Report of	Meeting	Date
Assistant Chief Executive Statutory Finance Officer (Introduced by the Executive Member for Resources)	Council	26/02/08

Appendix 9

STATUTORY REPORT ON THE BUDGET AND ANNUAL TREASURY MANAGEMENT STRATEGY

PURPOSE OF REPORT

1. To provide advice required under S25 of the Local Government Act 2003 and to seek approval of the Annual Treasury Management Strategy.

RECOMMENDATION(S)

2. The Council are recommended to:
   (a) Note the Statutory Finance Officers comments and advice under S25 of the Local Government Act 2003 set out in this report and have regard to it when considering the budget for 2008/09.
   (b) Approve the Treasury Management Strategy for 2008/-9 and the key principles contained in the Strategy that require:

   - The creation and maintenance of a Treasury Management Policy Strategy.
   - The creation and maintenance of Treasury Management Practices.
   - Delegation is given to the Strategy Finance Officer to implement and monitor treasury management activities.
   - Adoption of the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management

EXECUTIVE SUMMARY OF REPORT

3. The report is as required by statute and requires the Statutory Finance Officer to set out how the budget has been constructed and the assumptions that underpin that budget. The Statutory Officer is then required to comment on the Executive's budget proposals so that the Council can make an informed judgement as to the robustness of those assumptions.

4. Having reviewed the underlying assumptions and commented on the need to mitigate the indicated financial risk facing the Council by maintaining working balances higher than in the previous financial cycle, I have concluded that the budget is reasonable and deliverable and if my recommendations on the level of working balances is accepted then to a great extent the immediate risks are mitigated.

REASONS FOR RECOMMENDATION(S)

(If the recommendations are accepted)

5. To comply with the Statutory requirement to produce a S25 report.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

6. None.

CORPORATE PRIORITIES

7. This report relates to the following Strategic Objectives:

Put Chorley at the heart of regional economic development in the Central Lancashire sub-region	✓	Develop local solutions to climate change.	✓
Improving equality of opportunity and life chances	✓	Develop the Character and feel of Chorley as a good place to live	✓
Involving people in their communities	✓	Ensure Chorley Borough Council is a performing organization	✓

The robustness and deliverability of the budget has the propensity to affect in some way all the Council's strategic objectives.

BACKGROUND

8. Under the requirements of S25 of the Local Government Act 2003 the Statutory Finance Officer is required to advise members when setting the budget as to the robustness of the budget and the adequacy of reserves. Treasury Management issues are also now included as a specific requirement following the introduction of the Prudential Code for Capital Finance in Local Authorities. This report aims to fulfil all these various requirements.

LEVEL OF RESERVES

9. The Council for some time has established a budget based upon not using working balances to fund recurrent expenditure. Clearly this is good practice that delivers a prudent and sustainable budget.

10. The level of balances is a matter of judgement, however set out in the table below is a summary of the anticipated working balances and reserves the Council will have in hand over the medium term.

	Balance at 1/4/08 £'000	**Balance at 1/4/09 £'000**	**Balance at 1/4/10 £'000**
Working balances	698	1,467	1,467
Earmarked reserves	40	0	
	738	**1,467**	**1,467**

Working balances for 2009/2010 and 2010/2011 include the balance transferred from the Housing Revenue Account and assume no use of balances in-year.

THE ROBUSTNESS OF THE ESTMATE AND RISK ISSUES

11. In terms of the budget proposal there still remains a number of risk areas where actual performance may not match the assumptions made. In such an event this may impact on the Council's ability to deliver a balanced budget. The majority of these areas are not unique to Chorley and are recurrent issues in many cases, given the nature of local authority business.

12. The risk in almost all cases is a result of not having information on which to base future forecasts. This position is a result of either a budget being demand-led, as is the case with Concessionary Travel or information on particular funding streams not being available until later in the year as with the Housing and Planning Grant.

