RYEDALE DISTRICT COUNCIL

REPORT TO:	POLICY & RESOURCES
DATE:	7 FEBRUARY 2008
REPORTING OFFICER:	INTERIM CHIEF FINANCIAL OFFICER
SUBJECT:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2008-09**

1.0 PURPOSE OF REPORT

1.1 To consider the Treasury Management and Annual Investment Strategy, set the Prudential Code Indicators for 2008/09 and to update Members on current investments.

2.0 RECOMMENDATIONS

2.1 It is recommended the report be received and the strategies be noted and recommended to the Council for approval, and that the prudential indicators in the report also be recommended to the Council for approval.

3.0 REASONS SUPPORTING DECISION

3.1 The CIPFA Code of Practice on Treasury Management in Local Authorities (The Code) was adopted by the Council following consideration by this Committee.

3.2 The Local Government Act 2003 requires the Council to have regard to specified codes of practice, namely the CIPFA publications *Prudential Code for Capital Finance in Local Authorities* and *Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes.*

4.0 BACKGROUND

4.1 The CIPFA Code states that Members will receive reports on its Treasury Management policies, practices and activities at intervals, to include quarterly statements and an annual strategy together with an annual report.

4.2 The Local Government Act 2003 introduced legislation governing capital investment decisions, emphasis is now placed on Local Authority self regulation which is governed by the 2003 Prudential Code for Capital Finance in Local Authorities.

4.3 The Prudential Code regulates the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.

4.4 The Local Government Act 2003 also requires Authorities to produce an Annual Investment Strategy, which should be approved by the Full Council. The Strategy will set out the Council's policies for the prudent management of its investments including the security and liquidity of those investments

5.0 INTRODUCTION

5.1 The Treasury Management Strategy Statement details the expected activities of the Treasury function in the forthcoming financial year (2008/09). Its production and submission to the Council following consideration by the Policy & Resources Committee is a requirement of the CIPFA Code of Practice on Treasury Management.

5.2 The Annual Investment Strategy details the Specified and Non Specified Investment Instruments to be used by the Council and any fund managers in 2008/09. Approval is also sought for the specified use of credit ratings and the maximum periods for which funds may be prudently committed in each asset category.

5.3 The Prudential Code requires the Council to set a number of Prudential Indicators, and these are to be considered when determining the Council's treasury management strategy.

5.4 The suggested strategies for 2008/09 are based upon advice from the Council's treasury advisors, Sector.

5.5 The treasury management investment position as at 31 December 2007 is included in the report for information.

6.0 POLICY CONTEXT

6.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in local authorities and this report complies with the requirements under this Code, the report also complies with the relevant requirements of the Local Government Act 2003.

7.0 REPORT

7.1 Prudential Indicators for 2008/09 to 20010/11

7.1.1 Ryedale District Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

7.1.2 It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2008/09, 2009/10 and 2010/11 of 100% of its net outstanding principal sums.

7.1.3 It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2008/09, 2009/10 and 2010/11 of 20% of its net outstanding principal sums.

7.1.4 This means that the Chief Financial Officer will manage fixed interest rate exposures within the range 80% to 100% and variable interest rate exposures within the range 0% to 20%.

7.1.5 Ryedale District Council is currently debt free, therefore the performance indicator regarding the maturity structure of debt does not apply for the financial year 2008/09.

7.1.6 Limits to be placed on final maturities beyond 364 days:

31/3/2009	£5.0m
31/3/2010	£5.0m
31/3/2011	£5.0m

7.2 Prospects for Interest Rates

7.2.1 The Council has appointed Sector Treasury Services as treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table draws together a number of current City forecasts for short term or variable (the base rate or repo rate) and longer fixed interest rates.

