
South Bedfordshire District Council

Investment Options

March 2007



South Bedfordshire District Council

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1.0 Introduction

- 1.1 This report provides a brief background to South Bedfordshire District Council's [the Council] options in relation to its core treasury management investment balances.

2.0 Background

- 2.1 The Council has had relatively significant levels of treasury management investments although these have declined over recent years as they have been used to finance the Council's ongoing capital expenditure plans. These investments have been managed by external fund managers and the Council's treasury team. The security of the Council's investments is of primary importance and investments are invested in a range of assets and financial institutions meeting acceptable credit risk parameters.
- 2.2 The Council made a modest return to long term borrowing in 2005/06 to meet expenditure requirements in respect of the Decent Homes Standard on its Housing Stock. At the same time, the level of investments has declined to the extent that investment funds were withdrawn from Invesco, one of its external fund managers.
- 2.3 The difference between what the Council needs to spend and the resources that are available are subject to some uncertainty in the timing of payments and receipts. These differences in "cash-flow" have largely been financed from temporary loans - a relatively cheap and flexible form of borrowing although the cost of temporary loans has risen recently as short-term interest rates have been increased. These increases in interest rates have also created a very difficult environment for the Council's (and other) fund manager, Investec.

3.0 Regulatory Issues

- 3.1 The regulatory arrangements for the investment of surplus funds changed from the highly prescriptive "Approved Investment" Regulations to the broader Prudential Investment Guidance [the Guidance] with effect from 1st April 2004. The Guidance was an integral part of a wider revision of local government capital finance arrangements and the introduction of the Prudential Code.
- 3.2 The Guidance allows local authorities to develop investment strategies and activity that is prudent and reflects an authority's particular circumstances. The Guidance allows investment in a wider range of asset classes including the investment in investment funds provided they meet certain criteria. The over-riding principle in the Guidance is that investment activity should reflect

security, liquidity and yield considerations in that order. Security of public monies correctly remains the prime objective.

4.0 External Fund Managers

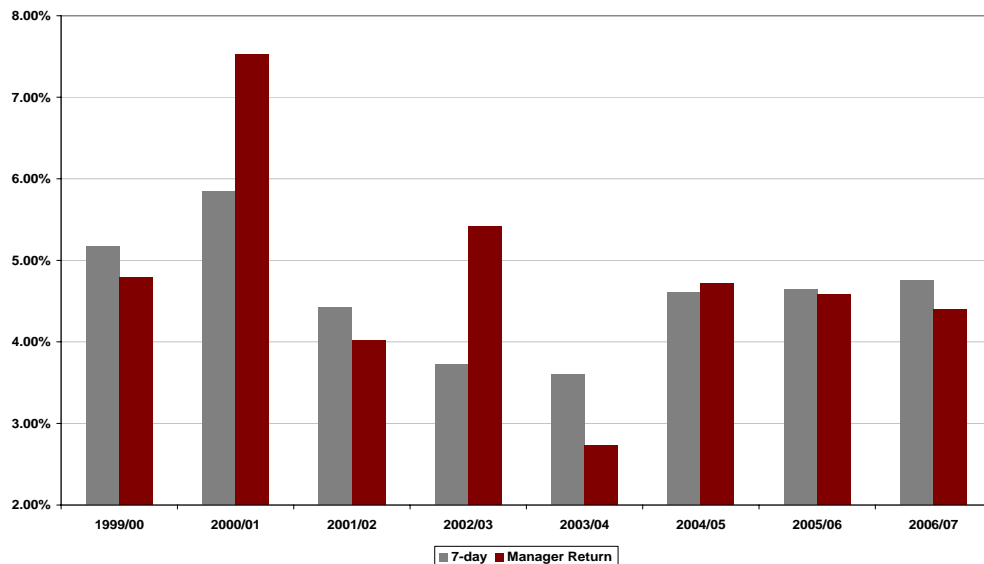
4.1 External fund managers have been used by local authorities to manage core cash balances since 1990. During the 1990’s up to 15 companies competed for funds in the local authority cash market, many believing this was a route to the more lucrative market of pension fund asset management.