13. In respect of the key assumptions in the budget, these are as follows:

Table 5. Budget Assumptions

Assumption	%/£
Pay Award	+2.5%
Pension Contribution	+1.0%
Housing and Planning Grant	+£75k
Concessionary Travel Net Cost Increase	+68%

14. In relation to each individual item I would make the following comments:

PAY AWARD

15. The assumption is based upon the 2007 settlement and the stated intention of the Government to restrain Public Sector Pay Awards.

PENSIONS CONTRIBUTION

16. A current revaluation is underway in relation to the Pension Scheme and this will set the employers contribution. Over the last 12 months there has been a general improvement in the pension deficit, due in the main to better investment performance but further increases in the employers contribution rate are required following the actuarial valuation which has recently been completed. I have therefore confirmed that the rate will be 16.8% in 2008/09 rising to 18.8% by 2010/11.

2008/09	+1%
2009/10	+1%
2010/11	+1%

17. Again the actual results will only be known later in the financial year, but before the budget setting meeting.

HOUSING AND PLANNING GRANT

18. This year 2007/08 is the last year of receipt for Planning Delivery Grant. This specific grant has been paid to the Council and other Councils to invest in improving planning service. The successor of this grant is the Housing and Planning Delivery Grant. I have assumed for budget planning purposes that the Council will receive some grant and this is

based upon my assessment of current performance against the allocations criteria, which may change, but the actual allocation has not yet been received from the DCLG.

CONCESSIONARY TRAVEL

19. This particular element of the budget represents the greatest risk in terms of identifying accurately the likely cost of the new concessionary travel scheme which is to be implemented from April 2008. There are two key risk issues namely:

- We cannot estimate the potential take up in terms of additional concessionaries or the impact having a free service will have on travel patterns.

- At present Councils are charged based upon estimated rather than actual usages. With the introduction of the free scheme new smart Council technology will be introduced so that individual authorities can be charged on an actual basis. This means historic cost will not be an indication of future costs.

20. Whilst the gross extra cost of the new concession and the scheme is estimated to be in the region of £657k over and above that previously budgeted, the Government has announced extra specific grant for Councils of £275k which will be pooled if an agreement can be reached.

21. In addition it is proposed that the current discretions granted by the Council in relation to both community transport and subsidised bus rates are maintained for 2008/09, with a review taking place in a year of the success or otherwise of maintaining those discretions. More details are provided in the note on concessionary travel included in these papers

EXPENDITURE SAVINGS

22. Turning to the savings and additional fees and charges income proposed in the draft budget, I made the following comments, which are strategic in nature and also do not focus on the minute of individual proposals.

23. The budget proposals as they currently stand includes expected expenditure savings of £466k. The bulk of the savings £418k are non staffing related and focus on areas where the impact on the delivery on front line services is minimised. As such and given the scale of the individual savings proposals, it is unlikely that they will impact at all on the Council's ability to deliver its corporate priorities.

24. In relation to the savings from staffing costs in the context of the balancing of the Council's budget these are less severe than in previous years and focus on streamlining middle management costs and some minor reductions in benefit staffing. Again I anticipate that this will not significantly affect our overall ability to deliver the corporate plan targets and objectives but may impact on the levels of services being provided, but only at the margins. In relation to the rebasing exercise some of the more significant adjustments have been as a consequence of the transfer of the Council's housing stock to CCH. The impact of this was not fully realised in the 2007/08 budget.

INCOME PROGRAMME - FEES AND CHARGES INCOME

25. This year the Council has undertaken a strategic review of fees and charges with the objective of ensuring that the fees and charges were correct, covering costs and at a market rate. In many instances the Council has not raised charges for over 5 years.

26. The budget contains a number of proposals in relation to increasing those fees and charges that in some cases, for a number of years have been frozen. This applies particularly to car parking income.

27. In pure finance terms the restructuring of the fees and charges for car parking and the changing of market tolls is wholly appropriate.

