BROMSGROVE DISTRICT COUNCIL

EXECUTIVE CABINET

13th June 2007

Treasury Management Strategy Statement and Investment Strategy 2007-08 to 2009-10

Responsible Portfolio Holder	Councillor G. Denaro
Responsible Head of Service	Head of Financial Services – Jayne Pickering

1. SUMMARY

1.1 A strategy statement for the treasury management and investments in relation to Bromsgrove District Council to comply with the Local Government Act 2003 and to ensure the Council demonstrates accountability and effectiveness in the management of its funds .

2. RECOMMENDATION

2.1 The strategy shown at **Appendix A**, is approved and adopted

2.2 That the Council be recommended to set the Authorised Limit for borrowing at £6,000,000 as required by CIPFA (this is the same as the Affordable Borrowing Limit as required by Section 3(1) of the Local Government Act 2003.)

2.3 That the Council be recommended to approve the maximum level of investment to be held within each organisation as detailed at £3m.

3. BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set Treasury Management Strategy Statement (TMSS) for borrowing each financial year.

3.2 In addition the Local Government Act 2003 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.

3.3 CIPFA has defined Treasury Management as:

"the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks

associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.4 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Treasury management risks are identified in the Council's approved Treasury Management Practices and include:

- Liquidity Risk (Adequate cash resources)
- Market or Interest Rate Risk Fluctuations in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).

4. FINANCIAL IMPLICATIONS

4.1 The financial implications are contained within the body of the strategy statement at Appendix A.

5. LEGAL IMPLICATIONS

5.1 This is a statutory report under the Local Government Act 2003.

6. CORPORATE OBJECTIVES

6.1 Approval of this strategy statement meets the Council objective to achieve improvement within the Council by ensuring that financial management of treasury funds are compliant and ensure accountability to the residents of Bromsgrove.

7. RISK MANAGEMENT

7.1 The risks associated with the Treasury Management of funds are included in the strategy and the mitigation of the risks is included in the Financial Services Risk Register that is monitored on a quarterly basis.

8. CUSTOMER IMPLICATIONS

8.1 The effective management of treasury operations will ensure that the management of the public funds is monitored and reviewed in a complaint way to satisfy the public of the use of their financial resources.

9.0. OTHERS CONSULTED ON THE REPORT

Portfolio Holder	Yes
Acting Chief Executive	Yes

Corporate Director (Services)	Yes
Assistant Chief Executive	Yes
Head of Service	Yes
Head of Financial Services	Yes
Head of Legal & Democratic Services	Yes
Head of Organisational Development & HR	Yes
Corporate Procurement Team	NA

10. APPENDICES

Appendix A Treasury Management Strategy Statement and Investment Strategy 2007-08 to 2009-10
Appendix B Prudential Indicators
Appendix C

BACKGROUND PAPERS

None

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APPENDIX A

Treasury Management Strategy Statement and Investment Strategy FY 2007-08 to FY 2009-10

Contents

Appendices

1. <u>Background</u>

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set Treasury Management Strategy Statement (TMSS) for borrowing each financial year.

1.2 CIPFA has defined Treasury Management as:

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- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).

1.4 The strategy also takes into account the outlook for interest rates, the Council's current treasury position and its approved Prudential Indicators (**Appendix B**) The PIs relevant to the treasury management strategy are set out below:

PI No.		2006-07 Estimate	**2007-08** Estimate	**2008-09** Estimate	**2009-10** Estimate
6	Authorised Limit for External Debt	*£6m*	*£6m*	*£6m*	*£6m*
7	Operational Boundary for External Debt	*£5m*	*£5m*	*£5m*	*£5m*
9	Upper Limit for Fixed Interest Rate Exposure	*75 %*	*75 %*	*75 %*	*75 %*
10	Upper Limit for Variable Rate Exposure	*100 %*	*100 %*	*100 %*	*100 %*
11	Upper Limit for total principal sums invested over 364 days	*£25m*	*£25m*	*£25m*	*£25m*
10	Maturity structure of fixed rate borrowing : under 12 months		Lower Limit % 0%		Upper Limit % 100%

	12 months and within 24 months	0%	100%
	24 months and within 5 years	0%	100%
	5 years and within 10 years	0%	100%
	10 years and above	0%	100%

As the Council is currently debt free, the limits in Prudential Indicator 10 are being proposed to afford the Council the flexibility to undertake long-term borrowing in the most appropriate maturity band. (See paragraph 4.5 of the report).

