Sector.

### **Reporting**

9.30 The Chief Financial Officer will:

- prepare an annual strategy report and review of the policy for the consideration of the Cabinet;
- report annually to the Cabinet on the achievement of the previous year's strategy;
- report relevant, key details of the treasury management activities to the Cabinet Member for Resources.