28. The financial risk to the Council is that there is a degree of consumer resistance to the proposed charges. For this reason, I have adjusted a number of the fees and charges budgets that are subject to consumer choice and not taken the totality of the additional income that could be generated.

29. I believe that in this way a prudent approach has been adopted. A summary of the levels of income currently anticipated for the major income streams and those subject to some amendments to the fees and charges is shown in the table below:

Major Income Streams

Table 6 - Total Fees and Charge Income)

	£'000
Licensing Fees	(165)
Local Land Searches	(189)
Parking Fees	(924)
Market Toll	(320)
Planning and Building Control Fees	(744)
Investment Portfolio	(416)
	(2,284)

30. The table shows the importance of fees and charges income to the Council. Its historic approach of containing the levels of fees and charges is not sustainable unless used for the delivery of strategic objectives.

CONCLUSION OF THE ADEQUACY OF WORKING BALANCES AND THE ROBUSTNESS OF THE BUDGETED WORKING BALANCES

31. The current financial strategy that takes us up until the end of 2007/08 concluded that working balances to be in a range £780k-£1.25m. This was based upon the financial risk profile which to a great extent has remained unchanged over that financial planning period.

32. However, from 2008/09 a number of the external factors influencing the Council's ability to either attract funding or to influence expenditure have changed. This is the main due to the following reasons:

- The CSR07 means that there is less Revenue Support Grant over the planning period 2008/09-2010/11.
- The full impact of the changes to the concessionary travel budget will not be known for at least 15 months in the new scheme.
- The Government is capping capitalisation applications and as such the cost of change may need to be resourced from revenue.

33. The greatest potential impact is likely to come from the concessionary travel issue, but all of the issues have the propensity to affect the Council's ability to both balance its budget and continue to deliver effective services.

34. In this respect, I am minded to propose that working balances are kept at a higher level in the next 12-18 months in recognition of the risks. I therefore propose that working

balances are kept in the range £1.25m-£1.50m for this period after which a further review needs to take place based upon the latest evidence.

35. As members will be aware, working balances are there to protect the Council's against the 'peaks and troughs' in expenditure and allows them to be able to manage any changes to the base level of expenditure that is required to bring the budget back into balance.

36. Sometimes this can take time so maintaining working balances means the Council does not have to make reactive changes that can significantly impact on service performance.

37. In terms of resource availability, members will be aware that the Council's overall working balances position is made up of balances in hand and those to be transferred from the Housing Revenue Account, following stock transfer. Whilst the exact date of the availability of these results is still subject to discussion with the CLG, they will become available over the planning period and as such will be available and this will mean that the working balances position is as follows:

Source	£'000
Estimated working balances based upon latest Revenue Monitoring Position 2007/08	698
Estimated transfer of working balance from HRA	869
Less commitment to spending in neighbourhoods 2008/09	(100)
Estimate 31.03.09	**1,467**

38. With regard to the robustness of the budget assumption for 2008/09 once again each Directorate has had a line by line review completed on their budget and whilst there are still some issues to resolve they represent adjustments that are reasonable and deliverable.

39. In previous years the Council has been faced with the prospects of making savings and 2008/09 will be exactly the same. The savings are necessary firstly to contain of Council Tax and secondly, to redirect resources into corporate priorities. This report has identified that most savings and investment plans are well developed but further work will be necessary as we work through the budget cycle and better and more up to date information becomes available.

40. Some inherent risks remain in the budget but the underlying assumptions I have made have been agreed by the executive and I believe they are reasonable. I have outlined my views and advice in relation to the level and adequacy of working balances and summarise the key risks and mitigation that are and should be put in place.

TREASURY MANAGEMENT STRATEGY

41. Appended to this report is the Annual Treasure Management Strategy which guides the Council in terms of its approach to borrowing and cash investments for 2008/09. In 2008/09 the Council continues to the relatively cash rich as a result of the stock transfer process.

42. Consequently getting the investment strategy right is important if we are to achieve the targets included in the Council's base budget.

