WOKINGHAM BOROUGH COUNCIL

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TREASURY MANAGEMENT

STRATEGY REPORT 2014/15

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TREASURY MANAGEMENT STRATEGY YEAR REPORT 2014/15

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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 appropriate 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 borrowed may be restructured to meet Council risk or cost objectives.

1.2 Reporting requirements

The Council is required to receive and approve three main reports each year, which incorporate a variety of policies, estimates and actuals.
These are the Treasury Management Strategy, the mid-year Treasury Management report and finally the Annual Treasury report:

Treasury management strategy:

The first and most important report covers:

- The capital plans (including Prudential indicators)
- A minimum revenue provision (MRP) policy **-H*ow outstanding capital expenditure is charged to revenue over time***
- The Treasury management strategy ***-How the investments and borrowings are to be organised*** including Treasury indicators
- An investment strategy -***The criteria on how investments are to be managed and the limitations***

Mid-year Treasury management report

This updates members with the progress of the capital position, amending prudential indicators as necessary, and confirming whether the Treasury strategy is meeting the strategy or whether any policies require revision. A quarterly treasury prudential indicators report is also produced for the Treasury Management Overview Group.

Annual Treasury report

This provides details of a selection of actual Prudential and Treasury indicators and actual Treasury operations compared with the estimates within the strategy.
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 2014/15

The strategy for 2014/15 covers two main areas:

Capital issues

- the capital plans and the Prudential Indicators
- The minimum revenue provision (MRP) policy

Treasury management issues

- The current Treasury position
- Treasury indicators which limit the Treasury risk and activities of the Council
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

The above 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 is to ensure that members with responsibility for treasury management receive adequate training in Treasury management. This especially applies to members responsible for scrutiny. Training was provided for members, in November 2013, on Treasury management by Capita Asset services. Any further training will be arranged as required. The training needs of the Treasury management officers are regularly reviewed.

1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury solutions, formerly called 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 access specialist skills and resources. The Council will ensure that the terms of their employment and methods on which their value will be assessed are properly agreed and documented and are subject to regular review.

2 The capital Prudential Indicators 2014/15-2016/17

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

2.1 Capital expenditure

This Prudential indicator is a summary of the Council is capital expenditure plans, both of these agreed previously, and those forming part the budget cycle.

Service	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Children's Services	11,419	24,979	20,634	15,660	10,237
Health and Wellbeing	2,321	9,601	9,559	15,880	5,824
Environment	19,513	11,252	40,478	54,108	33,682
Finance and Resources	3,545	3,284	2,560	9,300	5,550
Sub tototal (Non HRA)	**36,798**	**49,116**	**73,231**	**94,948**	**55,293**
Housing revenue Account (HRA)	4,574	4,968	7,140	7,000	6,000
Sub tototal (HRA)	**4,574**	**4,968**	**7,140**	**7,000**	**6,000**
Grand Total	**41,372**	**54,084**	**80,371**	**101,948**	**61,293**

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements.

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

Funding Source	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
HRA - major repairs reserve	4,574	4,766	7,000	6,000	5,942
Sub tototal (HRA)	**4,574**	**4,766**	**7,000**	**6,000**	**5,942**
NON -HRA					
Capital Receipts/Reserves	3,464	2,584	8,270	4,689	10,885
Section 106	2,486	5,574	5,745	8,361	4,633
Revenue	804	1,279	1,770	850	850
Capital Grants (Note 1)	16,269	29,318	32,562	9,796	10,781
Community infrastructure Levy	0	0	0	14,797	15,795
School funded (Note 2)	423	706	74	0	0
Sub tototal (Non HRA)	**23,446**	**39,461**	**48,421**	**38,493**	**42,944**
Borrowing need for the year (Note 3)	13,352	9,858	24,950	42,043	3,957
Grand Total	**41,372**	**54,085**	**80,371**	**86,536**	**52,843**

Note 1 Capital grants in 13/14 and 14/15 including carry forwards from previous allocations. 15/16 allocation assumes no Carry forwards.
Note 2. These are schemes funded by school contribution (i.e. Parent teacher association -PTA) and are added in year
Note 3. This is planned borrowing either internal or external.