4.2 The cash fund managers provided an attractive proposition for local authorities because they offered active management in assets that were rarely used by local authority treasury management officers, namely certificates of deposit and gilts. The timely investment in gilts enabled the fund managers to add substantial value over short dated cash equivalents.

4.3 The early to mid 1990’s were the “golden age” of cash fund managers as they and their clients benefited from a sustained period of declining interest rates in the UK. Any investment in longer dated assets – certificates of deposit (CDs) or gilts – resulted in capital gains in addition to any income. It was not uncommon for fund managers to comfortably add 1% additional return net of fees over the short dated cash benchmark.

4.4 However, in recent years a combination of more stable interest rates following the introduction of the Bank of England’s Monetary Policy Committee and global downward pressure on inflation has provided a much tougher environment for local authorities and fund managers to add value from established or traditional routes. This is illustrated in the following chart showing absolute returns generated by one of the “leading” cash fund managers and the short dated cash benchmark.

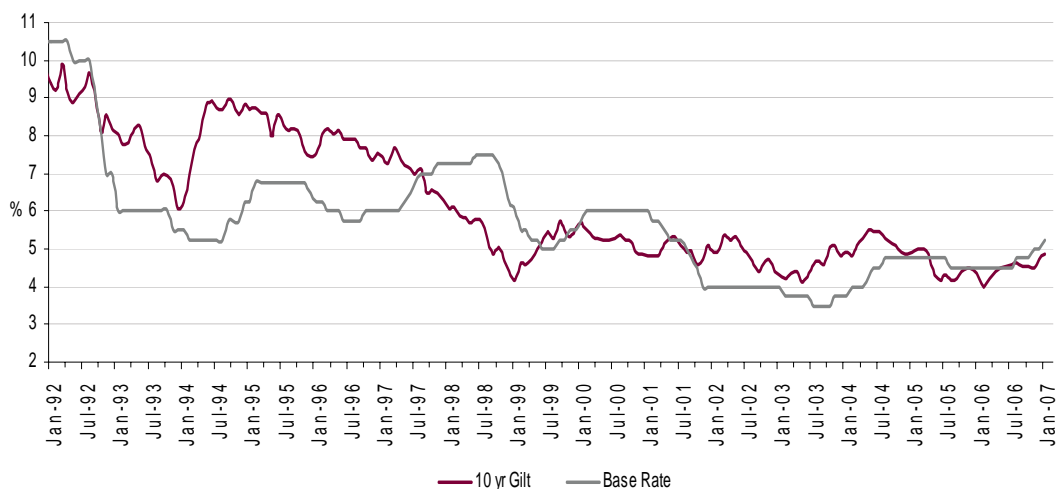
Chart 1: Fund management returns and benchmark returns since 1999/00



5.0 External Management in 2007

- 5.1 Lower, stable and, arguably, more predictable interest rates – even after the surprise move by the Bank of England’s Monetary Policy Committee (MPC) in January 2007 - have implications for external investment management. Unfortunately there has been very little response from the fund management or consulting industry to address this issue. The majority of fund managers and consultants continue to offer mandates that worked in the 1990’s but will ONLY work in the future if interest rate expectations fall. If interest rate expectations stay stable or rise they will simply not add value. This is fine if local authorities’ expectations are adjusted accordingly. Our general experience is that they are not but this is not necessarily the fault of the local authorities concerned.
- 5.2 The operational independence of the Bank of England’s Monetary Policy Committee has “dampened” interest rate movements to the extent that there are now typically one or, maybe, two 25bp (0.25%) movements each year. With less movement there is less opportunity to take acceptable risk into the portfolio – where we define risk as a deviation away from the agreed benchmark.
- 5.3 Returns from cash fund managers in 2006/07 are set to underperform cash benchmarks because it has been a year initially characterised by generally increasing interest rate expectations followed by sharply upward expectations as the MPC commenced a policy of higher official interest rates. The last time a sustained tightening phase occurred in official interest rates was in financial year 2003/04. It can be seen that this also presented a very challenging backdrop for cash fund manager performance.

Chart 2: Declining and more stable interest rates



5.4 Arlingclose has developed and explored a number of different approaches to external fund management for its clients and the Council and these are identified below.