Sector Interest Rate Forecast – 24 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%

7.2.2 Extract from Sector Economic Forecast, December 2007:

"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 some 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 has cut its rate again, to 4.5% in October 2007 and to 4.25% in December and is expected to cut by another 0.25% to 0.75% by April 2008 (*actual went to 3.0% in January*) to try to stimulate the economy and to ameliorate the extent of the downturn. However, the speed and extent of these cuts will be inhibited by inflationary pressures arising from oil prices and the falling dollar increasing the costs of imports. The US could well 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."

7.2.3 *"The MPC is very concerned at the build up of inflationary pressures especially the rise in the oil price to $90 – 100 per barrel (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 November 2007 – 4.5%. Food prices have also risen at their fastest rate for fourteen years (6.6% 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 exceptionally strong in Q3, as has also been the growth in the money supply. 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. However, if those pressures subside, then there is further downward risk to the Sector forecast which currently only allows for 0.25% cuts in Q1 and Q2 2008 before Bank Rate stabilises at 5.0% for the next two years."*

7.2.4 Sectors current interest rate view is that the base rate will reduce to 5.25% in Q1 2008, then fall by .25% in Q2 2008 to 5.00%, where it will remain for the following 2 years.

7.3 Borrowing Strategy

7.3.1 It is anticipated that there will be no capital borrowings required during 2008/09.

7.4 ANNUAL INVESTMENT STRATEGY

7.4.1 The Annual Investment Strategy, below, details the Specified and Non-Specified investment instruments to be used by the Council and any fund manager in 2008/09. Approval is also sought for the specified use of credit ratings and the maximum periods for which funds may be prudently committed in each asset category.

7.5 Investment Principles

7.5.1 All investments, both specified and non-specified, will be in sterling.

7.5.2 The general policy objective for the Council is the prudent investment of its treasury balances. In this respect the primary investment priorities are the security of capital and liquidity.

7.5.3 The Council will aim to achieve the optimum return on its investments commensurate with its investment priorities.

7.5.4 The Guidance makes it clear that the borrowing of monies purely to invest or to lend on and make a return is unlawful. Consequently, such borrowing will not be made.

7.6 Specified and Non-Specified Investments

7.6.1 Specified investments are those investments offering high security and high liquidity. Under the guidelines the Council is free to rely on these with minimal procedural formalities. All such investments should be in sterling with a maturity of no more than 1 year. Non-specified investments have a greater potential for risk, and can have a maturity date in excess of one year. However these investments must be identified in the Annual Investment Strategy and proper guidelines and procedures should be in place for dealing with these investments.

7.6.2 Investment instruments recommended for use in the financial year are listed in Annex B under the 'Specified' and 'Non-Specified' Investments categories.

7.6.3 Annex B also sets out:
(a) The advantages and associated risk of investments under the category of "non-specified";
(b) The upper limit to be invested in each 'non-specified' asset category;
(c) Which instruments would best be used by the Council's external fund manager or after consultation with the Council's treasury advisors.

7.7 Liquidity

7.7.1 Based on cash flow forecasts, the Council anticipates fund balances in 2008/09 to range between £11m and £20m.

7.7.2 Taking account of the level of balances over the next 3 years, the need for liquidity, spending commitments and a provision for contingencies, it is proposed that the Council determines that £5.0m may be held in 'non specified' investments during 2008/09.

7.7.3 Annex B sets out the maximum periods for which funds may be prudently committed in each asset category.

7.8 Security of Capital: The Use of Credit Ratings

7.8.1 The credit quality of counterparties and investment schemes will, in the first instance, be determined by reference to credit ratings published by Fitch credit rating agency. Annex A highlights the recommended policy on minimum credit criteria using this methodology.

7.8.2 The minimum long-term/short-term and other credit ratings considered "high" for each category of investment have also been established.

7.8.3 Your Officers will establish with the fund manager their credit criteria and the frequency of their monitoring.

7.8.4 Monitoring of credit ratings :
- All credit ratings will be monitored monthly including the Fitch ratings.
- If a downgrade results in the counterparty/investment scheme no longer meeting the minimum criteria, no new investments will be made and the external fund manager will be informed.
- If a counterparty/investment scheme is upgraded so that it fulfils the Council's criteria, the Chief Financial Officer will determine if it should be included on the lending list.

