4. ANNUAL TREASURY STRATEGY 2007/08

Introduction

4.1 The background to the Council's strategy is the requirement to take account of relevant Codes of Practice. The Council adopted the CIPFA Code of Practice on Treasury Management in February 2002. The Code of Practice on Prudential Borrowing was introduced in 2004, in order to underpin use of the wider powers of the Local Government Act 2003. The proposed Strategy follows the requirement of this code.

4.2 The Strategy covers:

- treasury market background;
- the current treasury position;
- Prudential Indicators;
- treasury limits;
- the borrowing strategy;
- debt rescheduling opportunities;
- investment strategy.

It takes into account views on interest rates, including market forecasts and the advice of the Council's treasury advisor.

4.3 At the end of the financial year a report on the Royal Borough's investment activity is produced as part of the Annual Treasury Report.

Market Background

4.4 The strategy takes into account the following broad economic assumptions. These are likely to vary during the year, but serve as a benchmark to assess whether change in external factors could prompt revision of the policy.

4.5 Economic Background – The UK is on the upswing of the economic cycle from a low point reached in 2005. Robust growth is expected to continue for a little longer but then cool slightly in 2007 before edging up to 2.5 per cent in 2008. Recovery in consumer spending and retail sales has underpinned this upswing in Gross Domestic Product (GDP) while the housing market has proved stronger than expected with house price inflation over 8 per cent last year. The three increases in Bank Rate in August and November 2006 and January 2007 are expected to dampen the housing market and increases in unsecured borrowing although one more increase in Bank Rate is forecast.

The Bank of England Monetary Policy Committee (MPC) decision to increase Bank Rate in November 2006 and January 2007 was needed to bring Consumer Price Index (CPI) down to the 2 per cent target level two years ahead. The MPC has been concerned that price increases with CPI being significantly above target since June 2006, could feed through to wage settlements in the current pay round. Household income growth is expected to recover in 2007 as inflation falls and pay rises. But extra income is likely to go into savings (including pensions) and servicing debt costs rather than consumer expenditure.

Public sector real increases in expenditure per annum are expected to weaken to 2.5 per cent over the next few years from the 3 per cent average over 2000 – 2005.

As well as the UK economy those of the United States (US) and European Union (EU) have been on the upswing of their economic cycles. Interest rates have been increased in order to cool the economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices. The US is ahead of the UK and EU in the business cycle and the Federal Reserve rate may have peaked at 5.25 per cent. A major feature of the US economy is the increasing downturn in the housing market which is likely to drag consumer spending, and so the wider economy down with it. The Federal Reserve may be reluctant to respond to the downturn in the economy if inflationary pressures remain high. This could exacerbate the downturn in both the US and world economies.

In the European Union growth picked up strongly in the first half of 2006 and is expected to remain healthy in the second half, however, due to weaker US and global demand growth is expected to slow moderately in 2007.

Despite sharply increased energy prices, disinflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3 per cent with the expectation that this will fall as the energy effects go into reverse.

4.6 Interest Rate Forecast – Interest rates cannot be predicted with certainty but our central expectation is that Bank Rate will peak at 5.50 per cent in the first quarter of 2007 and will then fall to 5.25per cent in the third quarter of 2007 and again to 5 per cent in the forth quarter of 2007. A further fall to 4.75 per cent is expected in the third quarter of 2008 and then to 4.5 per cent in the first quarter of 2009 before rising back to 4.75 per cent in the first quarter of 2010.

The Public Works Loan Board (PWLB) is the primary source of capital funding for local government, since it benefits from Government borrowing rates. Expectations are that the 50 year PWLB rate will remain flat at 4.25 per cent with the possibility of movements of +/- 25 basis points around this central rate. The 25-30 year PWLB rate is expected to stay at 4.50 per cent for the foreseeable future.

Tables 1 to 4 below show a number of current market forecasts. A significant feature is that long term rates are generally running below short term rates.

Sector Treasury Services (the Council's advisor) interest rate forecast 29 January 2007