43. Equally borrowing at the right time to fund the Council's capital investment programme is essential.

44. Whilst the strategy is quite technical the messages are relatively simple:
   - Invest now and for a fixed period as investment rates are likely to fall.
   - Borrow as required when rates are at 4.5%
   - The Council's borrowing is forecast to be well within the boundary set by the prudential code and is affordable.

45. Estimated prudential borrowing to finance capital investment over the period 2008/09 to 2010/11 exceeds that reported to Executive Cabinet on 6 December 2007, when the three-year capital programme was approved for consultation purposes. The main reasons for this increase are slippage of expenditure that would have been financed by borrowing from 2007/08 to 2008/09; and changes to the financing of the 2007/08 programme to minimise borrowing in that year, thereby reducing capital financing costs in 2008/09. Over the four years 2007/08 to 2010/11, prudential borrowing is the same as reported on 6 December 2007 but the phasing has been amended to reflect the slippage and financing changes. Furthermore, I will continue to review the availability of other capital resources, in particular receipts from the sale of surplus assets and contributions from developers, with a view to reducing the level of borrowing over the next three years.

    The Councils treasury advisors suggest that investment rates will peak at 5% in 2008/09 although I would anticipate a small marging over and above that figure

CONCLUSIONS

46. This report sets out the Council's overall financial position in relation to reserves and working balances and the delivery of a robust budget.

47. I have concluded that the budget is deliverable and that an increase in the level of working balances is prudent to protect against the key financial risks the Council now faces.

GARY HALL
ASSISTANT CHIEF EXECUTIVE
(BUSINESS TRANSFORMATION)

There are no background papers to this report.

Report Author	Ext	Date	Doc ID
Gary Hall	5480	18/02/08	ACE(BI)/Reports/2008/Council/ Statutory Report – Budget and Treasury (26-2)

Chorley
Borough Council

Treasury Management Strategy Statement

and

Annual Investment Strategy

2008/09 –2010/11

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2008/09

1. INTRODUCTION

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.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as paragraph 9); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy in respect of the following aspects of the treasury management function is based upon the statutory finance officers views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy;
- any extraordinary treasury issues

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

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". In England and Wales the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

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'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The 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

The following Prudential Indicators (in table 2 below) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management.

PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10	2010/11
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Capital Expenditure					
Non - HRA	11,369	7,412	11,888	2,680	1,925
HRA (applies only to housing authorities)	1,900	0	0	0	0
TOTAL	13,269	7,412	11,888	2,680	1,925
Ratio of financing costs to net revenue stream					
Non - HRA	2.3%	-3.0%	-2.9%	-0.9%	-0.9%
Net borrowing requirement					
brought forward 1 April	(1,674)	(3,526)	(275)	(8,257)	(6,735)
carried forward 31 March	(3,526)	(275)	(8,257)	(6,735)	(6,659)
in year borrowing requirement	(1,852)	(3,251)	(7,982)	1,522	75
Capital Financing Requirement as at 31 March					
Non – HRA	6,903	8,230	9,454	9,547	9,692
TOTAL	6,903	8,230	9,454	9,547	9,692
Annual change in Cap. Financing Requirement					
Non – HRA	(4,760)	1,327	1,224	93	145
TOTAL	(4,760)	1,327	1,224	93	145
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	0.00	0.00	3.46	3.27	0.72

PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10	2010/11
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Authorised Limit for external debt -					
borrowing	10,000	12,880	13,880	13,880	13,880
other long term liabilities	20	120	120	120	120
TOTAL	10,020	13,000	14,000	14,000	14,000
Operational Boundary for external debt -					
borrowing	9,000	8,880	9,880	9,880	9,880
other long term liabilities	20	120	120	120	120
TOTAL	9,020	9,000	10,000	10,000	10,000
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	30%	30%	30%	30%	30%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£10m	£10m	£10m	£10m	£10m

