APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2008/2009

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. 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.

Prudential Indicators for 2008/09 – 2010/11

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 2008/09 – 2010/11

PRUDENTIAL INDICATOR	2006/07 Actual	2007/08 Probable Outturn	2008/09	2009/10	2010/11
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.	43,522	46,384	62,351	55,507	65,492
Net Increase in council tax (band D per annum)					
The estimate of incremental impact of capital investment decisions proposed in this budget report, related to the added borrowing requirement.			2.17	9.45	16.43
Cumulative totals:			2.17	11.62	28.05
Capital Financing as % of Net Revenue Stream					
Net Revenue Stream based on "Net Operating Expenditure" from final accounts.	4.15%				
Estimates for net revenue stream for current and future years based on estimates of the amounts to be met from government grants and local taxpayers. (2006/07 also provided on this basis for comparative purposes)	4.90%	5.63%	6.48%	7.61%	10.23%
Capital Financing Requirement (as at 31 March)					
The capital financing requirement measures the authority's underlying need to borrow for a capital purpose.	77,977	93,732	113,922	133,049	160,846

PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10	2010/11
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	100,000	108,000	105,000	125,000	155,000
Other long term liabilities	2,000	2,000	2,000	2,000	2,000
Cumulative Total	**102,000**	**110,000**	**107,000**	**127,000**	**157,000**
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	90,000	103,000	100,000	120,000	150,000
other long term liabilities	2,000	2,000	2,000	2,000	2,000
Cumulative Total	**92,000**	**105,000**	**102,000**	**122,000**	**152,000**
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.	80%	80%	80%	80%	80%

Maturity Structure of new fixed rate borrowing during 2008/09	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

Current Portfolio Position

The Council's treasury portfolio position at 31st December 2007 comprised:

	Principal	**Ave. rate**
	£m	%
Fixed rate funding	PWLB 60 Market 10	4.22 3.49 *
Total fixed rate funding	70	4.11
Variable rate funding	Market 10	4.50
Other long term liabilities	Nil	N/A
TOTAL DEBT	**80**	**4.16**
TOTAL INVESTMENTS**	**61.90**	**6.23**

* 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.

Borrowing Requirement

	2006/07 Actual	2007/08 Probable Outturn	2008/09 Estimate	2009/10 Estimate	2010/11 Estimate
	£'000	£'000	£'000	£'000	£'000
New borrowing	30,000	0	20,000	20,000	30,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	0	0	0
TOTAL New Borrowing	**30,000**	**0**	**20,000**	**20,000**	**30,000**
Cumulative Council Borrowing	**80,000**	**80,000**	**100,000**	**120,000**	**150,000**

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 24th December 2007:

Sector interest rate forecast – 24th 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	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011
Bank Rate	5.50%	5.25%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.80%	4.70%	4.65%	4.55%	4.55%	4.60%	4.70%	4.75%	4.80%	4.80%	4.80%	4.85%	4.85%	4.85%
10yr PWLB rate	4.80%	4.70%	4.60%	4.55%	4.55%	4.55%	4.55%	4.60%	4.70%	4.75%	4.75%	4.80%	4.80%	4.80%
25yr PWLB rate	4.65%	4.60%	4.55%	4.55%	4.50%	4.55%	4.55%	4.60%	4.65%	4.70%	4.70%	4.70%	4.70%	4.75%
50yr PWLB rate	4.55%	4.50%	4.45%	4.45%	4.45%	4.45%	4.45%	4.50%	4.50%	4.55%	4.55%	4.55%	4.55%	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% and to 5.00% in Q2 2008.
- Then unchanged for the following two years
- There is a downside risk to this forecast if inflation concerns subside and so open the way for the MPC to be able to make further cuts in Bank Rate

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 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 Q3 2009 and to 4.55% in Q1 2010 and to 4.6% in Q1 2011.**

- **The 25 year PWLB rate is expected to fall progressively from 4.65% to reach 4.50% in Q4 2008 and to then be on the rise from Q1 2009 to reach 4.70% in Q1 2010 and 4.75% in Q1 2011.**

- **The 10 year PWLB rate is expected to fall from 4.70% in Q1 2008 to 4.55% in Q3 2008 and to then gradually rise from Q3 2009 to reach 4.80% in Q3 2010.**

- **The 5 year PWLB rate is expected to fall from 4.70% in Q1 2008 to reach 4.55% in Q3 2008 and to then gradually rise starting in Q1 2009 to reach 4.85% in Q3 2010.**

This forecast indicates, therefore, that the borrowing strategy for 2008/09 should be set to take 25 – 30 year borrowing towards the end of the financial year but in as much as little variation is expected in average quarterly rates, this is likely to mean that attractive rates could be available at any time in the year when there is a dip down in rates. 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.

The main strategy is therefore as follows:

- Focus on undertaking new borrowing in or near the 25 – 30 year period so as to minimise the spread between the PWLB new borrowing and early repayment rates as there is little, or no difference in the new borrowing rate between rates in these periods and the 50 year rate. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.
- This strategy also means that after some years of focusing on borrowing at or near the 50 year period, local authorities will be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.
- When the 25-30 year PWLB rates fall back to the central forecast rate of about 4.60%, borrowing should be made in this area of the market at any time in the financial year. This rate is likely to 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 4.60%. However, if shorter period loans become available around this rate, these will also be considered.

- The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.
- Consideration will also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate.

Against this background caution will be adopted with the 2008/09 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 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.

Debt Rescheduling

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.

The Council will give consideration during the year to taking advantage of movements in borrowing rates to reduce the cost of existing debt in the portfolio by re-borrowing 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 the borrowing strategy section above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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