6.0 Investment options for the future

6.1 Do nothing

The Council can, of course, continue with its current arrangements. Investec can continue to manage the investment Fund with the intention of generating added value and they will do so from time-to-time. Provided the Council accept the prospect of lower investment returns in total and relative to the agreed benchmark then it should do nothing.

Advantages

Simplicity
Minimal resource impact
Familiarity

Disadvantages

Out of date approach maintained
Lower investment returns
Outperformance of benchmark only in years of declining interest rate expectations

Estimated projected return in 2007/08 on £10m: 5.75%* = £575,000

Average return since 2003/04 to 2007/08 (estimate)	4.39%
Standard deviation	1.10%
Return range at 95% confidence level	2.20% to 6.59%

* Investec Revision to Forecasts announcement 16th January 2007.

6.2 Replace Investec with another fund manager

Investec has managed the Council's Fund for many years. The Council could replace Investec with another suitably qualified fund management company. Analysis undertaken by Arlingclose indicates that the performance of the various fund managers in the local authority cash fund management market is increasingly similar. In 2005/06, for example, the difference between the best and worst performing fund management company was just 8bps or 0.08%.

Advantages

None

Disadvantages

Resources required exceed benefits

Estimated projected return in 2007/08 on £10m: 5.75%* = £575,000

Average return since 2003/04 to 2007/08 (estimate)	4.39%
Standard deviation	1.10%
Return range at 95% confidence level	2.20% to 6.59%

* Investec Revision to Forecasts announcement 16th January 2007.

6.3 Bring back the management of all investments in-house

The Council already manages its day-to-day cash flow balances in-house within the existing resources of the Finance Department. This could be extended to include the funds currently managed by Investec.

It would inevitably place increased workload on the Council's existing and stretched resources. A balance may be struck by utilising a suitable Money Market Fund (a pooled investment fund of cash or near cash instruments) that may have a "sweep" facility to enable the Council's day-to-day cash to be effectively and simply transferred to the Money Market Fund. A sweep arrangement would reduce some of the ongoing resource implications of bringing investment activity into the Council's Finance Department.

Alternatively, the Council could adopt an in-house investment model based upon a semi-passive and simple investment approach. This could be based upon investing in fixed term deposits with approved investment counterparties (banks, building societies, other local authorities and money market investment funds) in accordance with a suitable model. An example could be as follows:

Length of Deposit	% of Investments	Current Indicative Rate%
2 year	10	5.80
1 year	10	5.75
6 months to 364 days	40	5.60
Less than 6 months	40	<u>5.30</u>
Weighted Average Indicative Return*		5.52

* Assumes £10m of investments

Estimated projected return in 2007/08 on £10m: 5.52%* = £552,000

The type of approach can generate a degree of stability in investment returns over the period of the investments made and it will save the costs associated with Investec's management fees. The Council will be fully exposed to the interest rate cycle – as rates fall as they inevitably will at some stage then so will reinvestment returns and vice versa. There will be a loss of liquidity since investments will be made in non-negotiable term deposits and this will place a potential increased emphasis on determining and monitoring the Council's cash-flow.

Advantages

Fee saving
Stability of returns
Simplicity

Disadvantages

Resource implications on Finance Staff
Lower investment returns likely
Credit quality of institutions may not be as high

6.4 Investec Pooled Funds

As part of this review of investment options, the Council's finance officers and treasury advisors received a presentation from Investec on an alternative approach to the management of the Council's investments on 20th December 2006. The presentation drew some difficult conclusions to the way that Investec (and other cash fund managers) manage investments. The principal conclusion was that the historical approach and parameters was no longer suitable for the interest rate environment of the 21st Century.

The Prudential Investment Guidance (para 3.1 refers) enable local authorities to invest in a wider range of asset classes appropriate to each authority's specific circumstances whilst maintaining the important principles of security, and liquidity before yield. One of the new and key flexibilities provided by the Guidance is that investments in unitised investment schemes (unit trusts for want of a better description) are allowed. Investec responded to this flexibility by proposing a solution utilising two of its established unitised investment funds – the Investec (GBP) Target Return Fund and the Investec (GBP) Cash Plus Fund.

