ITEM NO: 48.00

TITLE	**Treasury Management Strategy 2013/14**
FOR CONSIDERATION BY	The Audit Committee on 6 February 2013
WARD	None specific
STRATEGIC DIRECTOR	Graham Ebers, Strategic Director Resources

OUTCOME / BENEFITS TO THE COMMUNITY

Effective and safe use of our resources to deliver service investment priorities.

RECOMMENDATION

The Audit Committee are asked to recommend to the Executive for approval the following:

1) the capital Prudential indicators, 2013/14-2015/16;

2) the borrowing strategy 2013/14;

3) the annual Investment strategy 2013/14; and

4) the treasury Indicators: limits to borrowing activity 2013/14.

SUMMARY OF REPORT

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity and security initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital programme. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives

This report sets out the statutory statements that Council are required to approve, before the start of the financial year, relating to treasury operations. These include: -

- The capital plans (including prudential indicators). These show how the council will stay within its prudential indicators for the period of the strategy.
- A minimum revenue provision (MRP) policy. This represents the principal element of outstanding loans which must be charged to revenue each year.
- The treasury management strategy. This comprises the key guidelines by which the council both borrows and lends money.
- An investment strategy (the parameters on how investments are to be managed).

This sets out how the council will decide how and where to invest surplus funds. • The report gives an overview of the UK and world economy including detailed forecasts on interest rates and how they are likely to impact on to the council's treasury management strategy.
Background The Treasury Management Strategy for 2013/14 is shown in Appendix A.

FINANCIAL IMPLICATIONS OF THE RECOMMENDATION

	How much will it Cost/ (Save)	Is there sufficient funding – if not quantify the Shortfall	Revenue or Capital?
Current Financial Year (Year 1)	Investment £46,000 Debt £143,851	Yes	Revenue and Capital
Next Financial Year (Year 2)	Investment £33,100 Debt £141,151	Yes	Revenue and Capital
Following Financial Year (Year 3)	Investment £27,100 Debt £164,651	Yes	Revenue and Capital

Cross-Council Implications
To ensure that the Council's has an adequately funded cash flow to deliver the Councils services.

Reasons for considering the report in Part 2
N/A

List of Background Papers

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Date 28/08/2013	**Version No.** 2

Appendix A

WOKINGHAM BOROUGH COUNCIL

WOKINGHAM
BOROUGH COUNCIL

TREASURY MANAGEMENT

STRATEGY REPORT 2013/14

WOKINGHAM BOROUGH COUNCIL
TREASURY MANAGEMENT STRATEGY YEAR REPORT 2013/14

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1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

> *"The management of the local authority's investments and 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."*

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital programme, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

1.3 Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. It is intended that training will be arranged for the September 2013 audit meeting.
The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Sector as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle

Capital expenditure £'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Children's services	13,925	13,784	25,317	12,317	6,758
Neighbourhoods	5,890	9,230	13,628	7,381	8,220
Transformation	1,531	2,890	844	0	0
Development and regeneration	1,351	3,028	16,932	31,500	19,372
Health and wellbeing	1,087	2,092	6,067	15,300	17,350
Resources	406	2,289	3,315	730	530
Non-HRA	**24,190**	**33,313**	**66,103**	**67,228**	**52,230**
HRA	2,480	5,030	7,150	7,150	6,851
Total	**26,669**	**38,343**	**73,253**	**74,378**	**59,081**

*Note 1: capital expenditure in 2013/14 is broken down as follows (See appendix 5.4)

Estimated carry forwards from 2012/13	25,733
2013/14 capital programme	47,520
Total	**73,253**

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need.

