APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2007/2008

5.1 Treasury Limits for 2007/08 to 2009/10

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. This amount is termed the 'Affordable Borrowing Limit'.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit. The Code requires an authority to ensure that its total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

5.2 Prudential Indicators for 2007/08 – 2009/10

The following prudential indicators 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. This was adopted in January 2002 by full Council.

Table 1: Prudential Indicators for 2007/08 – 2009/10

PRUDENTIAL INDICATOR	2005/06 Actual	2006/07 Probable Outturn	2007/08	2008/09	2009/10
Current Financial Plan Data	£,000's	£,000's	£,000's	£,000's	£,000's
Estimate of Capital Expenditure					
This is the estimates of capital expenditure for the current and future years as per the Councils' Financial Plan.	42,793	51,121	53,500	49,270	55,238
Net Increase in council tax (band D per annum)					
The estimate of incremental impact of capital investment	£7.25	£13.24	£21.66	£13.29	£7.80

decisions proposed in the budget report, related to the added borrowing requirement.					
Cumulative totals:	£8.32	£21.56	£43.22	£56.52	£64.32
Capital Financing as % of Net Revenue Stream (including Dedicated Schools Grant)					
The estimates of financing costs include current commitments and the proposals in the budget report.	2.67%	3.16%	3.72%	4.30%	4.39%
Capital Financing Requirement (as at 31 March)					
The capital financing requirement measures the authority's underlying need to borrow for a capital purpose.	63,199	85,210	110,494	123,735	141,641

PRUDENTIAL INDICATOR	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10**
Treasury Management Indicators	£,000's	£,000's	£,000's	£,000's	£,000's
Authorised limit for external debt					
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.					
borrowing	70,000	100,000	108,000	120,000	138,000
Other long term liabilities	3,000	2,000	2,000	2,000	2,000
Cumulative Total	**73,000**	**102,000**	**110,000**	**122,000**	**140,000**
Operational limit for external debt					
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.					
borrowing	60,000	90,000	103,000	112,000	129,000
other long term liabilities	3,000	2,000	2,000	2,000	2,000
Cumulative Total	**63,000**	**92,000**	**105,000**	**114,000**	**131,000**
Upper limit for fixed interest rate exposure					
This is the maximum % of total borrowing which can be at fixed interest rate.	100%	100%	100%	100%	100%

Upper limit for variable interest rate exposure					
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping a degree of flexibility through the use of variable interest rates.					
This is the maximum % of total borrowing which can be at variable interest rates.	50%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days					
Given the Councils' financial position, i.e. of having low cash balances, any lending is likely to be the result of the phasing of cash flow. Investment periods are unlikely to be more than 6 months (although the position could change if the Council generated significant receipts pending review of its asset base)					
The maximum % of total investments which can be over 364 days.	20%	80%	80%	80%	80%

Maturity Structure of new fixed rate borrowing during 2007/08	Upper limit	Lower limit
Under 12 months	50%	NIL
12 months and within 24 months	50%	NIL
24 months and within 5 years	50%	NIL
5 years and within 10 years	50%	NIL
10 years and above	100%	NIL

5.3 Current Portfolio Position

The Council's treasury portfolio position at 31st December 2006 comprised:

	Principal	**Ave. rate**
	£m	%
Fixed rate funding	PWLB 60 Market 15	4.22 3.57 *
Total fixed rate funding	75	4.09
Variable rate funding	Market 5	4.50
Other long term liabilities	Nil	N/A
TOTAL DEBT	**80**	**4.12**
TOTAL INVESTMENTS**	**48.89**	**5.13**

* The market loans are 'lenders options' or LOBO's. These are fixed at a relatively low rate of interest for an initial period but then revert to a higher rate of 4.5%. When the initial period is over the loans are then classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower has the option to repay the loan without penalty.

** Total Investments includes Schools balances where schools have not opted for an external bank account and cash balances related to the Avon Pension Fund.

5.4 Borrowing Requirement

	2005/06 Actual	2006/07 Probable Outturn	2007/08 Estimate	2008/09 Estimate	2009/10 Estimate
	£'000	£'000	£'000	£'000	£'000
New borrowing	30,000	30,000	22,000	12,000	17,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	0	0	0
TOTAL New Borrowing	**30,000**	**30,000**	**22,000**	**12,000**	**17,000**

5.5 Prospects for Interest Rates

The Council appointed Sector Treasury Services as a treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix 3 draws together a number of current City forecasts for short term or variable and longer fixed interest rates. The following table gives the Sector central view as at January 2007:

Sector interest rate forecast – January 2007

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

Sector's current interest rate view is that Bank Rate will: -

- peak at 5.50% in quarter 1 2007
- fall to 5.25% in Q4 2007 and then to 5.00% in Q1 2008
  fall to 4.75% in Q2 2008 before rising back to 5.00% in Q2 2009.

5.6 Borrowing Strategy

The Sector forecast is as follows:

- **The 50 year PWLB rate is expected to remain flat at 4.25%. As the Sector forecast is in 25bp segments there is obviously scope for the rate to move around the central forecast by +/- 25bp without affecting this overall forecast.**

- **The 25-30 year PWLB rate is expected to stay at 4.50% for the foreseeable future.**

- **The 10 year PWLB rate will fall from 5.00% to 4.75.% in Q3 2007 and then fall again to 4.50% in Q1 2008 and remain at that rate for the foreseeable future.**

- **5 year PWLB rate will fall from 5.25% to 5.0% in Q3 2007 and continue falling until reaching 4.5% in Q1 2008 when it will remain at that rate for the foreseeable future.**

This forecast indicates, therefore, that the borrowing strategy for 2007/08 should be set to take very long dated borrowing at any time in the financial year. Variable rate borrowing and borrowing in the five year area are expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year compared to taking long term borrowing.

For authorities wishing to minimise their debt interest costs, the main strategy is therefore as follows:

- With 50 year PWLB rate at 4.25%, borrowing should be made in this area of the market at any time in the financial year. This rate will be lower than the forecast rates for shorter maturities in the 5 year and 10 year area. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4.25%.

Against this background caution will be adopted with the 2007/08 treasury operations. The Treasury Manager will monitor the interest rate market and adopt a pragmatic approach to changing circumstances.

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 in 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. [This strategy was adopted in 2006/07 and contributed to the underspend on capital financing costs]

- *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.

5.7 Debt Rescheduling

The Council will give consideration during the year to taking advantage of small movements in PWLB rates to reduce the cost of existing debt in the portfolio by reborrowing at lower rates without making significant changes to the type of debt (fixed / variable) or maturity periods, where this is possible without penalty.

The reasons for any rescheduling to take place will include:
- the generation of cash savings at minimum risk;
- help fulfil the strategy outlined in section 5.6 above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

CIPFA issued a draft accounting standards document (SORP 2007) on 18 October 2006 which includes major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premia and discounts arising from debt rescheduling. There will be a three month consultation period before proposals are finalised. It is also expected that these proposals, once finalised, may make necessary the issue of legislation by the Government to take effect from 1.4.2007. The Authority's treasury management strategy will be reviewed once the final decisions in this area are known to see whether any changes will be required in borrowing, investment or debt rescheduling strategies.

All rescheduling will be reported in the next available Treasury Management Monitoring report following its action.