The Target Return Fund

The Target Fund focuses on return opportunities in the bond markets. Specifically, the manager makes decisions in relation to the average time to maturity of the portfolio, the countries and currencies to which it is exposed, the extent to which it will benefit from changes in the relationship between high quality and high yield bonds and to changes in the structure of interest rates. The Fund will not invest in equities.

It is immediately obvious that the Target Fund takes additional risk in order to generate additional returns. In addition to the risks that the Council is currently exposed, the Fund introduces a managed exposure to currency and country risks and can invest in credit through high yield bonds issued by corporates. These different investment choices allow the fund manager to manage the fund in a wider set of circumstances. Returns are not dependent upon a single factor as is currently the case but are diversified across a range.

Risk is clearly an emotive subject at the Council with its experiences of a capital loss arising from the BCCI collapse in 1991. The Target Fund has the ability to buy bonds with sub investment grade credit ratings (BBB and lower). It will do so where analysis indicates an opportunity exists to generate value relative to the other risks and returns that can be taken. The point is that the risk is assessed, measured and taken in a modest way. If the investment in a bond results in a loss it will adversely affect performance but it will not result in a loss of the total sum invested in the Fund – this is a critical difference to any comparison with BCCI.

Risk is also monitored on a daily basis at the total portfolio level through Value at Risk (VaR) methodology. The VaR is limited to 7% of the net asset

value of the fund (the total fund size, currently £80m) per month at the 99% confidence level. This means that the value of the Fund (at current levels) will fall at most by £5.6m in a month with a 99% confidence or, in other words, with a probability of 1% the value of the Fund will fall by £5.6m or more during one month.

The Fund's objective is to produce returns of 3% to 4% in excess of its 3m LIBOR benchmark over rolling 3 year periods. It can only achieve this level of return by taking additional risks but rather than taking a single risk – interest rate risk – as has been the case with the Council's existing investment arrangements, it is able to take a range of risks to generate returns over and above cash. The key point to remember here is that the Target Fund is designed to deliver absolute returns over and above cash. As such, cash returns are not considered an achievement and to enhance returns over cash controlled risks have to be taken. This is a fundamental difference to the way external cash funds have been managed in the past and it truly reflects the absolute return approach to investment management.

How confident can we be of the return scenarios outlined above?

The Target Fund is a relatively new fund with a limited track record. It was launched to external investors in April 2006 but it had been tested by Investec since February 2005. This generates a performance track record of 23 months.

Month	Duration actual	Country actual	Curve actual	FX actual	High yield actual	TOTAL	Total ex FX and high yield	3m LIBOR
Feb 05	46.92	-14.92	8.55	-19.19	8.03	29.39	40.55	35.00
March	14.44	3.47	-0.82	-22.11	-2.12	-7.14	17.09	41.30
April	-23.96	13.90	-2.04	-23.40	0.00	-35.51	-12.10	41.30
May	-10.91	5.48	-3.24	83.34	2.77	77.43	-8.67	42.90
June	-8.76	11.51	0.65	18.26	1.34	22.99	3.39	42.30
July	30.02	9.26	-1.14	9.67	2.74	50.55	38.14	42.40
August	-10.36	-5.61	1.56	-22.50	0.00	-36.90	-14.41	39.40
Sept	24.62	1.99	6.08	20.25	0.00	52.95	32.69	37.20
Oct	4.38	3.56	1.76	-4.01	-0.02	5.67	9.70	38.40
Nov	-1.81	14.51	-0.92	8.71	2.83	23.31	11.78	37.40
Dec	-17.95	2.25	-5.27	24.51	23.66	27.20	-20.97	38.50
Jan 06	8.93	4.23	10.72	17.63	9.40	50.91	23.88	39.70
Feb	10.75	3.26	-8.46	18.52	0.86	24.93	5.55	35.30
March	50.39	-0.24	7.47	21.43	0.00	79.06	57.63	37.80
April	44.05	-9.29	7.91	46.50	0.57	89.75	42.67	36.40
May	-1.39	-15.46	-8.96	-21.16	-9.73	-56.69	-25.81	38.50
June	-1.95	-4.16	2.49	-13.75	2.31	-15.07	-3.62	37.50
July	-13.35	-4.38	-2.34	-60.95	1.08	-79.94	-20.07	39.30
August	3.01	-8.99	-6.52	-19.93	2.03	-30.40	-12.50	36.60