Capital expenditure £'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	Total Estimate
Non-HRA	24,190	33,313	66,103	67,228	52,230	243,064
HRA	2,480	5,030	7,150	7,150	6,851	28,661
Total	**26,669**	**38,343**	**73,253**	**74,378**	**59,081**	**271,274**
Financed by:						
Capital receipts / reserves	3,688	4,465	1,616	7,386	12,774	29,929
Capital grants	15,508	18,980	44,412	16,211	18,452	113,563
School funded	300	318	208	0	0	826
Revenue contribution	475	552	817	850	850	3,544
Other contribution	127	12	1,030	0	0	1,169
Section 106	1522	2,572	2,426	854	853	8,228
HRA-MRR	2480	4,584	4,160	5,023	6,851	23,098
HRA - Revenue Contribution	307	186	261	0	0	754
Subtotal	**24,407**	**31,669**	**54,929**	**30,324**	**39,780**	**181,110**
Net financing(borrowing)	2,262	6,674	18,324	44,054	19,301	90,615
Total	**26,669**	**38,343**	**73,253**	**74,378**	**59,081**	**271,724**

***Note 2:** Funding for 2013/14 break down see appendix 5.4.

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources.(external borrowing) It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life. This would all so reduce the CFR if no additional borrowing was taking out

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council is asked to approve the CFR projections below:

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
CFR – non housing	83,005	86,328	101,259	141,957	157,902
CFR – housing	96,592	96,592	93,892	93,892	93,892
Total CFR	**179,597**	**182,920**	**195,151**	**235,850**	**251,794**
Movement in CFR		**3,323**	**12,231**	**40,698**	**15,945**

Movement in CFR represented by					
Net financing need for the year (above)	2,262	6,674	18,324	44,054	19,301
Repayment of HRA Loan	0	0	-2,700	0	0
Less MRP and other financing movements		-3,350	-3,393	-3,356	-3,356
Movement in CFR	**2,262**	**3,323**	**12,231**	**40,698**	**15,945**

* including Carry forwards

Note the MRP will include PFI / finance lease annual principal payments

The table below illustrates the net borrowing compared to the capital financing requirement (CFR) . Which shows our borrowing headroom..

Borrowing (including other liabilities)	**2012/13 £'000**	**2013/14 £'000**	**2014/15 £'000**	**2015/16 £'000**
Non- HRA	56,133	56,133	86,633	98,733
HRA	87,718	85,018	85,018	85,018
Total	143,851	141,151	171,651	183,751

Investments (Estimated)	**2012/13 £'000**	**2013/14 £'000**	**2014/15 £'000**	**2015/16 £'000**
In-house	13,000	13,000	13,000	10,000
Brokers	33,100	20,100	14,100	13,100
Total	46,100	33,100	27,100	23,100

Net Borrowing (A)	97,751	108,051	144,551	160,651

Total CFR (B)	182,920	195,151	235,850	251,794

Head Room (B-A)	85,169	87,100	91,298	91,143

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).

CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR (option 2);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be

Asset life method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

This option provides for a reduction in the borrowing need over approximately the asset's life. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.5 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2011/12 Actual %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Non-HRA	3.56	3.43	TBC	TBC	TBC
HRA*	1.84	19.75	TBC	TBC	TBC

*The large increase to 19.75% in 2012/13 is due to the debt taken out in fund the HRA self-financing.

The estimates of financing costs include current commitments and the proposals in this budget report.

2.6 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the medium-term financial plan compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D	TBC	TBC	TBC	TBC	TBC

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2012, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000 General Fund - Borrowing	**2011/12 Actual**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
External Debt					
Debt at 1 April	46,464	46,464	46,464	46,464	76,964
Expected change in Debt			0	30,500	12,100
Other long-term liabilities (OLTL)	9,669	9,669	9,669	9,669	9,669
Actual gross debt at 31 March	**56,123**	**56,123**	**56,123**	**86,623**	**98,733**
The Capital Financing Requirement	**83,005**	**86,328**	**101,259**	**141,957**	**157,902**
(Under) / over borrowing	**(26,872)**	**(30,195)**	**(45,126)**	**(55,324)**	**(59,169)**