7.8.5 In the absence of a credit rating by Fitch, the Council will invest in institutions with a P1 short term rating to a maximum of 6 months, or an AAA long term rating for up to 5 years, using Moodys Investment Services credit rating criteria.

7.9 Investments Defined as Capital Expenditure

7.9.1 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended). Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.

7.9.2 A loan or grant or financial assistance to another body for capital expenditure by that body will be treated as capital expenditure.

7.9.3 Your Officers will not invest or allow its external fund manager to make any investment which will be deemed capital expenditure.

7.10 Provisions for Credit-related Losses

7.10.1 If any of the Council's investments were at risk of loss due to default (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

7.11 Investment Strategy to be followed In-house

7.11.1 The Council's in-house managed funds are split between cash flow derived balances and £5.0m of core investments. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

7.11.2 From time to time the fixed rate investments may span financial years. Currently the Council has 3 investments totalling £3.5m on deposit, which will mature between 30 May and 13 August 2008.

7.11.3 The Bank Rate has now started on a downward trend from 5.75% to 5.50% in December 2007. Sector is anticipating that this will continue with further cuts forecast to 5.25% in Q1 2008 and again to 5.00% in Q2 2008. It is then expected to remain unchanged for the next two years. The Council will, therefore, seek to lock in longer period investments at higher rates before this fall starts for some element of their investment portfolio which represents their core balances.

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

5.45% for 1 year lending
5.55% for 2 year lending
5.55% for 3 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.

7.12 External Cash Fund Management

7.12.1 Tradition (UK) Limited (Tradition) is a cash manager, appointed to manage, on a discretionary basis, a proportion of the Council's investment portfolio. Tradition is permitted to invest only in fixed term deposits, thus providing a level of certainty to investment returns. The agreement between the Council and Tradition formally document the terms for management, including guidelines and instruments they can use within pre-determined limits.

7.12.2 Currently 2 investments arranged through Tradition span financial years, one investment of £1.5m is on deposit until 8 May 2008, and the other investment of £1.0m is on deposit until 20 May 2008.

7.13 End of Year Investment Report

7.13.1 At the end of the financial year, a report will be submitted to the Council on investment activities as part of the Annual Treasury Report. This will be scheduled for the June Policy & Resources Committee for a recommendation to Council.

7.14 Current Investments

7.14.1 The following table shows the relative performance of the funds, with a 7-day rate benchmark for the period 1 April to 31 December 2007 for the internally and externally managed funds.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return
Internally Managed:				
Temporary Investments	£1,071,393	5.92%	n/a	n/a
Fixed Term Deposits	£1,142,783	5.78%	n/a	n/a
Externally Managed	£1,250,000	5.28%	5.22%	5.67%

7.14.2 As at 31 December 2007 investments totalled £16,520,000 which were lent out as follows:

	Internally Managed	Externally Managed
Temporary Investment	£7,020,000	0
Fixed Term Deposits :		
Repayable within 1 month	0	0
Repayable 1 month to 3 months	0	£2,500,000
Repayable 3 months to 6 months	£1,000,000	0
Repayable 6 months to 12 months	£3,500,000	£1,000,000
Repayable 12 months to 24 months	0	£1,500,000

The 12 to 24 months Cash Managers deposit of £1,500,000 is to mature on 8 May 2008.