1.5 This TMSS also incorporates the Council's Investment Strategy.

2. Resources and the Current Treasury Position

2.1 The estimated treasury position for 31/3/2007 and for the following financial years is :

Externally Managed Funds :

- **Invesco** **£10.886m**
- **HSBC** **£10.422m**

Internally Managed Funds **£ 0.700m**

TOTAL PORTFOLIO	**£22.008m**

2.2 The estimate for interest receipts for 2007/08 is £0.633m.

3. Outlook for Interest Rates (April 2007)

3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at **Appendix C.**

3.2 Consumer Price Inflation (CPI) for March 2007 rose to 3.1% year-on-year, breaching the 3% outer boundary in the Bank of England's inflation remit. This triggered the first open letter from the Governor in the Bank's 10 years of independence explaining why inflation had exceeded the outer limit.

3.3 Besides the strong CPI outlook, other data provides little indication of a slowing UK consumer or economy.

- The first estimate of Q1 2007 GDP shows the economy expanded above trend for the fifth consecutive quarter at 0.7% (2.8% y/y).
- The housing market has been and continues to be a key factor in the Bank of England Monetary Policy Committee's (MPC's) thinking and deliberations on monetary policy. Robust house price growth continues to be a major support to consumer confidence and spending; the cumulative increase of 0.75% in the Bank Rate since August 2007 having made little dent in consumer spending despite higher debt burdens and the associated mortgage servicing costs.

- The Bank is also concerned that there are signs of pricing power and widening margins (although evidence of the latter is patchy).
- Higher producer prices are likely to outweigh falls in utility prices and the risk is that CPI does not retreat to the Bank's 2% target as quickly as expected, providing the MPC a strong case to increase rates.

3.4 Arlingclose' central case scenario is than an increase in the Bank Rate to 5.5% looks assured in May, and that the strong data also keeps the door firmly open for the MPC raising rates further to 5.75% to bring CPI and inflation expectations back on track towards the 2% target. The 'risk' scenario is that an increase in rates to 5.5% will be sufficient to quell underlying inflationary pressures.

3.5 Interest rate cycles are becoming shorter and the range in the movement in the repo rates and gilt yields is also becoming smaller. As has been the case in the past few years, gilt yields are anticipated to fluctuate within narrow bands in 2007-08. Arlingclose expects yields for medium term maturities, i.e. 5- and 10-year maturities (which would have an influence on influence this Council's external fund management activity) to begin to see through higher inflation in the near term and will be on a falling trend as shown in Appendix B.

4. Borrowing Requirement and Strategy

4.1 The Council has not entered into any borrowing agreements due to the significant capital receipts generated over the past 5 years. The medium term financial plan for 2007/08 – 2009/10 estimates that the Council will have a balance of £1.92m of capital receipts available by 2010/11. This may result in the Council looking to borrow to fund any capital programme for the future.

4.2 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR). The CFR will determine the Council's requirement to make a Minimum Revenue Provision for Debt Redemption (MRP) from within its Revenue budget. Physical borrowing may be greater or less than the CFR.

Capital Financing Requirement	31/3/2007 Estimate £m	2007-08 Estimate £m	2008-09 Estimate £m	2009-10 Estimate £m
Balance carried forward	0.024	0.024	0.024	0.024

4.2 In accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

4.3 Capital expenditure not financed from Capital Receipts, Capital Grants and Contributions, Revenue or Reserves will produce an increase in the CFR (the underlying need to borrow) and may in turn produce an increased requirement to charge MRP in the Revenue Account.

4.4 The estimate for the long-term borrowing requirement is:

	31/3/2007 Estimate £m	2007-08 Estimate £m	2008-09 Estimate £m	2009-10 Estimate £m
New borrowing to finance capital expenditure	0.00	0.00	0.00	0.00
Total	**0.00**	**0.00**	**0.00**	**0.00**

4.5 If the Council were to take the decision to undertake long-term borrowing to fund any capital programme it would prefer to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising longer-term stability of the portfolio, and consistent with the Council's Prudential Indicators. Therefore, in conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the PWLB and from market and other sources identified in the Treasury Management Practices up to the available capacity within its Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

4.6 Actual borrowing undertaken and the timing will depend on capital expenditure levels, interest rate forecasts and market conditions during the year, in order to minimise borrowing costs. The Council will be advised by Arlingclose of the specific timing of borrowing. This may include borrowing in advance of future years' requirements provided that overall borrowing is maintained within the Council's Affordable Borrowing Limit.