£'000 HRA - Borrowing	**2011/12 Actual**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
External Debt					
Debt at 1 April	87,718	87,718	87,718	85,018	85,018
Expected change in Debt	0	0	-2,700	0	0
Actual gross debt at 31 March	**87,718**	**87,718**	**85,018**	**85,018**	**85,018**
The Capital Financing Requirement	**96,592**	**96,592**	**93,892**	**93,892**	**93,892**
(Under) / over borrowing	**(8,874)**	**(8,874)**	**(8,874)**	**(8,874)**	**(8,874)**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Strategic Director - Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	189,000	202,000	274,000	265,000
Other long term liabilities	1,000	10,000	10,000	10,000
Total	190,000	212,000	284,000	275,000

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £'000	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	200,000	212,000	287,000	278,000
Other long term liabilities	2,000	11,000	11,000	11,000
Total	202,000	223,000	298,000	289,000

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £'000	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Total	102,000	102,000	102,000	102,000

3.3 Prospects for interest rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates *(including certainty rate adjustment)		
		5 year	25 year	50 year
Dec-12	0.5	1.5	3.7	3.9
Mar-13	0.5	1.5	3.8	4
Jun-13	0.5	1.5	3.8	4
Sep-13	0.5	1.6	3.8	4
Dec-13	0.5	1.6	3.8	4
Mar-14	0.5	1.7	3.9	4.1
Jun-14	0.5	1.7	3.9	4.1
Sep-14	0.5	1.8	4	4.2
Dec-14	0.5	2	4.1	4.3
Mar-15	0.75	2.2	4.3	4.5
Jun-15	1	2.3	4.4	4.6
Sep-15	1.25	2.5	4.6	4.8
Dec-15	1.5	2.7	4.8	5
Mar-16	1.75	2.9	5	5.2

*PWLB certainty rate is a reduced rate from PWLB to principal local authorities who provided required information to government on their plans for long-term borrowing and associated capital spending.

The economic recovery in the UK since 2008 has been slowest in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, and general unease about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but will need to re-address the fiscal cliff, which has recently been deferred. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and may see the UK deficit reduction plans slip.

This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;

- Borrowing rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of borrowing in advance of need – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

The table below illustrates the estimated internal borrowing of the Council over the next three years.

	2012/13 £'000	**2013/14 £'000**	**2014/15 £'000**	**2015/16 £'000**
CFR* (year end position)	182,920	195,151	235,850	251,794
Less External Borrowing	(134,182)	(134,182)	(161,982)	(174,082)
Less Other long term liabilities	(9,669)	(9,669)	(9,669)	(9,669)
Internal Borrowing	**39,069**	**51,300**	**64,199**	**68,043**
Movement	0	12,231	12,898	3,845
% of internal borrowing to CFR	**21%**	**26%**	**27%**	**27%**

Sector's advice (Wokingham Borough Council's treasury advisors) suggests it is prudent not to exceed an internal borrowing level of 25-30% of our CFR to minimise our net debt interest exposure level

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

Interest rate exposures £'000	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100,000	150,000	165,000
Limits on variable interest rates based on net debt	0	0	0
Limits on fixed interest rates:			
· *Debt only*	180,000	230,000	245,000
· *Investments only*	(80,000)	(80,000)	(80,000)
Limits on variable interest rates			
· *Debt only*	40,000	40,000	40,000
· *Investments only*	(40,000)	(40,000)	(40,000)

Maturity structure of variable interest rate borrowing 2013/14		
	Lower	*Upper*
Under 12 months	*0%*	*13.95%*
12 months to 2 years	*0%*	*2.33%*
2 years to 5 years	*0%*	*16.28%*
5 years to 10 years	*0%*	*13.95%*
10 years and above	*0%*	*53.49%*

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to achieve the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council, at the earliest meeting following its action

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflect in the eyes of each agengy. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Strategic Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA (in house team only)