Maturity structure of fixed rate borrowing during 2008/09	upper limit	lower limit
under 12 months	10%	0%
12 months and within 24 months	10%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

4. CURRENT PORTFOLIO POSITION

The Council's treasury portfolio position at 31/01/08 comprised:

		Principal		Ave Rate
		£m		%
Fixed rate funding	PWLB	0.0		
	Market	0.0	0.0	n/a
Variable rate funding	PWLB	0.0		
	Market	0.0	0.0	n/a
Other long term liabilities			0.0	n/a
TOTAL DEBT			**0.0**	**n/a**
TOTAL INVESTMENTS			**7.7**	**6.1**

5. BORROWING REQUIREMENT

	2006/07	2007/08	2008/09	2009/10	2010/11
	£'000	£'000	£'000	£'000	£'000
	actual	probable	estimate	estimate	estimate
New borrowing	0	1,395	1,375	400	455
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	6,830	0	0	0
TOTAL	**0**	**8,225**	**1,375**	**400**	**455**

Total new borrowing for the four years 2007/08 to 2010/11 is the same as previously reported. However, the phasing of the borrowing has been revised to reflect slippage of expenditure from 2007/08 to 2008/09; and changes to the timing of the use of other capital resources, in particular receipt and contributions. The replacement borrowing in 2007/08 in required to bring external debt for financing of capital investment to approximately the level of the Capital Financing Requirement and to replace the use of internal cash balances. The Council plans to only borrow an additional £600k between 2007/08 and 2010/11 over and above that previously planned.

6. PROSPECTS FOR INTEREST RATES

The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix A draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector interest rate forecast – 1 February 2008

	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	Q/E4 2010	Q/E1 2011	Q/E2 2011
Bank Rate	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.55%	4.55%	4.50%	4.50%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.85%	4.85%
10yr PWLB rate	4.60%	4.55%	4.50%	4.50%	4.55%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.80%
25yr PWLB rate	4.55%	4.50%	4.50%	4.50%	4.50%	4.55%	4.60%	4.65%	4.70%	4.70%	4.75%	4.75%	4.75%	4.75%
50yr PWLB rate	4.50%	4.45%	4.45%	4.45%	4.45%	4.50%	4.55%	4.60%	4.60%	4.65%	4.65%	4.65%	4.65%	4.60%

Sector's 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%, to 5.00% in Q2 2008 and to 4.75% in Q3 2008**
- **then unchanged until an increase in Q4 2009 to 5.0%**
- **unchanged then for the rest of the forecast period**
- **there is downside risk to this forecast if inflation concerns subside and therefore opens the way for the MPC to be able to make further cuts in the Bank Rate**

ECONOMIC BACKGROUND

Introduction

- The sub prime crisis and the major downturn in the housing market in the US has prompted fears around the world of the potential impact on world banking systems and on world growth. This has led to a sharp downturn in economic sentiment at the start of 2008 which caused the U.S. Fed to take emergency action in January to counteract these hugely negative developments. These have led some forecasters to make a sharp downward re-assessment of forecast interest rates in 2008 and 2009.

International

- The US, UK and EU economies have all been on the upswing of the economic cycle during 2005 and 2006 and so interest rates were successively raised in order to cool their economies and to counter the build up of inflationary pressures.
- The US is ahead of both the UK and EU in the business cycle and started on the downswing of the economic cycle during 2007. The Fed. rate peaked at 5.25% and was first cut in September by 0.5% to 4.75%. This was a response to the rapidly deteriorating prospects for the economy in the face of the downturn in the housing market, the sub prime mortgage crisis and the ensuing liquidity crisis which started in August 2007 and has subsequently resulted in banks making major write offs of losses on debt instruments containing sub prime mortgages. Banks have also tightened their lending criteria which has hit hard those consumers with poor credit standing.
- The Fed cut its rate again, to 4.5% in October 2007 and to 4.25% in December. A steep plunge in equity markets around the world in January precipitated by widespread concerns

as to recession in the US, the financial viability of bond insurers in the US as a result of the sub-prime crisis and the unwinding of huge unauthorised positions taken by a rogue trader at the French bank SocGen, triggered an emergency between meetings cut of 0.75% by the Fed followed by another cut of 0.50% at its regular meeting a few days later on 30 January.