Table 1

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

UBS Economic interest rate forecast – 15 January 2007

Table 2

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

Capital Economics interest rate forecast – 15 January 2007
Table 3

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

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

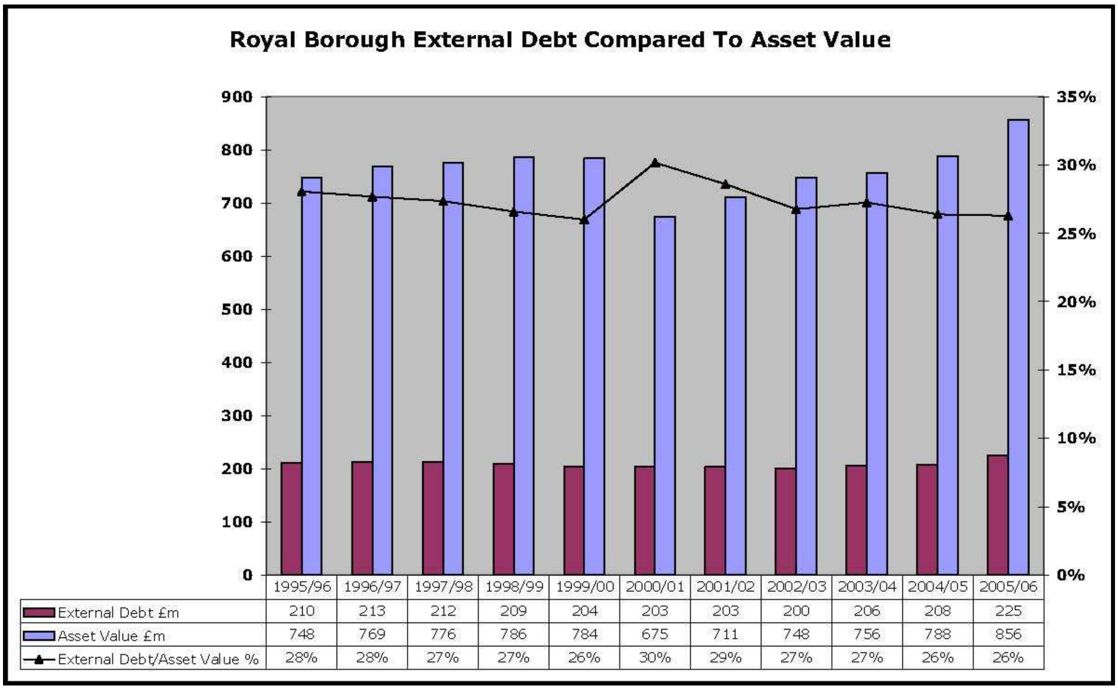
Table 4

	bank rate	Quarter ended		annual average bank rate		
	actual	Q4 2006	Q4 2007	ave. 2008	ave. 2009	ave. 2010
Indep. forecasters BoE Bank Rate	5.25%	4.98%	4.97%	4.86%	4.88%	4.85%
Highest bank rate	5.25%	5.00%	5.80%	5.90%	5.60%	6.10%
Lowest bank rate	5.25%	4.75%	4.50%	3.75%	4.00%	4.00%

BORROWING STRATEGY

Current Portfolio Position

4.7 The Council's overall long term borrowing for capital purposes at 31 January 2007 is £225 million. This represents about 26 per cent of the value of long term fixed assets (housing, operational, infrastructure and community assets) in their current use.



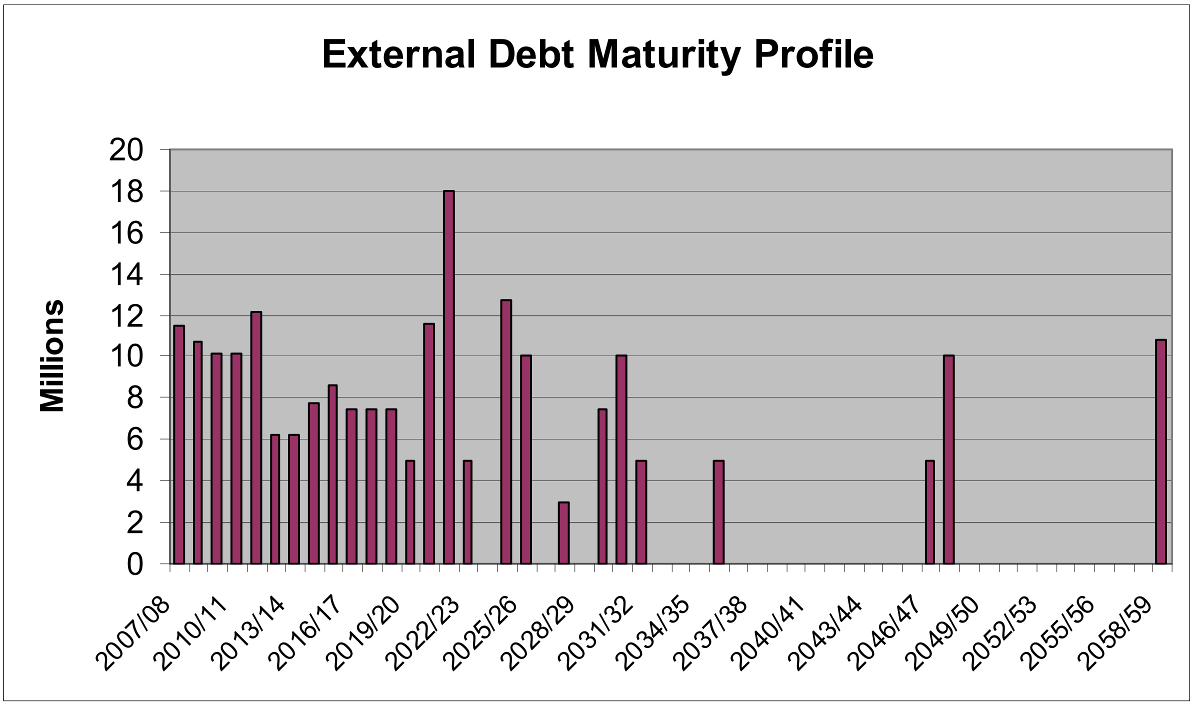
4.8 The Council's portfolio at 31 January 2007 is shown below. Borrowing represents the historic and current funding of the Council's asset portfolio (valuation in current use at 31 March 2006 of £858 million). Investments include funds held on behalf of schools, the Housing Revenue Account and the Pension Fund as well as the General Fund.

	£	£
Borrowing		
Public Works Loan Board (PWLB)	224,990,356	
Total (all at fixed rates)		**224,990,356**
Investments		
Internally managed	171,501,437	
Externally managed	60,000,000	
Total		**231,501,437**

Borrowing is not earmarked to the General Fund or Housing Revenue Account (HRA), but, using the Capital Financing Requirement as a proxy, the interest on external borrowing met by the HRA is 76 per cent of the total charge. Conversely the General Fund receives 82 per cent of the income generated by investments, with the HRA receiving 9 per cent and other funds (primarily the Pension Fund) also receiving 9 per cent.

The Council is not confined to borrowing from the PWLB. However the PWLB offers rates based on central Government borrowing powers and are typically lower than obtainable elsewhere. It offers long term fixed rates which can meet the Council's long term asset financing requirement with certainty for its budget.