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

i. Short term – F1+(highest rating)
ii. Long term – *AA- (AAA is the highest rating)*
iii. Viability / financial strength – *B/C*(Fitch / Moody's only)
iv. Support – *2* (Fitch only)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker (Nat West) for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Building societies the Council will only use Societies which are eligible to use the Bank of England's Credit Guarantee Scheme, subject to a minimum asset size of £5bn and meeting a minimum credit rating of A- (where rated).
- UK Government: including Money market funds – the Council and its Fund Managers will use AAA rated funds. The Strategic Director of Resources will keep under review the Money Market Funds used and will amend as necessary.
- gilts and the Debt Management Account Deposit Facility (DMADF)
- Local authorities, parish councils etc
- Supranational institutions – multilateral investment organisations such as the World Bank or European Investment Bank (sometimes used by the Fund Managers)
- **The Local Authority Mortgage Scheme (LAMS)** – The Council is currently investigating the potential of this scheme. This is a cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.
- **In the event of an emergency, to allow an unlimited amount to be invested in the RBS Money Market Fund.** This would be done in the event of an extreme IT failure of the Council's computer systems. This fund is an AAA rated investment and would be a less risky option than leaving the funds in the NatWest accounts.
- **Group Limits** – For each banking group the following limits will apply, dependent on the rating of the Parent Bank
  i. **AAA** : £7m with a maximum average duration of 1 year
  ii. **AA-** :£5m with a maximum average duration of 6 months

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long term Rating	Moody's	Standard & Poors	Money Limit	Time Limit
Banks 1 higher quality	*F1+/AAA*	*P-1Aaa*	*A-1+/AAA*	**£5m**	**1 Year**
Banks 1 medium quality	*F1+/AA-*	*P-1Aa3*	*A-1+/AAA*	**£3m**	**1 Year**
Building Societies				**£2m**	**6 Months**
Debt Management Office DMADF Account (DMADF)	-	-	-	**£20m**	**3 Months**
Guaranteed Organisations	-	-	-	**£2m**	**3 Months**
Other Institution Limits (other local authorities, Money Market Funds, Gilts and Supranational investments)	-	-	-	**£5m**	**1 Year**
Other named Banks (those subject to HM Treasury Credit Guarantee Scheme) Other named Banks (those subject to HM Treasury Credit Guarantee Scheme)	-	-	-	**£3m**	**6 Months**

The proposed criteria for specified and non-specified investments are shown in Appendix 5.3 for approval.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch or equivalent ratings agencies. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

While the UK currently has an AAA sovereign rating, it is possible that the UK could have this rating downgraded by one, or more, rating agencies. If this must happen, we would need to change our minimum sovereign rating from AAA so as to ensure continuity of being able to invest in UK banks if such a downgrading were to occur.

4.4 Investment strategy

In-house funds. Investments will 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).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Bank Rate forecasts for financial year ends (March) are:

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next five years are as follows:

2012/13	0.50%
2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£'000	**2013/14**	**2014/15**	**2015/16**
In house	0	0	0
Fund Managers	£10,000	£10,000	£10,000

<u>Review of investment strategy during 2013/14</u>

During 2013/14 the Treasury function will review the possibility of using The Sector creditworthiness service (colour coded system). This uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

4.5 Icelandic bank investments

Wokingham Borough Council currently had the following investment(s) frozen in Icelandic banks in 2008.

- Heritable £3,000,000,
- Landsbanki £2,000,000.

The Icelandic Government had stated its intention to honour all its commitments as a result of their banks being placed into receivership. The U.K. Government has been working with the Icelandic Government to help bring this about. The Local Government Association is co-ordinating the efforts of all UK authorities with Icelandic investments. At the current time, the process of recovering assets is still on going with the administrators.

Heritable bank is a UK registered bank under Scottish law. The company was placed in administration on 7 October 2008. The current position on actual payments received and estimated future pay outs is as shown in the table below and this council has used these estimates to calculate the impairment based on recovering 88p in the £. Recoveries are expressed as a percentage of the authority's claim in the administration, which includes interest accrued up to 6 October 2008.