Sept	-6.92	4.15	3.02	-18.10	0.68	-17.17	0.25	38.60
Oct	1.12	-1.93	3.43	-2.34	8.06	8.34	2.63	40.20
Nov	-3.12	4.09	7.89	-4.58	5.24	9.52	8.86	41.10
Dec	10.37	3.65	8.97	17.35	6.12	46.46	22.99	42.80
Jan 07*	22.00	3.00	-19.00	5.00	17.00	27.00	4.00	39.60
Min	-23.56	-15.46	-19.00	-60.95	-9.73	-79.94	-25.81	35.00
Max	50.39	14.51	10.72	83.34	23.66	108.32	61.25	42.90
Average	7.11	1.75	0.49	2.46	3.45	15.26	9.34	39.15
Std Dev	20.27	7.80	6.98	28.70	6.53	44.96	23.81	2.30

* Unaudited returns

The monthly returns are volatile, however, reflecting the risks that the fund takes. The standard deviation of monthly returns is nearly 45bps (0.45%) but, importantly, the incidence of negative monthly returns has been limited to just 2 months out of the 23 (May and June 2006) with returns of -18.99bps and -41.84bps respectively. Overall, the Fund is doing what it is designed to do and delivering returns in excess of the cash benchmark by 3 to 4%.

Fees on the Target Fund are set at 20% of the additional return over cash. So for a return of 3% over cash the fee would be 60bps (0.6%) and for a return of 4% over cash the fee would be 80bps (0.8%).

The Enhanced Cash Fund

The Fund has UCITS III status (Undertakings for Collective Investments in Transferable Securities). UCITS are a set of European Union regulations that aim to allow collective investment schemes operate freely throughout the EU on the basis of single authorisation by one member state. The concept is to provide a single market in transferable securities across the EU. The Fund will also have a AAAf rating from the Standard & Poor's Credit Rating Agency.

UCITS III (the latest) allows managers to utilise certain approved techniques in the management of the Funds and for the Cash Plus fund this is the ability to structure the Fund to benefit from rises and falls in the interest rate cycle. As we noted earlier (para 5.1 refers), traditional cash fund management arrangements can only add value when interest rate expectations are falling. UCITS III would maintain this ability but also add the ability for the Fund to benefit from rising interest rate expectations.

The manager would do this by using approved and controlled derivative exposures that would enable him to “sell” a position at price higher than the price at which he “buys” the position, thus crystallising a capital gain. Existing arrangements only allow the manager to “buy” a position and “sell” it at a potentially higher price.

The investment process that drives investment activity is now directly linked to the Target Fund and risks taken in that Fund are replicated in the Enhanced Cash Fund in respect of interest rate risk, country and yield curve only.

Currency and credit risk are, therefore, excluded. The extent of the interest rate, country and yield curve risk is adjusted down as well and reflects 60% of the position that will apply in the Target Fund.

Historic returns from this Fund are similar to the returns achieved on the Council's existing segregated fund managed by Investec. This historic data enables to us to estimate with some confidence the likelihood of a given outcome in the future but the value of the historic data does not reflect the revisions to the investment process and the risk and return opportunities provided by the UCITS status. The track record of the Target Fund is a more useful analysis and despite it only having a track record since February 2005 it is delivering the performance it is designed to deliver.

Fees on the Enhanced Cash Fund are identical to the Target Fund and are 20% of any performance over the cash benchmark. If the Fund delivers a return 1% over the cash benchmark then the fees would be 20bps or 0.2%.

Blending the Funds

Utilising unitised funds provides the Council with significant flexibility since the minimum investment level is £1m in each Fund. A structure can then be created to fit the Council's specific investment strategy and risk appetite.