4.7 The Council will undertake a financial options appraisal process to establish how it has arrived at its 'value for money' judgement in the use of resources.

5. Investment Policy and Strategy

Background

5.1 Guidance from the then ODPM (now DCLG) on Local Government Investments in England requires, similarly, that an Annual Investment Strategy (AIS) be set. The Guidance permits the TMSS and the AIS to be combined into one document.

Investment Policy

5.2 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

The speculative procedure of borrowing purely in order to invest is unlawful, but treasury strategy will result in surplus investments arising from treasury activity from time to time.

5.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the ODPM Guidance. Potential instruments for the Council's use within its investment strategy are contained in **Appendix D.**

5.4 The Council will maintain a counterparty list based on its criteria and monitor and update the credit standing of the institutions on a regular basis. This assessment may include credit ratings, alternative assessments of credit strength, and other information.

5.4 The Council's estimated levels of investments are set out in 2.1 of this TMSS.

Investment Strategy

5.5. The Council's shorter term cashflow investments are made with reference to the outlook for the repo rate and money market rates. For these monies, the Council will mainly utilise its business reserve accounts, Money Market Funds and term deposits.

5.6 The Council's core balances are invested with a longer-term strategic focus.

5.7 The Council will continue with the use of fund managers on a segregated and pooled basis (i.e. collective investment schemes). This will enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. Investments in pooled funds will be undertaken with advice from Arlingclose.

5.8 Based on the forward projections for its investments balances and its budgeted income requirement, the Council will evaluate and consider investment opportunities to earn an optimum return, to build in consistency of return over the medium term to the extent practicable, and to diversify and manage risk. For example, investments in longer-term multilateral development bank bonds provide excellent credit quality and provide certainty of investment income over the life of the bond.

5.9 The Head of Financial Services, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Cabinet meeting on a quarterly basis.

5.10 The Council's funds are also managed on a discretionary basis by Invesco and HSBC. The fund's remit allows the managers scope to add value through the use of investments contained in **Appendix D** and within the parameters and guidelines set for the Council's fund.

7. **<u>Balanced Budget Requirement</u>** :

7.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

8 **<u>Potential Changes to Accounting for Financial Instruments in Local Government</u>**

8.1 The CIPFA/LASAAC Joint Committee released the 2007 SORP Exposure Draft and Invitation to Comment for public consultation in October 2006. The 2007 SORP would apply to accounting periods starting on or after 1 April 2007. The main proposed amendment concerns new requirements for accounting for financial instruments based on the new financial instruments standards FRS 25, FRS 26 and FRS 29.

The main changes as they relate to the Council's Treasury Management activities are outlined in **<u>Appendix E.</u>**

9 **<u>Reporting on the Treasury Outturn</u>**

9.1 The Head of Financial Services will report to the Performance Management Board an Cabinet on treasury management activity / performance as follows :
(a) quarterly against the strategy approved for the year.
(b) after the completion of the financial year, the Council will report on its treasury activity during 2007-08. This report will include the latest approved Prudential Indicators for the year together with final outturn position and will also confirm compliance with the balanced budget requirement.

APPENDIX B

PRUDENTIAL INDICATORS

Prudential Indicators FY 2007-08 to FY 2009-10

1 Background:
There is a requirement under the Local Government Act 2003 for local authorities to have regard to Cipfa's Prudential Code for Capital Finance in Local Authorities (the "Cipfa Prudential Code") when setting and reviewing their Prudential Indicators.

2. Estimates of Capital Expenditure:

2.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

No. 1	**Capital Expenditure**	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
		Estimated £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
	Non-HRA	**6.798**	**6.798**	**4.659**	**7.812**	**1.656**

2.2 Capital expenditure will be financed as follows:

Capital Financing	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
	Estimated £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
Capital receipts	4.624	4.624	**3.548**	7.401	1.375
Government Grants	.960	.960	**0.443**	0.281	0.281
S106	1.214	1.214	**0.668**	0.130	0
Total	**6.798**	**6.798**	**4.659**	**7.812**	**1.656**

3. Ratio of Financing Costs to Net Revenue Stream:

3.1 This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet borrowing costs associated with capital spending (any required revenue provision for debt redemption and interest charges). The financing costs include existing and proposed capital commitments.