In the cases of Heritable Bank plc the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2013/14.

Heritable	Dividend date	Amount £'000
Original Investment	2008	(3,000)
	28-Jul-09	484
	16-Jan-09	382
	30-Mar-10	186
	14-Jul-10	188
	20-Oct-10	124
	14-Jan-11	141
	19-Apr-11	188
	15-Jul-11	122
	21-Oct-11	125
	23-Jan-12	100
	01-May-12	114
Outstanding	**@ Jan-13**	**(846)**

Repayment as a percentage of the original loan	**@ Jan-13**	72%

Repayment as £'000	**@ Jan-13**	£2,154

Landsbanki Islands is an Icelandic entity. Following steps taken by the Icelandic Government in early October 2008 its domestic assets and liabilities were transferred to a new bank (new Landsbanki) with the management of the affairs of Old Landsbanki being placed in the hands of a resolution committee. The Icelandic Supreme Court decision granted UK local authorities priority status, the winding up board made a distribution to creditors in a basket of currencies in February 2012.

An element of the distribution is in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 3.35%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland and as a result is subject to exchange rate risk, over which the Council has no control. The current position on estimated future pay-outs is as shown in the table below and this council has used these estimates to calculate the impairment based on recovering 100p in the £.

Investments outstanding with the two Iceland –domiciled banks (Glitnir Bank hf and Landsbanki Islands hf) have been subject to decisions of the Icelandic Courts. Following the successful outcome of legal test cases in the Icelandic Supreme Court in late-2011, the administrators have now confirmed Wokingham Borough Council to be preferential creditors and began the process of dividend payments.

Landsbanki	Dividend date	Amount £'000
Original Investment	2008	(2,000)
	17-Feb-12	121
	17-Feb-12	204
	17-Feb-12	254
	29-May-12	123
	29-May-12	127
	04-Oct-12	44
	04-Oct-12	40
	04-Oct-12	34
Outstanding	**@ Jan-13**	**(1,053)**

Repayment as a percentage of the original loan	**@ Jan-13**	47%

Repayment as £'000	**@ Jan-13**	£947

The amounts and timing of payments to depositors such as the authority will be determined by the administrators / receivers. The current situation with regards to recovery of the sums deposited varies between each institution. Based on the latest information available the authority considers that it is appropriate to consider an impairment adjustment for the deposits, and has taken the action outlined below. As the available information is not definitive as to the amounts and timings of future payments to be made by the administrators / receivers, it is likely that further adjustments will be made to the accounts in future years.

The impairment has been calculated in line with FRS 25 and 26, however, in cash terms the Council currently expects to have recovered a total of **£4.769m** of the original £5m invested by December, 2018. The carrying amounts of the investments included in the Balance Sheet, have been calculated using the present value of the expected repayments, discounted using the investment's original interest date.

4.6 Investment risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached on occasion, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.
Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **0.01% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £2m
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted average life benchmark is expected to be 0.25 years, with a maximum of 0.5 years.

Yield - local measures of yield benchmarks is:

- Investments – internal returns above the 7 day LIBID rate

4.7 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.8 External fund managers

As at 31 December 2012 £42,392m of the Council's funds are externally managed on a discretionary basis . The table below shows a breakdown fund managers.

Investments	2012/13 £'000 Actual
Royal London Asset Management (Rlam)	19,679
Scottish Widows Investment Partnership (SWIP).	22,713
Total	**42,392**

4.9 Use of External Fund Managers

It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories and are contractually committed to keep to the Council's investment strategy, which will be defined in an updated Treasury Management Strategy post fund manager's appointment. The performance of each manager is reviewed at least quarterly by the Strategic Director of Resources.

5 Appendices

5.1 Interest rate forecasts (Interest rates are forecast to start rising from late 2013/14 and continue rising through 2016.)