Indicative returns from different allocations between the two Funds are as follows:

Enhanced Cash Fund exposure %	Target Return Fund Exposure %	Indicative Gross Return over 3m LIBOR %
100	0	0.75
90	10	1.03
80	20	1.30
70	30	1.58
60	40	1.85
50	50	2.13
40	60	2.40
30	70	2.68
20	80	2.95
10	90	3.23
0	100	3.50

Advantages

Flexibility
 Suitability to interest rate structure
 Innovative
 Enhanced return opportunities
 Makes better use of investment Guidance
 Diversification of risk

Disadvantages

Complexity
 Innovative

6.5 Diversify the portfolio into wider range of asset classes

The Prudential Investment Guidance allows the Council to diversify its investments across a range of suitable asset classes and the Council's treasury adviser, Arlingclose, has developed an approach known as the Prudential Investment Portfolio (PIP) and is implementing it with some of its local authority clients.

In practice, the PIP has resulted in investments in appropriate property, corporate bond and gilt funds alongside more typical investments in cash instruments. The aim is to build an investment portfolio that meets the risk and return requirements of each local authority and provides diversification away from the reliance upon the performance of two related asset classes – cash and gilts.

The approach utilises an increased number of fund managers responsible for managing an agreed allocation of the Council's investments in appropriate asset classes. For example, our clients are currently using the following fund management companies:

Company	Asset Class	Fees
Close Finsbury Asset Management	Gilt Enhanced	50bps
Cazenove Capital Management	Corporate Bond	40bps
CCLA	Property	65bps
Morley Fund Management	Property	50bps
Investec Asset Management	Cash plus	20bps

There is no predetermined allocation or mixture as a portfolio can be constructed that meets each client's requirements. The objective is to create a portfolio that provides an attractive level of return for an acceptable degree of risk. One of the key implications is that the portfolio is diversified across a wider set of asset classes that behave differently rather than in a similar or parallel fashion.

The exposure to external fund managers is achieved by buying units in an investment fund as opposed to establishing a segregated fund with each fund manager. The advantages of utilising a unitised or pooled fund approach is flexibility since relatively small exposures in appropriate asset classes can be established, monitored and reviewed. Liquidity is maintained since units can be readily bought and sold although there are some liquidity constraints with investments in property.

Indicative fees are provided and range from 17.5bps (0.175% of the value of the portfolio managed) to 65bps (0.65%).

What is the benefit in terms of returns?

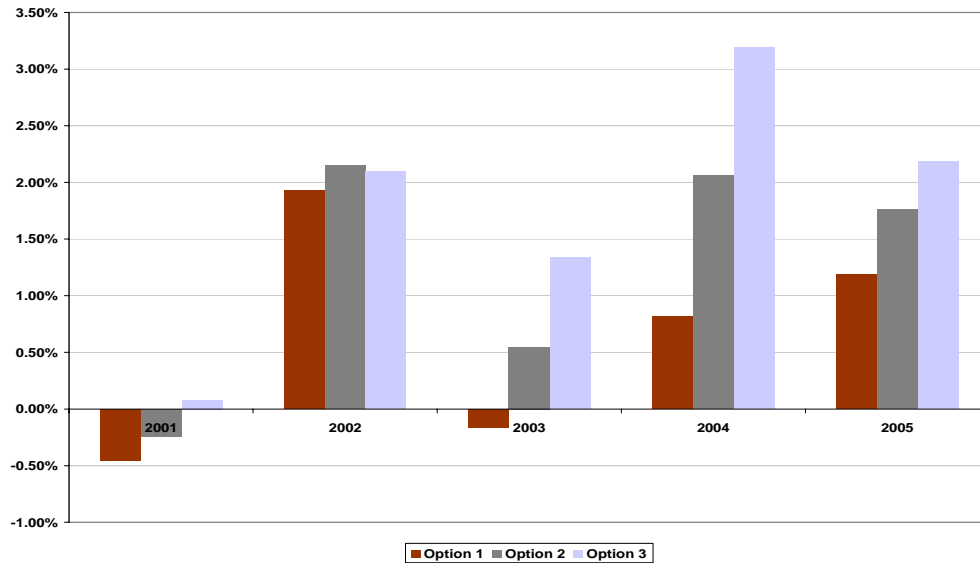
This is best illustrated in terms of a range of portfolio options:

Portfolio 1: 65% Cash, 25% Gilts, 10% Corporate Bonds

Portfolio 2: 60% Cash, 20% Gilts, 10% Corporate Bonds, 10% Property

Portfolio 3 60% Cash, 10% Gilts, 10 % Corporate Bonds, 20% Property

Chart 3: Historic returns relative to returns generated from cash



Over a 5 year period, a diversified exposure to cash, gilts, corporate bonds and property has generated up to an additional 8% (gross of fees) above a passive short dated cash investment. The volatility of returns is higher than from cash returns but this is to be expected given the additional relative return, the investor is being rewarded for the additional volatility by receiving higher investment returns.