4.9 The maturity profile of the Council's borrowing is shown in the graph below:



Borrowing Requirements

4.10 The Council's borrowing requirement is driven by:
- the past and present financing needs of the capital programme. The Council is permitted to raise finance for its capital needs forecast within the next three years of its capital programme
- the amount of current external debt maturing which will need to be refinanced
- any day to day temporary borrowing for short term cash flow purposes.

4.11 The issues which have been taken into account in determining the borrowing strategy are:

- the forward capital programme proposed to Council
- the current level of external debt
- interest rate risks including the balance between variable and fixed rates
- the desirability of a smooth debt maturity profile, to limit exposure to adverse interest rates in any one period.

4.12 The Council seeks to manage its risks by setting limits around treasury management activity under the Prudential Code. These are proposed in Tables 5–9 below. Within these limits the Council will take into account market circumstances in timing its external borrowing. Pending external borrowing it can use its internal cash balances to finance its long-term capital financing requirements.

4.13 The Capital Financing Requirement (CFR) as defined in the Prudential Code is designed to measure the local authority's underlying need to borrow for capital expenditure or to finance its other long-term liabilities. The Council's CFR is expected to rise over the next three years, due to the size of the programme. Table 5 shows the forecast requirement. This assumes that we take no additional borrowing in 2007/08 outside the HRA, but that this ramps up as the new school construction takes off. The school funding is currently predicated on the related capital receipt being payable at the end of the construction period. When the decision on the school is taken later in 2007/08 it will also be an opportunity to consider the profile of the capital receipt and this could change the CFR projections. Given the amounts projected in the council's reserves that is available for capital expenditure the Council would have the option to avoid new borrowing altogether in 2008/09 and use internal funding instead. This relies on the council's ability to externalise its funding requirement at any point in the future, as the Prudential Borrowing regime allows. However the Treasury also decides annually whether to set a limit on prudential borrowing if this is expected to exceed macro economic plans nationally. In view of the much tighter public sector environment forecast for 2008/09 onwards and the increasing take up nationally of prudential borrowing it may be prudent to continue to take a mixed approach with both internal and external funding.

Table 5 £'000

Capital Financing Requirement (as at 31 March)	2006/07	2007/08	2008/09	2009/10
General Fund	55,219	47,348	58,863	62,346
HRA	174,938	180,280	185,630	190,980
Total	230,157	227,628	244,493	253,326

4.14 Maximum borrowing limits (the Authorised Limit) are **proposed** in Table 6. These take into account the potential capital programme financing requirement, the potential maximum requirement for temporary borrowing and the refinancing of maturing debt. This includes the possibility of borrowing in advance against the needs of the future two years of the capital programme i.e. to 2009/10. The borrowing limits are also required to allow for any credit arrangements, of which the Council currently has none. The limit is set on a rolling basis for three years ahead. In practice the maximum limit is unlikely to be required. The 'Operational Boundary' also **proposed** in Table 6 is the expected normal upper requirement, and borrowing in practice will also be monitored and reported against this limit.

Table 6 £'000

Authorised limit for external debt	2006/07	2007/08	2008/09	2009/10
Borrowing	295,194	287,233	306,396	256,560
Other long term liabilities	0	0	0	0
Total	295,194	287,233	306,396	256,560
Operational boundary				
Borrowing	258,092	253,326	270,568	217,916
Other long term liabilities	0	0	0	0
Total	258,092	253,326	270,568	217,916

4.15 Table 7 shows the upper limits which are **proposed** on the Council's interest rate exposure. This means we intend to always hold more than half of our total projected debt requirements (Table 5) at fixed interest rates.

Table 7 £'000

Interest rate exposure limits	2006/07	2007/08	2008/09	2009/10
Fixed interest upper limit	253,000	244,000	244,000	244,000
Variable rate interest upper limit	127,000	122,00	122,000	122,000

4.16 Table 8 **proposes** limits on the debt maturity structure to ensure that the Council faces a manageable profile of financing in the long term.

Table 8

Maturity structure of fixed rate borrowing during 2007/08	Lower limit	Upper limit
Under 12 months	0%	10%
12 months and within 24 months	0%	10%
24 months and within 5 years	5%	20%
5 years and within 10 years	10%	50%
10 years and above	30%	85%
Limit of maturity in any one year	0%	10%

Executing the Strategy

4.17 Based on the interest rate forecasts, it could be advantageous to take long dated borrowing at any time during the financial year. Variable rate borrowing and borrowing in the five-year area are expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to long term borrowing. On this basis we would want to defer borrowing at variable rates until they have become more attractive. Variable rates carry greater budgetary risks than secure longer term fixed rates if these are available at low levels. However variable rate borrowing would reduce our overall exposure to interest rate fluctuations on investments.

4.18 With cash balances currently high the Council will not be forced into a borrowing position to fund capital spending and we could use cash balances instead. However we will take opportunities to secure long term finance for our long-term assets if particular market opportunities present themselves. With 50 year PWLB forecast to be around 4.25 per cent, it is likely that we would regard 4.00 per cent as a trigger for opportunities. As rate prospects are updated over the year we will adjust our assessment of good value opportunities.

4.19 The main sensitivities of the forecast are likely to be the two scenarios below. We will monitor both prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- If we expected rates to rise sharply we would have the option of taking money before it became more expensive, or of sitting out the upswing. Given our current levels of investments it is more likely that we would use internal cash to meet spending requirements than increase our borrowing. However if the rate rise looked to be a long term structural shift we would draw further fixed rate funding while rates were still cheap.