- More cuts may be required to try to further stimulate the economy and to ameliorate the extent of the expected downturn. However, the speed and extent of these cuts may be inhibited by inflationary pressures arising from oil prices, the falling dollar increasing the costs of imports, etc. The US could be heading into stagflation in 2008 – a combination of inflation and a static economy (but the economy could even tip into recession if the housing downturn becomes severe enough).
- The major feature of the US economy is a steepening downturn in the housing market which is being undermined by an excess stock of unsold houses stoked by defaulting sub prime borrowers pushed into forced sales. Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure. Petrol prices have trebled since 2003 and, with similar increases in the price of home heating oil, this will also depress consumer spending with knock on effects on house building, employment etc.
- The downturn in economic growth in the US in 2008 will depress world growth, (especially in the western economies), which will also suffer directly under the impact of high oil prices. However, strong growth in China and India will partially counteract some of this negative pressure.
- EU growth has been strong during 2006 and 2007 but will be caught by the general downturn in world growth in 2008.

UK

- GDP: growth has been strong during 2007 and hit 3.3% year on year in Q3 and 2.9% in Q4 despite expectations of a significant slowdown in the pace of the economy. Growth is expected to cool to 2.0% in 2008.
- Higher than expected immigration from Eastern Europe has underpinned strong growth and dampened wage inflation.
- House prices started on the downswing in Q3 2007 and this is expected to continue into 2008.
- 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.
- 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.
- Government expenditure will be held under a tight reign for the next few years, undermining one of the main props of strong growth during this decade.
- The MPC is very concerned at the build up of inflationary pressures, especially the rise in the oil price to reach $90 – 100 per barrel from time to time (was $30 in 2003) and the consequent likely knock on effects on general prices. The prices of UK manufactured goods have risen at the fastest rate in 16 years in December 2007 – 5.0%. Food prices have also risen at their fastest rate for fourteen years (7.4% annual increase) driven by strong demand from China and India. Consequently, the MPC is going to be much more cautious about cutting rates compared to the Fed in the face of these very visible inflationary pressures. In addition, UK growth was still strong in Q4 (despite expectations of a significant cooling off). The downward trend in Bank Rate is now expected to be faster than at 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. If those pressures subside, then there is further downward risk to the Sector forecast which currently only allows for 0.25% cuts to reach 4.75% in Q3 2008.

7. BORROWING STRATEGY

The Sector forecast is as follows. (These forecasts are based around an expectation that there will normally be variations of +/- 25bp during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur if should there be any unexpected shocks to financial and/or political systems.) These forecasts are for the PWLB new borrowing rate: -

- **The 50 year PWLB rate is expected to fall marginally from 4.50% in Q1 2008 to 4.45% in Q2 2008 before rising back again to 4.50% in Q2 2009 to eventually reach 4.65% in Q2 2010.**

- **The 25 year PWLB rate is expected to fall from 4.55% to 4.50% in Q2 2008 and then to rise in gradual steps from Q2 2009 to reach 4.75% in Q3 2010.**

- **The 10 year PWLB rate is expected to fall from 4.60% in Q1 2008 to 4.55% in Q2 and to 4.50% in Q3 2008 and to then gradually rise from Q1 2009 to reach 4.85% in Q3 2010.**

- **The 5 year PWLB rate is expected to fall from 4.55% in Q2 2008 to 4.50% in Q3 2008 and to then gradually rise starting in Q1 2009 to reach 4.85% in Q2 2010.**

This forecast indicates, therefore, that there is a range of options available for borrowing strategy for 2008/09. Variable rate borrowing is expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to taking fixed rate borrowing. There is expected to be little difference between 5 – 50 year PWLB rates so this may open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long dated debt. There is also expected to be little variation in rates during the year so borrowing could be undertaken at any time in the year.