Advantages

- Enhances investment returns
- Diversification
- Makes better use of the investment
- Guidance
- Moves investment portfolio away from parallel relationship of cash and gilt investment markets

Disadvantages

- Complexity
- Volatility of returns may increase

7.0 A note about risk

- 7.1 Risk is an emotive and overused word. We are looking to enhance return by an appropriate level and in an appropriate manner but this means that we are taking risk.
- 7.2 In the context of this report, risk relates to the volatility of returns or how much they fluctuate quarter-by-quarter or year-by-year. Certainty of returns is attractive but clearly comes at a price and that price is often – but not always – a lower return. By investing in a wider range of appropriate investments – and we are generally focusing on investments that generate an income with the potential for some capital growth – we can lower the volatility of a portfolio because the risk is spread across a range of asset classes.
- 7.3 The volatility of investment returns or risk can be measured by standard deviation. Standard deviation is a statistical calculation that measures the volatility of a given set of data around the mean or average return for that same data set. The importance of standard deviation is that it allows you to estimate with a degree of confidence the likelihood of a given outcome.

Table 1: Volatility of various asset classes from 1st Jan 01 to 31st Dec 06

Asset Class	Average/Mean Return per annum	Standard deviation of annual returns
Cash	4.40%	0.46%
Gilts	5.32%	3.81%
Corporate Bonds	6.42%	3.49%
Property	13.73%	5.88%
Equities	3.72%	19.23%

Source: Bloomberg

- 7.4 An established “rule of thumb” for the statistical behaviour of returns following a normal distribution around the mean has established that 95% of outcomes will occur in the range of the mean return plus or minus 2 standard deviations. Consequently, if we know the mean and standard deviation of a set of observations, we can obtain some useful information by simple arithmetic. By putting two standard deviations above and below the mean we can estimate the ranges that would be expected to include about 95% of the observations.
- 7.5 Table 1 can be recalculated using this “rule of thumb” to predict the range of return outcomes with 95% probability.

Table 2: Range of return outcomes with 95% probability

Asset Class	Minimum	Average	Maximum
Cash	3.49%	4.40%	5.31%
Gilts	- 2.30%	5.32%	12.94%
Corporate Bonds	- 0.56%	6.42%	13.40%

Property	1.98%	13.73%	25.48%
Equities	-34.74%	3.72%	42.18%

Source: Bloomberg

8.0 Conclusions and Recommendations

- 8.1 The Council’s investment approach has remained unchanged for a number of years. This is despite significant changes in the behaviour of the underlying financial markets, the regulatory background and the evolving circumstances and requirements of the Council.
- 8.2 This report has reviewed these changes and presented a range of options now open to the Council. There are advantages and disadvantages attached to each available option but staying as things are is no longer a valid way forward.
- 8.3 Investec is offering the Council a new approach to cash management that reflects its conclusion that the segregated fund model will no longer deliver the returns that South Bedfordshire DC requires. The Target Fund is a riskier model utilising a range investments to add value over the cash benchmark. The Enhanced Cash Fund is a variation on the Target Fund and effectively freshens up the traditional and outdated approach that the Council currently uses.
- 8.4 Diversifying the Council’s core investments away from cash and near cash assets also has attractions to provide a “cushion” against cyclical movements in the return of cash and near cash markets – although the development of the Target and Enhanced Cash Fund has been designed to mitigate that effect by being able to add value from a wider basket of risk. Property has been a strong performing asset class and has attractions to local authority investors given the nature of its underlying assets.
- 8.5 Arlingclose recommends that the following investment strategy is adopted on the core investment fund of £10m.