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. 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 CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.
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 currently has £9.2m of such schemes within the CFR.
The Council is asked to approve the CFR projections below:

Capital Financing Requirement	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
CFR (Non HRA)	93,134	99,506	121,101	159,788	160,023
CFR (HRA)	95,952	93,252	93,252	93,252	89,776
Total CFR	**189,086**	**192,759**	**214,353**	**253,040**	**249,800**

Movement in CFR represented by	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Net financing Need for the year	13,545	9,858	24,950	42,043	3,957
less MRP and other financing movements (this includes Repayment of HRA principle)	-4,056	-6,186	-3,356	-3,356	-7,198
	9,489	**3,672**	**21,594**	**38,687**	**-3,241**

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), although it is also allowed to undertake additional voluntary payments (voluntary revenue provision - VRP).
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:
Either

- 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 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).
Repayments included in annual PFI or finance leases are applied as MRP.

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) against the income streams.

% Ratio of financing costs to net revenue stream	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Non- HRA (Percentage of financing cost against Net Expenditure)	3.5%	3.6%	4.7%	4.7%	4.7%
HRA (Percentage of financing cost against gross income)	18.2%	19.0%	18.7%	18.1%	18.2%

** (General fund (non hra to be added) **
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 this budget report 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

	2013/14 Budget £	2014/15 Budget £	2015/16 Budget £	2016/17 Budget £
Council tax - band D (Note 1)	29	33	42	41

Note 1: Increase in 15/16 is due to the increase in the capital programme

2.8 HRA ratios

HRA	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
HRA Debt	95,952	93,252	93,252	93,892	90,416
Number of dwellings	2,714	2,703	2,699	2,695	2,691
Debt per dwelling	35	34	35	35	34

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 2013, with forward projections is 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.

	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
External Debt					
Debt at 1 April	134,182	134,182	131,482	148,541	181,706
Expected change in debt (note 1)	0	-2,700	17,059	33,165	-3,476
Other long-term liabilties (OTL)	9,708	9,454	9,200	9,000	8,800
Expected change in OTL	-254	-254	-200	-200	-200
Actual Gross debt at 31 March	143,636	140,682	157,541	190,506	186,830
The Capital Financing requireme	189,086	192,759	214,353	253,040	249,800
Under / (over) borrowing	-45,450	-52,076	-56,812	-62,535	-62,970

Note 1: Negative is repayment of HRA self-financing loans. The positive movement are increases in borrowing.

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 2014/15 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 Director of Finance and Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties in staying within this indicator over the next 3 years 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	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Debt	134,182	202,000	202,000	202,000	220,000
Other long term liabilities	9,620	10,000	10,000	10,000	10,000
Total	143,802	212,000	212,000	212,000	230,000

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	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Debt	134,182	212,000	210,000	220,000	230,000
Other long term liabilities	9,620	11,000	12,000	10,000	10,000
Total	143,802	223,000	222,000	230,000	240,000

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

HRA Debt Limit £m	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
HRA debt cap	102,000	102,000	102,000	102,000
HRA CFR	93,252	93,252	93,252	89,776
HRA headroom	8,748	8,748	8,748	12,224

3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.
The table demonstrates the current view:

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar-14	0.5	2.5	4.4	4.4
Jun-14	0.5	2.6	4.5	4.5
Sep-14	0.5	2.7	4.5	4.5
Dec-14	0.5	2.7	4.6	4.6
Mar-15	0.5	2.8	4.6	4.7
Jun-15	0.5	2.8	4.7	4.8
Sep-15	0.5	2.9	4.8	4.9
Dec-15	0.5	3	4.9	5
Mar-16	0.5	3.1	5	5.1
Jun-16	0.75	3.2	5.1	5.2
Sep-16	1	3.3	5.1	5.2
Dec-16	1	3.4	5.1	5.2
Mar-17	1.25	3.4	5.1	5.2
Mar-17	1.25	3.4	5.1	5.2

Economic update

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US and the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international lack of competitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Interest rates for borrowing have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served the council well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;
- There will remain a cost of carry to any new borrowing taken out well in advance of the relevant capital investment as this causes an increase in investments as this 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.