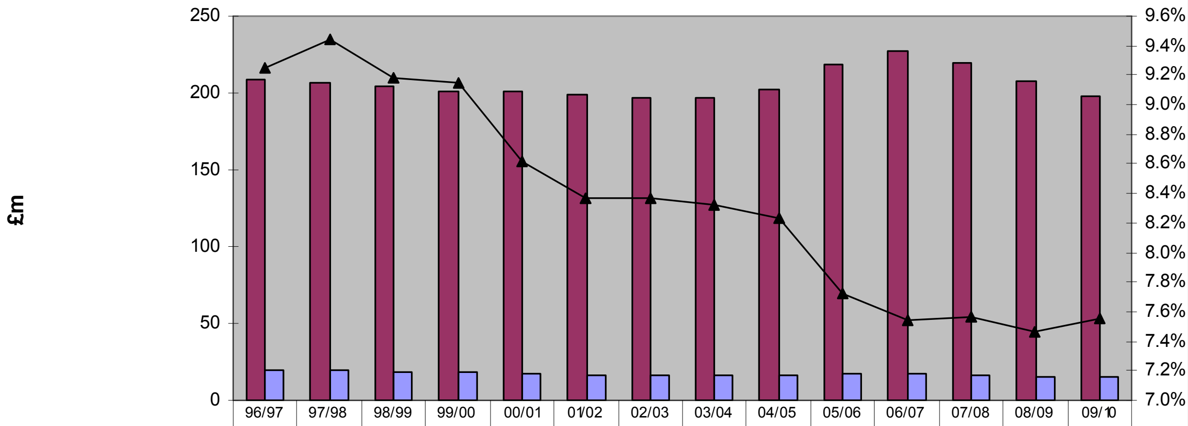
- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to, for example, growth rates remaining low or weakening, then long term borrowing will be deferred, and rescheduling from fixed rate funding into variable or short rate funding will be considered.

Maturing Debt and Rescheduling

4.20 The Council's average borrowing rate on its legacy debt is 7.51 per cent as at 31 January 2007. This average rate is falling as new debt is taken at lower rates and existing debt matures; £11.5 million of debt will mature in 2007/08 and £32.4 million in total during 2007/08 to 2009/10 with an average interest rate of 9.02 per cent. The historic rate is higher than current market rates but the Council cannot repay debt early without paying a premium to compensate the PWLB for higher interest payments forgone. The benefit to the local taxpayer is also reduced because interest charges on debt apportioned to the HRA is met by Government subsidy. Reduced debt costs therefore reduces subsidy. The Council will therefore only restructure its debt if there is a genuine economic benefit to the Council and its taxpayers.

The following graph shows the average interest rates on external debt over the past ten years and has been projected forward to 2009/10 assuming no new borrowing:

Royal Borough External Debt and Interest Paid



	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09	09/10
Average Debt in year	208.180	206.323	204.541	201.248	200.547	198.904	197.180	197.056	201.709	218.801	227.504	219.181	208.082	197.628
Interest Paid	19.265	19.473	18.784	18.416	17.272	16.633	16.504	16.398	16.615	16.898	17.157	16.574	15.541	14.937
Crude Average Interest	9.3%	9.4%	9.2%	9.2%	8.6%	8.4%	8.4%	8.3%	8.2%	7.7%	7.5%	7.6%	7.5%	7.6%

4.21 It is also worth remembering that past higher rate loans were taken out when inflation was much higher, so the capital sum borrowed will be considerably reduced in real terms.

4.22 CIPFA issued a draft accounting standards document (SORP 2007) on 18 October2006, and a final draft in November, which includes major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premia and discounts arising from debt rescheduling. There is a three month consultation period before these proposals will be finalised. This strategy may be reviewed once the final decisions are known.

ANNUAL INVESTMENT STRATEGY

The Regulatory Framework

4.23 The Investment Strategy must have regard to the department for Communities and Local Government (CLG) Guidance on Local Government Investment ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). These guidance notes were issued following the Local Government Act 2003. Prior to this Act the Council's powers to lend were restricted to short term lending to very high credit rated institutions. The Act allows Councils to exercise a broader risk assessment, within the same overall objectives of prudence, liquidity and return.

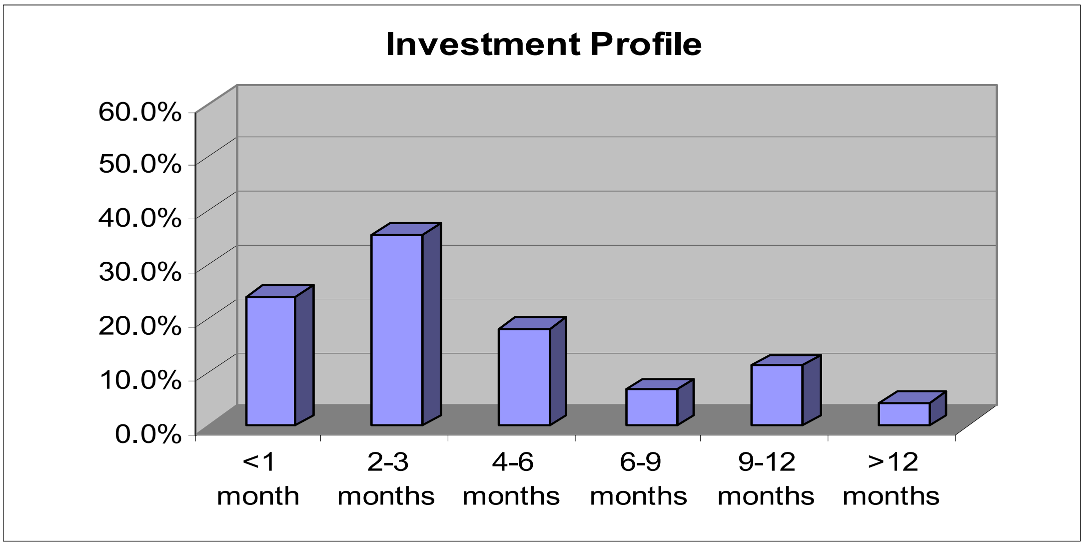
4.24 The Guidance states that the Investment Strategy should set out the local authority's policies for giving priority to the security and liquidity of its investments, rather than the yield. The Council's agreed policy objective is the prudent investment of treasury balances. The Council's investment priorities are to achieve the optimum returns on investments subject to a very high level of security of capital and an appropriate level of liquidity in its investments, taking account of the Council's projected need for funds over time. All investments must be in sterling.