7.14.3 The current investments as at 31 December 2007 were placed with the following types of institution.

	Internally Managed	Externally Managed
UK Clearing Banks	£2,520,000	0
Foreign Banks	£3,000,000	£2,500,000
Building Societies	£6,000,000	£2,500,000
British Government Securities	0	0
Total	**£11,520,000**	**£5,000,000**

7.14.4 Average interest rates for internal investments raised for the three quarters of this financial year were as follows:

	June-07	September-07	December-07	March-08
Temporary	5.49599%	6.04699%	6.15918%	0
Fixed Term Deposits :				
Repayable within 1 month	0	0	0	0

Repayable 1 month to 3 months	0	0	0	0
Repayable 3 months to 6 months	5.89000%	0	6.20000%	0
Repayable 6 months to 12 months	0	6.24000%	0	0
Repayable 12 months to 24 months	0	0	0	0
Cash Managers Deposits :				
Repayable within 1 month	0	0	0	0
Repayable 1 month to 3 months	0	0	6.55000%	0
Repayable 3 months to 6 months	0	0	0	0
Repayable 6 months to 12 months	5.94000%	0	0	0
Repayable 12 months to 24 months	0	0	0	0

8.0 OPTIONS/RESULT OF OPTION APPRAISAL

8.1 Options for investment are constantly reviewed by both the internal and external managers. The objective is to maximise income while minimising risk.

9.0 FINANCIAL IMPLICATIONS

9.1 The results of the investment strategy affect the funding of the capital programme and to a lesser extent the revenue programme. It is essential to maximise interest receipts in view of the ongoing pressures facing the capital and revenue budgets.

10.0 RISK ASSESSMENT

10.1 There are significant risks when investing public funds especially with unknown institutions. However by the adoption of the CIPFA Code and a prudent investment strategy these are minimised. The employment of Treasury Advisors also helps reduce the risks.

10.2 There are, however, three main risk areas:

(a) Credit risk – the security of the investment
(b) Market risk – the poor performance of the chosen investment
(c) Liquidation risk – use of fixed term deposits and/or instruments/investments over the next 12 months with low marketability may mean a lack of liquidity.

11.0 CONCLUSION

11.1 Over the next financial year the base rate is forecast to fall to 5%. It is imperative therefore, that performance is maximised to support the Council’s plans for capital investment. It is noted that by the adoption of the Treasury Management and Annual Investment Strategies this will be achieved and risk minimised.

BACKGROUND PAPERS:

CIPFA Treasury Management in Public Services Code of Practice
DCLG's Guidance on Local Government Investments
The Prudential Code for Capital Finance in Local Authorities

OFFICER CONTACT:

Please contact John Patten, Interim Chief Financial Officer if you require any further information on the contents of this report. The Officer can be contacted at Ryedale House.
Tel 01653 600666, Ext 214 and e-mail john.patten@ryedale.gov.uk.

Annex A

Recommended Credit Rating Criteria using Fitch Credit Ratings

Long-term and short-term ratings are used by rating agencies for banks and building societies to express their opinion on an institution's capacity to service and repay punctually its debt obligations

Individual ratings are a measure of an institution's intrinsic safety and soundness on a stand alone basis and provide an assessment of the strength of the institution's financial structure, its performance and credit (and therefore risk) profile.

Support rating: At present Fitch is the only credit rating agency which explicitly states its view of the likely presence of a lender of last resort, either government or parent with the willingness and the resources to aid a failing financial institution

Lending *up to* 365 days to banks and building societies

Short-term rating of F1+
Long Term Rating of AAA, AA+, AA, AA-

Individual Rating	Support Rating			
	1	2	3	4
A				
A/B				
B				
B/C				
C				
C/D				
D				

Short term rating of F1
Long Term Rating of A+, A

Individual Rating	Support Rating			
	1	2	3	4
A				
A/B				
B				
B/C				
C				
C/D				
D				

Maximum Length of Investment

365 days 3 months

<u>Lending *longer than* 365 days</u>

Short-term rating of F1+
Long-term rating of AAA, AA+, AA

Individual Rating	Support Rating			
	1	2	3	4
A				
A/B				
B				
B/C				
C				
C/D				
D				

For Investments between 1 and 5 years

Short-term rating of F1+
Long-term rating of AA-

Individual Rating	Support Rating			
	1	2	3	4
A				
A/B				
B				
B/C				
C				
C/D				
D				

For Investments between 1 and 2 years

.