5.2 Economic background (A summary of events expected to face the major world economies from 2013-16 is attached.)

5.3 Treasury management practice (Proposed guide lines and specific limits for loans and investments are attached.)

5.4 Capital Expenditure Summary (The estimated carry forward from 12/13 and 13/14 programme are set out in the attached tables.)

5.5 Glossary of Terms (This explains the key technical phrases in the document)

5.1 APPENDIX: Interest Rate Forecasts 2013 – 2016

Sector's Interest Rate View	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.40%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%	1.90%
6 Month LIBID	0.56%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%	2.20%
12 Month LIBID	0.92%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%	2.40%
5yr PWLB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PWLB Rate	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PWLB Rate	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PWLB Rate	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate															
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.64%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.64%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.04%	4.10%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.04%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

5.2 APPENDIX: Economic Background

The Global economy

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth at 1% in quarter 3 is unlikely to prove anything more than a washing out of the dip in the previous quarter before a return to weak, or even negative, growth in quarter 4.

The **Eurozone sovereign debt crisis** has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request (for a national bailout) and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a crunch point as the Eurozone imminently faces up to having to relax the time frame for Greece reducing its total debt level below 120% of GDP and providing yet more financial support to enable it to do that. Many commentators still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP i.e. unsustainably high, unless the Eurozone were to accept a major write down of Greek debt. The possibility of a write down has now been raised by the German Chancellor, but not until 2014-15, and provided the Greek annual budget is in balance.

Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

The US economy has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

Hopes for a broad based recovery have, therefore, focused on the **emerging markets**. However, there are increasing concerns over flashing warning signs in various parts of the Chinese economy that indicate it could be in risk of heading for a hard landing rather than a gradual slow down.

The UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order, have now had to be extended in the autumn statement over a longer period than the original four years. Achieving this new extended time frame will still be dependent on the UK economy returning to a reasonable pace of growth towards the end of this period. It was important for the Government to retain investor confidence in UK gilts so there was little room for it to change course other than to move back the timeframe.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

Unemployment. The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.

Inflation and Bank Rate. Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased back to 2.7% in October though it is expected to fall back to reach the 2% target level within the two year horizon.

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

- the potential for the Eurozone to withdraw support for Greece at some point if the Greek government was unable to eliminate the annual budget deficit and the costs of further support were to be viewed as being prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;

- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;

- the risk of the UK's main trading partners, in particular the EU and US, falling into recession ;

- stimulus packages failing to stimulate growth;

- elections due in Germany in 2013;

- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

- the potential for action to curtail the Iranian nuclear programme

- the situation in Syria deteriorating and impacting other countries in the Middle East

The focus of so many consumers, corporates and banks on reducing their borrowings, rather than spending, will continue to act as a major headwind to a return to robust growth in western economies.

Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. The interest rate forecast in this report represents a balance of downside and upside risks. The downside risks have already been commented on. However, there are specific identifiable upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields: -

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields
- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held
- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone
- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth
- The possibility of a UK credit rating downgrade (Moody's has stated that it will review the UK's Aaa rating at the start of 2013).

5.3 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 21/02/2013 and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

1. **Specified investments** – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but *where the Council has the right to be repaid within 12 months if it wishes.* These are low risk assets where the possibility of loss of principal or investment income is very low. These would include sterling investments with:

a.	The UK Government (such as the Debt Management Office, UK Treasury Bills or a gilt with less than one year to maturity).
b.	Supranational bonds with less than one year to maturity.
c.	A local authority, parish council or community council.
d.	• Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
e.	*A body that has been awarded a high credit rating by a credit rating* agency (such as a bank or building society)

2. For category (d) this covers a money market fund rated AAA by Standard and Poor's, Moody's or Fitch rating agencies. For category (e) this covers bodies with a minimum short term rating of F1+ (or equivalent) as rated by Standard *and Poor's, Moody's or Fitch rating agencies.*