4.25 The Guidance states that borrowing purely to invest or on lend and make a return is speculative and the Royal Borough will not engage in such activity.

Investment Cash Projections

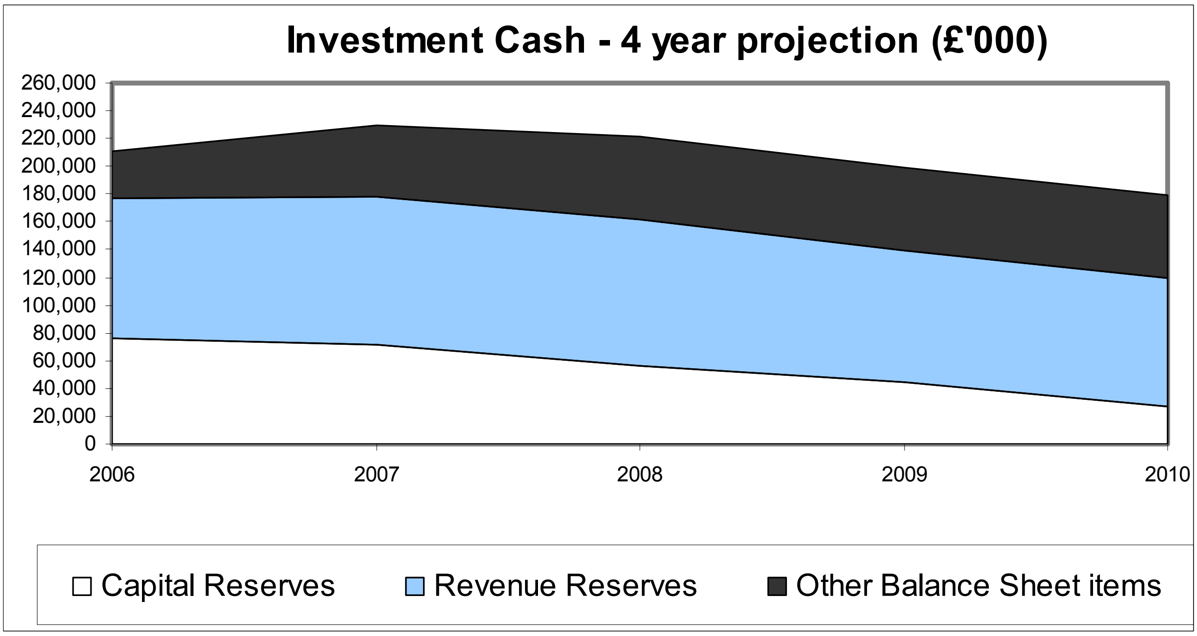
4.26 At the 31 January the Council's cash investments were £232 million. £30 million is with Investec Asset Management who were re-appointed in March 2006 and £30 million is with Scottish Widows Investment Partnership (SWIP) who were appointed in March 2006. Currently the Investec portfolio consists of certificates of deposit with maturities ranging from one to twelve months. The SWIP portfolio is invested in two money market funds of differing duration; money from these funds is used to undertake tactical guilt trading throughout the year. £164.5 million is managed in-house and is invested on fixed terms with agreed counterparties up to a period of 364 days, with emphasis on short term investments in order to meet the Council's day to day cash flow requirements. £7.5 million is invested in longer term fixed deposits with two year maturities.

Bank	Amount £	Maturity	Rate
IIB	2,500,000	2 May 2008	5.01%
Alliance & Leicester	2,500,000	22 Sept 2008	5.33%
Alliance & Leicester	2,500,000	7 Nov 2008	5.4025%