Fund/Asset Class	Allocation
Investec Target Fund	£ 1m
Investec Enhanced Cash Fund	£ 8m
<u>Property Fund (i.e. LAMIT)</u>	<u>£ 1m</u>
Total	£10m

The potential investment returns from this strategy are as follows and have been illustrated across central, pessimistic and optimistic return scenarios. Whilst long run property average returns are 13.73% our discussions with property fund managers indicate that forecast returns for the future are 8%.

Allocation	Central Forecast Returns		
	2007/08	2008/09	2009/10
Cash	5.25%	5.00%	5.00%
Target Fund (Cash +3%)	8.25%	8.00%	8.00%
Enhanced Cash	6.00%	5.75%	5.75%
Property	8.00%	8.00%	8.00%

Allocation	Optimistic Forecast Returns		
	2007/08	2008/09	2009/10
Cash	5.50%	5.00%	5.00%
Target Fund (Cash +3%)	9.00%	8.50%	8.50%
Enhanced Cash	6.25%	6.00%	6.00%
Property	10.00%	10.00%	10.00%

Allocation	Pessimistic Forecast Returns		
	2007/08	2008/09	2009/10
Cash	5.25%	5.00%	5.00%
Target Fund (Cash +3%)	7.00%	7.00%	7.00%
Enhanced Cash	5.75%	5.50%	5.50%
Property	6.00%	6.00%	6.00%

Gross Returns

Allocation	Gross Central Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 82,500	£ 80,000	£ 80,000
£8m Enhanced Cash	£480,000	£460,000	£460,000
£1m Property	£ 80,000	£ 80,000	£ 80,000
Total	£642,500	£620,000	£620,000
Return	6.43%	6.20%	6.20%

Allocation	Gross Optimistic Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 90,000	£ 85,000	£ 85,000
£8m Enhanced Cash	£500,000	£480,000	£480,000
£1m Property	£100,000	£100,000	£100,000
Total	£690,000	£665,000	£665,000
Return	6.90%	6.65%	6.65%

Allocation	Gross Pessimistic Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 72,500	£ 70,000	£ 70,000
£8m Enhanced Cash	£460,000	£440,000	£440,000
£1m Property	£ 60,000	£ 60,000	£ 60,000
Total	£592,500	£570,000	£570,000
Return	5.93%	5.70%	5.70%

Fee Assumptions

Target Fund	20% of value added over cash
Enhanced Cash	20% of value added over cash
Property	Initial 3.35% (Year 1) and annual 0.65%
Net Returns	

Allocation	Net Central Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 76,500	£ 74,000	£ 74,000
£8m Enhanced Cash	£468,000	£448,000	£448,000
<u>£1m Property</u>	<u>£ 40,000</u>	<u>£ 73,500</u>	<u>£ 73,500</u>
Total	£584,500	£595,500	£595,500
Return	5.85%	5.96%	5.96%

Allocation	Net Optimistic Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 83,000	£ 78,000	£ 78,000
£8m Enhanced Cash	£488,000	£464,000	£464,000
<u>£1m Property</u>	<u>£ 60,000</u>	<u>£ 93,500</u>	<u>£ 93,500</u>
Total	£631,000	£635,500	£635,500
Return	6.31%	6.36%	6.36%

Allocation	Net Pessimistic Forecast Cash Returns		
	2007/08	2008/09	2009/10
£1m Target	£ 68,500	£ 66,000	£ 66,000
£8m Enhanced Cash	£452,000	£432,000	£432,000
<u>£1m Property</u>	<u>£ 20,000</u>	<u>£ 53,500</u>	<u>£ 53,500</u>
Total	£540,500	£551,500	£551,500
Return	5.41%	5.52%	5.52%

- 8.6 The advantages of the proposed structure are that the Council is recognising that the current fund management structure and arrangements do not reflect its income requirements or the legislative and interest rate backdrop. It provides an innovative, diversified and up-to-date solution. It does not avoid risk but the risk is diversified, managed and is appropriate.
- 8.7 Transition to this structure is relatively simple, once approval has been obtained by the Council's Executive.

Mark Horsfield

Arlingclose Ltd
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