Against this background caution will be adopted with the 2008/09 treasury operations. The Statutory finance officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions at the next available opportunity.

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.

8. DEBT RESCHEDULING

If the Council chooses to borrow, opportunities to restructure long term debt will be monitored on an ongoing basis.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;

- help fulfil the strategy outlined in paragraph 7 above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings will still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans.

All rescheduling will be reported at the next available opportunity following its action.

9. ANNUAL INVESTMENT STRATEGY

9.1 Investment Policy

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 TM Code"). The Council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

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

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.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

<u>SPECIFIED INVESTMENTS</u>

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	Minimum 'High' Credit Criteria	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies **	Short-term **F1**, Long-term **A**, Individual **C**, Support **2**	In-house and fund managers

Certificates of deposits issued by banks and building societies	Short-term **F1**, Long-term **A,** Individual **C**, Support **2**	In-house buy and hold and fund managers
UK Government Gilts	Long term **AAA**	In-house and Fund Managers
Bonds issued by multilateral development banks	Long term **AAA**	In-house and fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	Long term **AAA**	In-house and for fund managers
Sovereign bond issues (i.e. other than the UK govt)	**AAA**	In house and Fund Managers
Treasury Bills	--	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Money Market Funds	Short-term **AAA** Long-term **A** volatility rating	In-house and fund managers
2. Enhanced cash funds	Short-term **AAA** Long-term **A** volatility rating	In-house and fund managers
3. Bond Funds	long-term **A** volatility rating	In-house and Fund Managers
4. Gilt Funds	long-term **A** volatility rating	In-house and Fund Managers

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

NON-SPECIFIED INVESTMENTS

1. Maturities of ANY period.

	Minimum Credit Criteria	Use	*** Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: -				
1. Callable deposits	Short-term **F1**, Long-term **A,** Individual **C**, Support **2**	In-house	**25%**	**5 years**
2. Range trade	Short-term **F1** Long-term **A**, Individual **C**, Support **2**	In-house		
3. Snowballs	Short-term **F1**, Long-term **A**, Individual **C**, Support **2**	In-house		
Corporate Bonds : ***the use of these investments would constitute capital expenditure***	Short-term F1, Long-term **AA**, Individual **C,** Support **2**	In house and Fund Managers	25%	10 years
Floating Rate Notes : ***the use of these investments would constitute capital expenditure unless they are issued by a multi lateral development bank***	Long-term **AA**,	Fund managers	25%	5 years

2. Maturities in excess of 1 year

Term deposits – local authorities	--	In-house	25%	5 years
Term deposits – banks and building societies	Short-term **F1**, Long-term **A,** Individual **C**, Support **2**	In-house	25%	5 years
Certificates of deposits issued by banks and building societies	Short-term **F1**, Long-term **A,** Individual **C,** Support **2**	In house and Fund managers	25%	5 years
UK Government Gilts	**AAA**	In house and Fund Managers	100%	10 years
Bonds issued by multilateral development banks	**AAA**	In-house and fund managers	25%	10 years
Bonds issued by a financial institution which is guaranteed by the UK government	**AAA**	In-house and fund managers	25%	10 years
Sovereign bond issues (i.e. other than the UK govt)	**AAA**	In house and Fund Managers	100%	10 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond Funds	long-term **AA** volatility rating	In-house and Fund Managers		
2. Gilt Funds	long-term **AA** volatility rating	In-house and Fund Managers		

The Council uses Fitch ratings to derive its counterparty criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings will be monitored monthly. The Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

9.2 Investment Strategy

The Council's funds are managed on a non-discretionary basis by Sector Treasury Services who are contractually required to comply with this strategy.