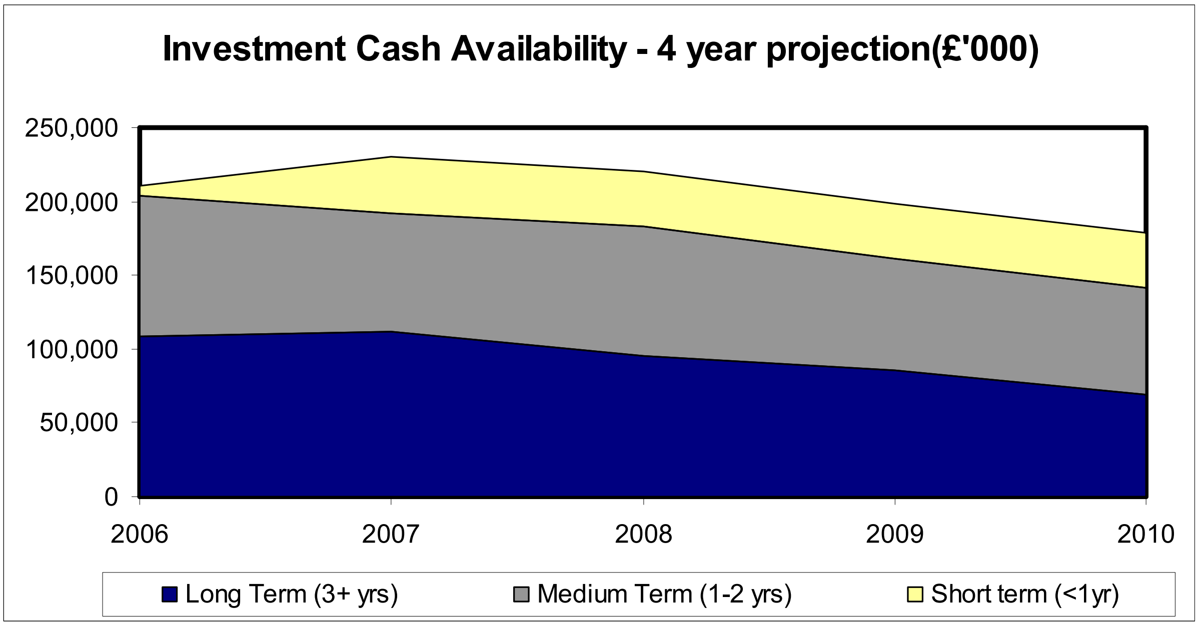


4.27 The sums available for investment come from a number of sources (council tax/housing rent, capital and car parking reserves, cash held in schools reserves, pension fund cash not yet invested etc.). Within this sum there are some items which are relatively stable over the medium term (e.g. Schools reserves) and some that may reduce or increase according to circumstances (e.g. car parking reserves and capital expenditure reserves). The profile below is the Council's projections based on the following assumptions:

- year end balances are projected from the March 2006 balance sheet
- where possible the expected movements in reserves and balances are used
- use of capital reserves are only shown to the extent of the present three year capital programme.



4.28 The periods for which it is estimated these balances will be available is shown as follows:



This graph is based on the assumption that the future Capital Financing Requirement (CFR) is financed by external borrowing and not by use of cash balances. If internal cash balances are used temporarily, as a matter of market timing and interest rate judgement, then cash balances could fall by some £45 million, plus further fall of £30 million if maturing debt is not replaced.

4.29 It is therefore predicted that the Council could have a core of medium/longer term cash balances of approximately £75 million available for investment up to three years ahead. It would be desirable to diversify the holdings in which cash is placed to reduce volatility and stabilise returns on the portfolio.

4.30 Future investment income is affected by the level of short and long term interest rates. U.K. short-term interest rates are forecast to peak at 5.5 per cent in the first quarter of 2007 before falling to 5.25 per cent in the third quarter of 2007, to 5 per cent in the forth quarter of 2007, to 4.75 per cent in the third quarter of 2008 and then to 4.5 per cent in the first quarter of 2009 remaining at this level before rising again to 4.75 per cent in the first quarter of 2010.

4.31 It is therefore proposed to continue to:

- diversify investment instruments where possible with minimum dilution of creditworthiness
- take opportunities to extend in-house investments at fixed rates, to reduce the exposure of the Council's interest receipts to volatility, if rates permit

- potentially use some longer term investment instruments in-house up to a maximum of five years, again to diversify and add stability.

Investment Instruments

4.32 Investments are categorised in the CLG guidance between 'specified' and 'non-specified':

- Specified investments are those offering high security and high liquidity e.g. UK Government, local authorities and other counterparties with high credit ratings. All such investments must have a maturity of no more than one year. Authorities will be able to invest with these counterparties with minimal formalities.

- Non-specified investments are with any counterparty that is not classified as specified. A local authority must identify the general categories of acceptable non-specified investments, the limit to the overall amount that may be held and the guidelines for use of such investments. Some non-specified investments count as capital expenditure, e g. investments in bonds or shares. When these are liquidated the income counts as a capital receipt and cannot therefore be used to pay for revenue spending. Using these investments therefore makes fully flexible revenue cash into less flexible capital cash.

4.33 Following consultation with the Council's treasury advisor the investment instruments proposed for use in 2007/08 are listed in Appendix 1. It is proposed to allow the external fund managers to hold 100% of their £60 million portfolio in gilts (short and long term) with a maximum maturity of up to 30 years, however the average duration of funds held would not exceed three years. Because these are held in pooled funds by the managers they can be regarded as liquid assets.

4.34 A maximum of 50 per cent will be held in aggregate in non-specified investments.

4.35 In accordance with the Treasury Management Practices – Schedules (formulated in compliance with the CIPFA Code of Practice) the Executive Director of Finance, Information Systems and Property in consultation with the Cabinet Member for Finance and Property is responsible for constructing a lending list comprising type, sector and specific counterparty limits.

4.36 The Royal Borough uses Fitch ratings to determine its lending 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 are formally monitored monthly; however notification is received from the advisor of any changes in credit ratings as they occur. If a downgrade results in the counterparty no longer meeting the Royal Borough's minimum criteria, its further use as a new investment will be withdrawn immediately.

4.37 It is **proposed** that for **in-house cash management** purposes the Investment Strategy permits a maximum of £20 million to be for periods over 364 days and up to a maximum of five years. This is to provide some diversification and stability of returns while maintaining a considerable degree of liquidity. As a result we will not hold more than £20 million, approximately 10% of our current investments, in illiquid assets over 364 days. Within the long term investments we will be cautious about extending the length of maturity. Our guidelines for spreading the long term investments are shown in the table below.

Long term investments – period to maturity	Maximum limit
4 years up to maximum of 5 years	£2 million
3 years and above	£4 million
2 years and above	£10 million
1 year and above	£20 million

4.38 The external managers hold £60 million of total investments to add diversification to the portfolio. Around 50 per cent (£30 million) can be attributable to longer-term core funds and managers are permitted to invest up to this amount in approved non-specified investments. They will not be allowed to hold illiquid long term investments without our prior approval, in which case the internal limits set out above would be reduced accordingly. The balance of the core funds are to be managed in house as outlined in 8.6 above.

4.39 Traditionally, at the year end, the external managers have returned income received during the year to the Council. It is now **proposed** to capitalise the income received and increase the amount held by the external managers by this sum each year, with immediate effect. The amount invested by external managers will be kept under review during the year.