3.2 The ratio is based on costs net of investment income.

No. 2	Ratio of Financing Costs to Net Revenue Stream	2006-07	2006-07	2007-08	2008-09	2009-10
		Estimated £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
	Non-HRA					
	Total					

4. Capital Financing Requirement:

4.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is balance sheet based and an aggregation of the Council's fixed assets, intangible assets (plus any other expenditure treated as capital**), Fixed Asset Restatement Account, Capital Financing Account and Government Grants Deferred.

No. 3	Capital Financing Requirement	31/3/07	31/3/07	**31/3/08**	**31/3/09**	**31/3/10**
		Estimated	Actual	Estimate	Estimate	Estimate
		£m	£m	£m	£m	£m
	Non-HRA	.024	0.024	**0.024**	0.024	0.024

** if applicable*

*** in line with CIPFA's guidance, any investments or other items not falling within the classification of fixed or intangible assets, but financed from capital resources must be included within the CFR for the purposes of this calculation.*

4.2 The year–on-year change in the CFR is due to the following

Capital Financing Requirement	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
	Estimated £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
Balance B/F	0.024	0.024	0.024	0.024	0.024
Capital expenditure financed from borrowing.	0	0	0	0	0
Revenue provision for debt Redemption.	**0**	**0**	**0**	**0**	**0**
Balance C/F	**0.024**	**0.024**	**0.024**	**0.024**	**0.024**

4.3 In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should make sure that net external borrowing does not, except in the short term, exceed the Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.4 The Head of Financial Services reports that this Council had no difficulty meeting this requirement in 2005-06 nor are difficulties envisaged for the current 2006-07 or future financial years.

5 Actual External Debt:

5.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is consistent with the presentation used for the Operational Boundary and Authorised Limit.

No. 4	**Actual External Debt as at 31/3/2006**	£m
	Borrowing	0
	Other Long-term Liabilities	0
	Total	**0**

6. Incremental Impact of Capital Investment Decisions:

6.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

6.2 The Council's capital plans, as estimated in forthcoming financial years, has a neutral impact on council tax. This reflects the fact that capital costs are predominantly financed from traditional resources (grants and capital receipts) and that any borrowing undertaken is supported through the Revenue Support Grant system.

7 Authorised Limit and Operational Boundary for External Debt:

7.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending.

7.2 The Council has set the **Authorised Limit** for its total external debt (i.e. gross of investments, in line with the Balance Sheet presentation of borrowing and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

7.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

7.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

No. 6	**Authorised Limit for External Debt**	2006-07	**2007-08**	**2008-09**	**2009-10**
		Estimate £m	Estimate £m	Estimate £m	Estimate £m
	Borrowing	6.0	**6.0**	6.0	6.0

7.5 The **Operational Boundary** links directly to the Council's plans for capital expenditure, the estimates of the capital financing requirement and the estimate of cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

7.6 The Head of Financial Services has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Executive Cabinet and Council.

No. 7	**Operational Boundary for External Debt**	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
		Estimate £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
	Borrowing	5.0	5.0	**5.0**	5.0	5.0

8. Adoption of the CIPFA Treasury Management Code:

8.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	**Adoption of the CIPFA Code of Practice in Treasury Management**
	The Council approved the adoption of the CIPFA Treasury Management Code at its Executive Cabinet meeting 18th May 2005

9. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

9.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments.

9.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

N	Prudential Indicator	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
		Estimate %	Actual %	Estimate %	Estimate %	Estimate %
9	**Upper Limit for Fixed Interest Rate Exposure**	75%	75%	75%	75%	75%
1	**Upper Limit for Variable Rate Exposure**	100%	100%	100%	100%	100%

Note: These limits may be expressed as financial amounts or as percentages.