3. Within these bodies, and in accordance with the Code, the Council will set the following limits:

a.	For Fund Managers: *– Subject to new fund managers arrangements post appointment.* Any changes to be communicated in an update to the treasury management strategy.
b.	For In House Investments: - Each banking group will be subject to an overall money limit and duration limit: ▪ AAA : £7m with a maximum average duration of 1 year ▪ AA- : £5m with a maximum average duration of 6 months *- See table in 4.2 main report.*

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

a.	Supranational Bonds greater than 1 year to maturity (a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). (b) A financial institution that is guaranteed by the United Kingdom Government (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.
b.	Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.
c.	Building societies which are eligible to use the Bank of England's Credit Guarantee Scheme, subject to a minimum asset size of £5billion and meeting a minimum credit rating of A- (where rated). These investments will be restricted to a maximum period of 6 months and £2m per institution.
d.	NatWest Bank for the provision of Banking Services. The Council is limited to daylight exposure only (i.e. the flow of funds in and out during the day), with a maximum limit of 1 working day.
e.	A body which has been provided with a government issued guarantee for wholesale deposits within specific timeframes. Where these guarantees are in place and the government has a AAA sovereign long term rating these institutions will be included within the Council's criteria, temporarily until such time as the ratings improve or the guarantees are withdrawn. Monies will only be deposited within the timeframe of the guarantee. In addition to this, a maximum limit of £2m with a maximum duration of 3 months is also set.
f.	Eligible Institutions for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary ratings required in Bank 3 above. These institutions have been subject to suitability checks before inclusion and have access to HM Treasury liquidity if needed.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

Use of external fund managers – It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories and are contractually committed to keep to the Council's investment strategy, which will be defined in an updated Treasury Management Strategy post fund manager's appointment. Ahe performance of each manager is reviewed at least quarterly by the Strategic Director of Resources.

5.4 Appendix: Capital Expenditure Summary

Estimated Carry Forward from 12/13 (A)

Capital expenditure £'000	2013/14 Estimate
Children services	18,413
Neighbourhoods	2,436
Transformation	844
Development and Regeneration	480
Health and well-being	1,714
. Resources	1,846
Non-HRA subtotal	**25,733**
HRA	0
Total	**25,733**

Financed by:	
Capital receipts / reserves	1,662
Capital grants	19,504
School funded	208
Revenue contribution	117
Other contribution	285
Section 106	641
HRA-MRR	0
HRA - Revenue Contribution	261
	0
Subtotal	**22,677**
Net financing need for the year (Borrowing)	3,056
Total	**25,733**

Proposed Capital Programme 2013/14 (B)

Capital expenditure £'000	**2013/14 Estimate**
Children services	6,904
Neighbourhoods	11,192
Transformation	
Development and Regeneration	19,624
Health and well-being	1,453
Resources	1,469
Non-HRA subtotal	**40,642**
HRA	7,150
Total	**47,792**

Financed by:	
Capital receipts / reserves	6,642
Capital grants	18,492
School funded	0
Revenue contribution	700
Other contribution	745
Section 106	1,785
HRA-MRR	4,160
HRA - Revenue Contribution	0
	0
Subtotal	**34,052**
Net financing need for the year (Borrowing)	15,268
Total	**47,792**

Total estimated capital expenditure in 2013/14

Estimated carry forwards from 2012/13 (A)	25,733
2013/14 capital programme (B)	47,792
Total	**73,525**

5.5 APPENDIX: Glossary of Terms

PWLB - Public Works Loan Board

ECB - European Central Bank

CFR - Capital Financing Requirement

MRP - Minimum Revenue Provision

Authorised Limit – Represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term

Boundary Limit – Is an estimate as the authorised limit but reflects an estimate of the most likely, prudent, but not worse case scenario, without the additional headroom included within the authorised limit to allow for example for unusual cash movements.

PWLB certainty rate - A reduced rate from PWLB to principal local authorities who provided required information to government on their plans for long-term borrowing and associated capital spending.

DMADF - Debt Management Account Deposit Facility