4.40 The Council's external fund managers must comply with the Annual Investment Strategy. The agreement between the Council and the fund managers additionally stipulates guidelines and duration and other limits in order to contain and control risk.

4.41 The balance of cash management carried out in-house will primarily be for short-term cash flow purposes and will use investments up to 364 days.

4.42 It is not proposed to use corporate bonds or property for investment. Both of these increase risk to the capital sum and property in particular is illiquid. This could be significant if interest rate structures in the future meant that the Council wished to avoid external borrowing and therefore to run down its cash balances, particularly if this coincided with a period of drawing down reserves. These instruments also count as capital expenditure and are therefore less flexible. This proposal refers to treasury management investments only. It does not prevent the Council purchasing property for operational or economic development/regeneration purposes as part of its capital programme.

4.43 The timing of investments will be dependent on the prevailing view on interest rate movement and will be taken in consultation with the treasury advisor.

Financial, Legal Personnel and/or Race Equality Implications

4.44 The Local Government Act 2003 requires the Royal Borough to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Royal Borough's capital investment plans are affordable, prudent and sustainable.

4.45 The Act requires the Royal Borough to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Royal Borough's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Investment Strategy will have regard to guidance issued by the CLG. The Investment Strategy has to be agreed by the full Council.

4.46 In order for the Council to be able to deliver effective services within the Council's policy framework to members of the public it is necessary to have a sound financial base.

Recommendations

4.47 The Council is recommended to **approve** the Annual Treasury Strategy, incorporating the Annual Investment Strategy for 2007/08. This includes:

- the proposed Prudential Indicators which limit treasury management activity as shown in tables 5 to 8 of the report (items 4.4 to 4.7)
- the proposed allocation of core fund investments (item 8.6 to 8.8)
- the use of specified and non-specified investments shown in Appendix 1.

Sue Beauchamp
Executive Director of Finance, Information Systems and Property

Background papers: CIPFA Code of Practice on Treasury Management for the Public Sector
CLG Guidance on Local Government Investments
Further background statistics on Treasury Management are included in section C of "Vital Finances" on the Council's Intranet (Plans and performance>Plans and strategies>Financial>Vital Finances) reported to the Cabinet in July 2006.

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Appendix 1

LOCAL GOVERNMENT INVESTMENTS
SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated.

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Capital Expenditure ?	Circumstance of use	Maximum period
Debt Management Agency Deposit Facility* (DMADF) * this facility is at present available for investments up to 6 months	No	Yes	Govt-backed	No	In-house	1 year *
Term deposits with the UK government or with UK local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 1 year	No	Yes	High security although most LAs not credit rated.	No	In-house	1 year
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 1 year	No	Yes	Yes-varied Banks and building societies with a long term credit rating of A, a short term credit rating of F1 and a support rating of 3.	No	In-house and by external fund managers	1 year
Certificates of Deposit issued by credit-rated deposit takers (banks and building societies) : up to 1 year.	No	Yes	Yes-varied Banks and building societies with a long term credit rating of A, a short term credit rating of F1 and a support rating of 3.	No	External fund managers subject to the guidelines and parameters agreed with them.	1 year
Gilts : up to 1 year	No	Yes	Govt-backed	No	(1) Buy and hold to maturity : to be used in-house after consultation	1 year

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Capital Expenditure ?	Circumstance of use	Maximum period
					with treasury advisor (2) For trading : by external cash fund managers only subject to the guidelines and parameters agreed with them	
Money Market Funds	No	Yes	Yes Local Authorities must use AAA rated funds	No	In-house and by external fund managers subject to the guidelines and parameters agreed with them	The period of investment may not be determined at the outset but would be subject to cash flow and liquidity requirements
Forward deals with credit rated banks and building societies < 1 year (i.e. negotiated deal period plus period of deposit)	No	Yes	Yes-varied Banks and building societies with a long term credit rating of A, a short term credit rating of F1 and a support rating of 3	No	In-house	1 year in aggregate
Gilt Funds and other Bond Funds (dependent on set-up structure)	No	Yes	Yes Long term rating of AA-	No	By external fund managers subject to the guidelines and parameters agreed with them. **In the selection of a fund the manager will ensure that the fund is not a body corporate by virtue of its set up structure**	These are open-end mutual funds investing predominately in UK govt gilts and corporate bonds. These funds do not have any maturity date. The

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Capital Expenditure ?	Circumstance of use	Maximum period
						fund would hold highly liquid instruments and investments can be sold at any time
Treasury bills [*Government debt security with a maturity less than one year and issued through a competitive bidding process at a discount to par value*]	No	Yes	Govt-backed	No	In-house and external fund managers subject to the guidelines and parameters agreed with them	1 year
Bonds issued by a financial institution that is guaranteed by the United Kingdom Government (as defined in SI 2004 No 534) with maturities under 12 months e.g Guaranteed Export Finance Corporation	Yes	Yes	AAA / Govt-backed	No	For trading by external fund managers subject to the guidelines and parameters agreed with them	1 year
Bonds issued by multilateral development banks (as defined in SI 2004 No 534) with maturities under 12 months	Yes	Yes	AAA	No	(1) Buy and hold to maturity : to be used in-house after consultation with treasury advisors (2)For trading : by external cash fund managers only, subject to the guidelines and parameters agreed with them	1 year

Monitoring of credit ratings :

All credit ratings will be monitored monthly. If a counterparty downgraded with the result that it no longer meets the Council's minimum credit criteria, the use of that counterparty will be withdrawn.

Any intra-month credit rating downgrade that the Council identifies will be similarly dealt with.

LOCAL GOVERNMENT INVESTMENT (England)

NON-SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated.