The Council will discuss with its adviser instruments that they consider may be prudently used to meet the Council's investment objectives. The Council will evaluate the risk-reward characteristics of asset categories to decide whether to use instruments that complied with the Guidance.

The management agreement between the Council and the adviser formally document the terms for management, including guidelines and instruments they can use within pre-determined limits.

Interest rate outlook: Bank Rate started on a downward trend from 5.75% with the first cut to 5.50% in December 2007. This is forecast to continue with further cuts to 5.25% in Q1 2008, 5.00% in Q2 and 4.75% in Q3 2008. It is then expected to rise back to 5.0% in Q4 2009 and stabilise there for the foreseeable future.
Councils should, therefore, seek to lock in longer period investments at higher rates ahead of these cuts for some element of their investment portfolio which represents their core balances. For 2008/09 clients should budget for an investment return of 4.90% - 5.0% on investments placed during 2008/09.

The Council has identified the following Minimum Investment Levels for investments as follows:

<< 5.20% >> for 1 year lending
<< 5.30% >> for 2 year lending
<< 5.35% >> for 3 year lending
<< 5.50% >> for 4 year lending
<< 5.60% >> for 5 year lending

The Minimum Investment Levels will be kept under review and discussed with Sector so that investments can be made at the appropriate time.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (over night to three months) in order to benefit from the compounding of interest.

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

APPENDIX A

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.
The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 1 February 2008

	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	Q/E4 2010	Q/E1 2011	Q/E2 2011
Bank Rate	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.55%	4.55%	4.50%	4.50%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.85%	4.85%
10yr PWLB rate	4.60%	4.55%	4.50%	4.50%	4.55%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.80%
25yr PWLB rate	4.55%	4.50%	4.50%	4.50%	4.50%	4.55%	4.60%	4.65%	4.70%	4.70%	4.75%	4.75%	4.75%	4.75%
50yr PWLB rate	4.50%	4.45%	4.45%	4.45%	4.45%	4.50%	4.55%	4.60%	4.60%	4.65%	4.65%	4.65%	4.65%	4.60%

Capital Economics interest rate forecast – 12 December 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
Bank rate	5.50%	5.25%	5.00%	4.75%	4.50%	4.25%	4.00%	4.00%	4.00%
5yr PWLB rate	4.65%	4.45%	4.35%	4.05%	3.95%	4.05%	4.25%	4.35%	4.75%
10yr PWLB rate	4.65%	4.45%	4.25%	4.15%	4.15%	4.25%	4.45%	4.65%	4.85%
25yr PWLB rate	4.65%	4.55%	4.45%	4.45%	4.35%	4.45%	4.55%	4.75%	4.95%
50yr PWLB rate	4.55%	4.55%	4.45%	4.35%	4.25%	4.35%	4.55%	4.65%	4.75%

UBS interest rate forecast (for quarter ends) – 25 January 2008

	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
Bank Rate	5.25%	5.00%	4.75%	4.25%	4.25%	4.25%	4.25%	4.25%
10yr PWLB rate	4.65%	4.60%	4.55%	4.55%	4.55%	4.55%	4.65%	4.75%
25yr PWLB rate	4.50%	4.50%	4.50%	4.45%	4.45%	4.45%	4.55%	4.65%
50yr PWLB rate	4.43%	4.40%	4.45%	4.45%	4.50%	4.55%	4.65%	4.75%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – January 2008 summary of forecasts of 24 City and 13 academic analysts for Q4 2007 and 2008. (2009 – 2011 are based on 21 forecasts)

BANK RATE FORECASTS		quarter ended		annual average Bank Rate		
	actual	Q4 2007	Q4 2008	ave. 2009	ave. 2010	ave. 2011
Median	5.50%	5.50%	4.88%	5.20%	5.24%	5.27%
Highest	5.50%	5.75%	6.25%	6.25%	6.25%	6.25%
Lowest	5.50%	5.00%	4.25%	4.80%	4.50%	4.50%