APPENDIX A

TREASURY MANAGEMENT STRATEGY 2007/08 – 2009/10

1. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in the main report consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process, which ensures the Councils meets the balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy, which require 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 (24th February 2004). This adoption meets the requirements of the first of the treasury prudential indicators.

3. Financial Regulations require an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year.

4. This strategy covers:

- The Council's debt and investment projections
- The expected movement in interest rates
- The Council's borrowing and investment strategies
- Treasury performance indicators
- Specific limits on treasury activities
- Any local treasury issues

5. The borrowing requirement comprises the expected movement in the CFR and any maturing debt, which will need to be re-financed. There is expected to be no change to the current outstanding debt level of £5,000,000. No change to levels of investment is predicted either and these are likely to remain around £18,000,000 for the coming three years.

6. Interest rate uncertainty is set to persist in the year ahead. The threat of higher inflation is considered a real danger for the UK economy in the near term, not least the possibility that an annual increase in RPI of close to 4.5% in January 2007 could translate to a buoyant pay round.

7. The Bank of England remains concerned that domestically generated inflation could strengthen in the months ahead and increase to unacceptably high levels. The key in this respect lies in a number of relationships within the economy.

- ✓ The buoyancy of the international economy and the effect upon UK growth
- ✓ The strength of domestic activity and the extent of spare capacity
- ✓ The state of the labour market and the outcome of the forthcoming pay round
- ✓ The strength of domestic demand and the pricing power of companies

8. UK growth has been stronger than expected. This has been driven mainly by domestic factors, in particular the buoyancy of consumer spending. While the recent rise in official interest rates may lead to some deceleration, the extent of this is expected to be comparatively modest.

9. Long-term interest rates have been underpinned by the twin effects of concerns about domestic inflation prospects and the unexpected buoyancy of the US and German economies. Uncertainties generated by these developments are likely to underpin yields in the months ahead, although market conditions will remain erratic and occasional phases of downbeat economic data should generate declines in interest rates.

10. However, these phases will prove temporary until the markets are convinced the US economy has unquestionably entered a weaker activity phase and a return to lower dollar interest rates is a near certainty. This coupled with evidence of decelerating activity and moderating inflation on the domestic front should create conditions for a sustainable, yet moderate, decline in long-term yields.

11. The 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.

12. The Head of Finance and Business Development is not intending to take out any additional borrowing for the foreseeable future.

13. The primary 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 and monitoring their security. This is set out in the Specified and Non-specified investment sections below.

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

15. Expectations on shorter-term interest rates on which investment decisions are based, show a likelihood of peaking at 5.25% in early 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 investment rates to lock in good value and security of return if opportunities arise. The Head of Finance and Business development 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.

16. 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.

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

	2007-08 Upper	**2008-09 Upper**	**2009-10 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%

	2007-08	**2008-09**	**2009-10**
Maximum principle sums invested over 364 days	£12,000,000	£12,000,000	£12,000,000

Annex A1

TREAURY MANAGEMENT PRACTICE (TMP) 1 (5) – CREDIT AND COUNTERPARY RISK MANAGEMENT

The Office of the Deputy Prime Minister (now DCLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pensions funds, which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Council's to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services; code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 14th March 2002 and will apply its principles to all investment activity. In accordance with the Code the Head of Finance has produced its treasury management practices. This part, TMP 1 (5) covering investment counterparty policy requires approval each year.

Annual Investment Strategy – The key requirements of both the Code and the investment guidance are to set an annual investment strategy as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for decision making on investments, particularly non-specified investments
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (ie high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investment in sterling and with a maturity of no more than a year
- Non-specified investments, clarifying the greater risk implications identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time

This strategy is to be approved by full Council.

The investment policy proposed for the Council is:

Strategy Guidelines – the main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes.

These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:

- The UK Government (debt bills, UK treasury Bills or a Gilt with less than one year to maturity
- Supranational bonds of less than one year's duration
- A local authority, parish council or community council
- Pooled investment vehicles – such as money market funds, that have been awarded a high credit rating by a credit rating agency
- A body that has been awarded a high credit rating by a credit rating agency – such as a bank or building society

The monitoring of Investment counterparties – The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its advisers, Butlers, on a daily basis as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

The use of external fund managers – The Council currently uses an external fund manager for part of its investment portfolio. However, performance over the last couple of years has not been satisfactory, and Executive recently approved the bringing back "in-house" of these investments. This will take effect during the 2007-08 financial year.