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating	Capital Exp?	Circumstance of use	Max amount as part of overall investments	Maximum maturity of invest-ment
Term deposits with UK Government or UK Local Authorities with maturities greater than 1 year	(A) (i) Excellent credit quality. (ii) Certainty of rate of return over period invested (iii) No movement in capital value of deposit despite changes in interest rate environment (iv) No currency risk (B) (i) Illiquid: as a general rule, cannot be traded or repaid prior to maturity (ii) Return will be lower if interest rates rise after making the investment	No	No	High security although most Local Authorities are not credit rated	**No**	In- house	15%	5 years
Term Deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A) (i) Certainty of rate of return over period invested (ii) No movement in capital value of deposit despite changes in interest rate environment (B) (i) Illiquid: as a general rule, cannot be traded or repaid prior to maturity (ii) Return will be lower if interest rates rise after making the investment (iii) Credit risk: potential for greater deterioration in credit quality over longer period	No	No	Yes – varied Banks and building societies with a long term credit rating of A+, a short term credit rating of F1 and a support rating of 2	**No**	In-house	15%	5 years
Certificates of Deposit with credit	(A) (I) Although in theory tradable, are relatively illiquid.	No	Yes	Yes – varied Banks and	**No**	To be used by external fund	10% of the funds under	5 years

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating	Capital Exp?	Circumstance of use	Max amount as part of overall investments	Maximum maturity of invest-ment
rated deposit takers (banks and building societies) with maturities greater than 1 year	(B) (I) Market or interest rate risk: yield subject to movement during life of CD which could negatively impact on price of the CD			building societies with a long term credit rating of AA-, a short term credit rating of F1+ and a support rating of 2		managers subject to the guidelines and parameters agreed with them	management	
UK government gilts with maturities in excess of 1 year	(A) (i) Excellent credit quality. (ii) Very liquid (iii) If held to maturity, known rate of return per annum which aids forward planning (iv) If traded, potential for capital gain through appreciation in value. (v) No currency risk (B) (i) Market or interest rate risk: Yield subject to movement during the life of the gilt which could negatively impact on the price of the bond i.e. potential for capital loss	No	Yes	Government backed	**No**	(1) Buy and hold to maturity: To be used in-house after consultation with treasury advisors (2)For trading : by external cash fund managers only, subject to the guidelines and parameters agreed with them	20% 100% of invested securities	5 years 30years
Sovereign issues ex UK government gilts	(A) (i) Excellent credit quality (ii) Liquid (iii)If held to maturity, known yield per annum – aids forward planning (iv) If traded, potential for capital gain through appreciation in value (v) No currency risk (B) (i) Market or interest rate risk: yield subject to movement during life of sovereign bond which could negatively impact on price of the bond	No	Yes	AAA	**No**	(1) Buy and hold to maturity : to be used in-house after consultation with treasury advisors (2)For trading : by external cash fund managers only, subject to the	30% 10% of invested securities	5 years

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating	Capital Exp?	Circumstance of use	Max amount as part of overall investments	Maximum maturity of invest-ment
						guidelines and parameters agreed with them		
Forward deposits with credit rated banks and building societies for periods > 1 year (i.e. negotiated deal period plus period of deposit)	(A) (i) Known rate of return over period the monies are invested – aids forward planning (B) (i) Credit risk is over the whole period, not just when monies are actually invested (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period	No	No	Yes – varied Banks and building societies with a long term credit rating of AA-, a short term rating of F1+ and a support rating of 2	**No**	To be used in-house after consultation with treasury advisor	5%	2 years in aggregate
Deposits with unrated deposit takers with unconditional financial guarantee from HMG or credit-rated parent institution : any maturity	Credit standing of parent will determine ultimate extent of credit risk	No	Yes	Not rated in their own right, but parent must be rated with a long term rating of AA-, a short term rating of F1 and a support rating of 2	**No**	In-house	20%	1 year
Unrated deposit takers (building societies) which do not have an unconditional guarantee	(A) (i) Good standing in the London money market (ii) Potential for more competitive rates offered to local authorities (iii) Due to the nature of Building Society finance credit rating is not always necessary. (iv) Building Societies are regulated by the FSA (B) Credit quality unknown	No	Yes	Capitalisation must be in excess of £3bn	**No**	In-house	10%	1 year
Bonds issued by a financial institution that is guaranteed	(A) (i) excellent credit quality (ii) Relatively liquid (although not as liquid as gilts	Yes	Yes	AAA / government guaranteed	**No**	For trading : by external cash fund managers	10% of invested securities	5 years

<u>Investment</u>	<u>(A) Why use it?</u> <u>(B) Associated risks?</u>	<u>Share/ Loan Capital</u>	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating	Capital Exp?	Circumstance of use	Max amount as part of overall investments	Maximum maturity of invest-ment
by the United kingdom Government (as defined in SI 2004 No 534) with maturities in excess of 1 year	(iii) If held to maturity, known yield per annum,– aids forward planning (iv) Enhanced return compared to gilts (iv) If traded, potential for capital gain through appreciation in value (B) (i) Market or interest rate risk : yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss. (ii) Spread verses gilt could widen					only, subject to the guidelines and parameters agreed with them		
Bonds issued by multilateral development banks (as defined in SI 2004 No 534) with maturities in excess of 1 year	(A) (I) Excellent credit quality. (ii) Relatively liquid. (although not as liquid as gilts) (iii) If held to maturity, known yield (rate of return) per annum, which would be higher than that on comparable gilt ~ aids forward planning, enhanced return compared to gilts. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (B) (i) Market or interest rate risk : Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss. (ii) Spread versus gilts could widen	Yes	Yes	AAA or government guaranteed	**No**	(1) Buy and hold to maturity : to be used in-house after consultation with treasury advisors (2)For trading : by external cash fund managers only, subject to the guidelines and parameters agreed with them	30% - to a maximum of £50 million 10% of invested securities	5 years