TREASURY MANAGEMENT STRATEGY 2006-07 – 2008-09

1. The Treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in the report above consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy, which need approval.

2. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 14th March 2002, and as a result adopted a treasury management policy statement on 24th February 2004. This adoption meets the requirements of the first of the treasury prudential indicators.

3. The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A further report is produced after the year-end to report on actual activity for the year.

4. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service.

5. This strategy covers:

- The current treasury position
- The expected movement in interest rates
- The Council's borrowing and debt strategy
- The Council's investment strategy (in compliance with ODPM guidance)
- Treasury performance indicators
- Specific limits on treasury activities
- Local treasury issues

Treasury Position

6. Paragraph 4 of the Prudential Indicators report highlights both the current treasury position and the expected movement in debt and investment levels over the next three years.

Expected movement in Interest Rates

7. The Monetary Policy Committee (MPC) announced the long-awaited cut in base rates following its August meeting. However, the downturn in the UK interest rates cycle is expected to be prolonged and shallow with the low point not being too wide of the 4.25% level (currently 4.50%). GDP growth had been substantially weaker than anticipated as the slowdown in house price inflation and higher debt servicing costs combined to undermine consumer-spending growth. Activity is expected to remain weak through the balance of 2005 but to stage a recover in 2006.

8. The Bank of England believes that the rebound in consumer activity, together with continued strength in public sector spending and a rise and a rise in corporate investment, will encourage higher growth in the future. This is open to debate and it is clear that the forecasting of interest rates in the current climate is difficult and a cautious approach is needed in treasury activity.

9. The international economic situation creates further uncertainty in the forecast. UK longer-term interest rates have been influenced by US interest rates, which currently appear unrealistically low, and there continues to be risk of an upward shift in rates. The exact timing of this is however difficult to predict.

10. Medium-Term Rate Forecasts *– Annual Averages %

	Base Rate - %	**5-year Gilt - %**	**20-year Gilt - %**
2005-06	4.6	4.3	4.5
2006-07	4.3	4.4	4.6
2007-08	4.5	4.6	4.7
2008-09	4.8	4.8	4.7

* Butler's forecasts (November 2005)

11. There are significant risks to the forecast, which expects positive but low world and UK economic growth. Further weakness in growth could see short and longer term rates return to historic lows, although there is a higher probability within the forecast that rates will return to historic norms and shift to a higher level.

Borrowing and Debt Strategy 2006-07 – 2008-09

12. The growing uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

13. The Head of Finance and Business Development does not envisage the need for further borrowing over the following three financial years.

14. With the likelihood of increasing interest rates, debt restructuring of our remaining debt may take place in future financial years, although the Head of Finance and our Treasury consultants will monitor prevailing rates for any opportunities during the year.

INVESTMENT STRATEGY 2006-07 – 2008-09

1. The main principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:
    - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security.

2. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

3. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of falling by ¼% in early 2006, and potentially rising again in 2007. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return, if opportunities arise. The Head of Finance, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

Treasury management prudential indicators and limits on activity

4. There are four further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive, they will impair the opportunities to reduce costs. The indicators are:

    - Upper limits on variable interest rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments

- Upper limits on fixed interest rate exposure – similar to the previous indicator this covers a maximum limit on fixed interest rates
- Maturity structure of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- Total principal funds invested for greater than 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

5. The Council is asked to approve the following prudential indicators:

	2005-06 Upper	**2006-07 Upper**	**2007-08 Upper**
Limits on fixed interest rates	£5,000,000	£5,000,000	£5,000,000
Limits on variable rates	£0	£0	£0

	Lower	Upper	Lower	Upper	Lower	Upper
Under 12 months	0%	50%	0%	50%	0%	50%
12 months to 2 years	0%	0%	0%	0%	0%	0%
2 years to 5 years	0%	0%	0%	0%	0%	0%
5 years to 10 years	0%	0%	0%	0%	0%	0%
10 years and above	0%	100%	0%	0%	0%	100%

	2005-06	**2006-07**	**2007-08**
Maximum principle sums invested over 364 days	£12,000,000	£12,000,000	£12,000,000

6. The Code of Practice on Treasury management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing – average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – internal returns above the 7 day LIBID rate
- Investments – External fund managers – returns 110% above 7 day compounded LIBID.

7. The results of these indicators will be reported in the Treasury Annual Report for 2005-06.