9.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

10 Maturity Structure of Fixed Rate borrowing:

10.1 This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

10.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11	**Maturity structure of fixed rate borrowing**	**Lower Limit %**	**Upper Limit %**
	under 12 months	0%	100%
	12 months and within 24 months	0%	100%
	24 months and within 5 years	0%	100%
	5 years and within 10 years	0%	100%
	10 years and above	0%	100%

11. Upper Limit for total principal sums invested over 364 days:

11.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

No. 12	**Upper Limit for total principal sums invested over 364 days**	2006-07	2006-07	**2007-08**	**2008-09**	**2009-10**
		Estimate £m	Actual £m	Estimate £m	Estimate £m	Estimate £m
		25.0	**25.0**	**25.0**	**25.0**	**25.0**

APPENDIX C

Arlingclose's Interest Rate Forecast – April 2007

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09
Official Bank Rate								
Central case	5.75	5.75	5.75	5.50	5.25	5.00	5.00	4.75
Risks	-0.25	-0.25	-0.25	-0.25				
1-yr LIBID								
Central case	5.80	5.75	5.65	5.30	5.15	5.00	5.00	4.75
Risks	+0.05		-0.10	-0.10	-0.10			
5-yr gilt								
Central case	5.25	5.20	5.05	5.00	4.90	4.75	4.75	4.75
Risks	+0.20	+0.20	+0.10	+0.05				
10-yr gilt								
Central case	4.90	4.80	4.75	4.70	4.60	4.50	4.50	4.50
Risks	+0.10	+0.10	+0.10					
20-yr gilt								
Central case	4.75	4.70	4.60	4.50	4.30	4.30	4.30	4.30
Risks	+0.10	+0.10	+0.10	+0.10				
50-yr gilt								
Central case	4.15	4.10	4.00	4.00	4.00	4.00	4.00	4.00
Risks	+0.20	+0.20	+0.20	+0.20				

- **The Central Case** for the UK Bank Rate (i.e. base rate) : an increase in the Bank Rate to 5.5% looks assured in May, the strong data also keeps the door firmly open for the MPC raising rates further to 5.75% to bring CPI and inflation expectations back on track towards the 2% target.
- **The 'Risk 'scenario** is that an increase in rates to 5.5% will be sufficient to quell underlying inflationary pressures.

Underlying assumptions :

UK :

- CPI rose to 3.1% in March, pushed up by the rise in household goods prices and triggered the open letter from the Bank of England's Governor to the Chancellor as CPI breached the outer boundary of 3%.
- Core earnings growth remains benign (February earnings ex-bonus 3.6%), but wage pressures loom through headline earnings growth staying above the MPC's 4.5% comfort level.

- Producer pricing power and the rebuilding of margins by the service and manufacturing sectors (although surveys suggest this is patchy) will remain a key area of concern for the MPC.
- House price growth remains around 10% p.a. on most measures, supported by supply shortages. Despite rising debt servicing costs, buoyant housing continues to underpin consumer confidence and spending.
- Sterling's strength cheapens imports but adds to exporters' woes. The short-term growth outlook at 2.8% is healthy but vulnerable to a slowdown in the global economy.
- The risk remains that Money Supply growth remains high, feeding an inflation surge.

International :

- Benign core CPI numbers (2.5% in March) will allow the Federal Reserve to refocus on growth risks. Core inflation is forecast to abate towards the Fed's 1-2% comfort zone but lower US interest rates from the current 5.25% may be some way off.
- The ECB will continue to increase rates by 'a quarter each quarter' in 2007 from the current 3.75% level – slowing global growth or a faster rise in the Euro will be the most likely triggers for a change to this policy.
- Recovery in Japan remains modest; the Bank of Japan could defer raising rates from current level of 0.5% until Q3 2007.
- Risks : US demand slows sharply through 2007 becoming the catalyst for a wider and significant global slowdown.

<u>Invesco's outlook on interest rates (April 2007)</u>

Two key indicators that the BoE appears to be focusing on, when assessing the medium-term outlook for inflation, are consumer inflation expectations and company pricing power, both derived from monthly surveys. Although current consumer inflation expectations have stabilised, they still remain considerably above the Band of England's central target of 2% and, with some recent evidence of companies being able to pass price increases on, the Bank is unlikely to remove its bias to increase rates yet. However, consumer disposable income is growing below its long-run trend and the impact of the previous rate increases are yet to be fully felt.

Invesco's view is that markets continue to discount at least another rate hike and with inflation at the present remaining above target this looks justified. The strength in the data releases currently show little sign of waning and Invesco expects the Bank to remain aware of the upside risks to inflation. The market currently appears happy to trust the Band of England's expectations that inflation will indeed dip down under 2% however there is a risk that inflation remains 'sticky' and that short dated gilts could continue to trade weakly. The three previous rate hikes have so far failed to dent both the consumer and the housing market and it is likely that the Bank will move again to tighten monetary conditions, i.e. raise interest rates.

Therefore, the manager's strategy at the beginning of FY 2007-08 is to remain cautious but not unduly so with market expectations already pricing in at least one more rate hike.

APPENDIX D

Specified and Non Specified Investments

Specified Investments identified for use by the Council**:**

Specified Investments will be those that meet the criteria in the ODPM Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- Money Market Funds, i.e. 'AAA' liquidity funds with a 60-day Weighted Average Maturity (WAM)
- * Other Money Market Funds – i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534, SI 2007 No 573 and subsequent amendments

1. ** Investments in these instruments will be on advice from the Council's treasury advisor.*

2. *The use of the above instruments by the Council's fund managers will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.*

For credit rated counterparties, the minimum criteria will be the short-term ratings assigned by one or more of the following agencies (Moody's Investors Services, Standard & Poor's, Fitch)
example : Short-term : P-1 (Moody's) or A-1 (S&P) or F1 (Fitch)

<u>Non-Specified Investments determined for use by the Council:</u>

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use :

	In-house use	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓ ✓	 ✓	5 yrs	60% in aggregate	No
Gilts and bonds ▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government ▪ Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	✓	10 years	75% in aggregate	No
Money Market Funds (pooled funds which meet the definition of a	✓ (on advice from treasury advisor)	✓	These funds do not have a defined	50%	No

collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573 and subsequent amendments) but which are not credit rated			maturity date		
Bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies		✓	10 years	£3M	**Yes**

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
2. The use of the above instruments by the Council’s fund managers will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

APPENDIX E

Potential Changes to Accounting for Financial Instruments

The CIPFA/LASAAC Joint Committee released the 2007 SORP Exposure Draft and Invitation to Comment for public consultation in October 2006. The 2007 SORP would apply to accounting periods starting on or after 1 April 2007. The main proposed amendment concerns new requirements for accounting for financial instruments based on the new financial instruments standards FRS 25, FRS 26 and FRS 29.

In addition to the Exposure Draft, the Department for Communities and Local Government has produced the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations SI 2007 No 573. The effect of these regulations is to mitigate any adverse effects arising from the accounting requirements included in the Exposure Draft relating to the treatment of Premiums and Discounts arising from debt rescheduling.

The main changes as they relate to the Council's current Treasury Management are:

1. The valuation of investments

With the exception of Loans and Receivables and Investments not held for treasury management purposes, local authority investments are to be valued at "fair value", with movements taken through the Statement of Recognised Gains and Losses (STRGL), using the terminology of 'available for sale'. The calculation of the gain or loss is to be based on the 'clean' price of the instrument, i.e. its fair value excluding accrued interest.

Interest and dividends will be taken to the Income and Expenditure Account.

On valuation, movements taken through the STRGL will not impact on the Income & Expenditure Account. Reductions in fair value below cost will not constitute "impairment". On disposal of the investment, the cumulative movement in fair value should be transferred from the STRGL to the Income & Expenditure Account

Specific examples are given of instances which may result in the "impairment" of an asset (e.g. credit default). Where these arise a charge to the Income & Expenditure Account will be required.

Loans and receivables (i.e. Investments not capable of being traded, such as deposits with Banks and Building Societies) are to be measured at "amortised cost".

The changes as they would relate to future treasury management activity (e.g. borrowing) would be

2. The valuation of financial liabilities

(a) Local authority loans fall within the standard's definition of loans to be measured at amortised cost.

(b) There are no types of loans payable that are "held for trading"

Measurement at amortised cost can expected to be applied successfully to the majority of financial liabilities held by local authorities. The revenue account would bear an averaged cost over the life of a loan. In the case of loans not subject to stepped interest rates there would be no difference in the amount charged to the revenue account, when compared to existing practices.

Where necessary, the Council will seek advice from its treasury advisor, Arlingclose.