Internal borrowing	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
CFR (year end position)	189,086	192,759	214,353	253,040	249,800
Less External Borrowing	-134,182	-131,482	-148,541	-181,706	-178,230
Less Other long term liabilities	-9,454	-9,200	-9,000	-8,800	-8600
Internal Borrowing	45,450	52,076	56,812	62,535	62,970
Movement	9,974	6,626	4,736	5,722	435
% of internal borrowing to CFR	**24%**	**27%**	**27%**	**25%**	**25%**

Capita Asset Services (Wokingham Borough Council's treasury advisors) suggests it is prudent not to exceed an internal borrowing level of 25-30% of the CFR to minimise the net debt interest exposure level. However, there is no fundamental level of internal borrowing which can be prescribed for every organisation.

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	2012/13 Actual £'000	2013/14 Budget £'000	2014/15 Budget £'000	2015/16 Budget £'000	2016/17 Budget £'000
Limits on fixed interest rates based on net debt	84,842	110,000	120,000	120,000	120,000
Limits on variable interest rates based on net debt	6,066	0	0	0	0
Total	90,908	110,000	120,000	120,000	120,000
Limits on fixed interest rates:					
· Debt only	110,182	180,000	190,000	200,000	200,000
· Investments only	(25,340)	(80,000)	(80,000)	(80,000)	(80,000)
Limits on variable interest rates					
· Debt only	24,000	40,000	40,000	40,000	40,000
· Investments only	(17,934)	(40,000)	(40,000)	(40,000)	(40,000)

Maturity structure of fixed interest rate borrowing 2013/14		
	Lower	Upper
Under 12 months	0%	9.68%
12 months to 2 years	0%	0.00%
2 years to 5 years	0%	9.68%
5 years to 10 years	0%	16.13%
10 years and above	0%	64.52%

Maturity structure of variable interest rate borrowing		
	Lower	Upper
Under 12 months	0%	50.00%
12 months to 2 years	0%	25.00%
2 years to 5 years	0%	8.33%
5 years to 10 years	0%	16.67%
10 years and above	0%	0.00%

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 fulfil 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, and 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 clearly stipulated below 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 agency. 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 and monitor 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 diversification 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 5.2 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 Director of Finance and 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 those which determine 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 Capita Sector Asset Services, 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)
  - iii 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. 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 Director of Finance and 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.

4.3 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**
uilding 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**

4.4 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA. The exception will be the UK, which currently has an AA+ sovereign rating; it is possible that the UK could have this rating downgraded by one, or more, rating agencies.

4.5 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 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

2014/15	0.50%
2015/16	0.50%
2016/17	1.00%
2017/18	2.00%

Investment treasury indicator and limit – amount 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: -

Amount invested > 364 days				
Principal sums invested > 364 days	**2013/14 Budget £'000**	**2014/15 Budget £'000**	**2015/16 Budget £'000**	**2016/17 Budget £'000**
In house	0	0	0	0
Fund managers	10,000	10,000	10,000	10,000

<u>Review of investment strategy</u>

As part of continued improvement the treasury function will review the latest information and tools that are available to ensure the strength of the council's investment strategy.

4.6 Icelandic bank investments

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

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

Significant progress has been made in recovering these investments. 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.
In the cases of Heritable Bank plc the administrators have made a number of dividend payments to date, with updates anticipated during 2013/14

Heritable	Amount £'000
Original Investment	3,000
Amount Received to 31 December 2013	2,922
Repayment to date as a percentage of the original loan	97%
Expected future repayments	0
Total Repayments as a percentage of the original loan	97%

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.

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	Amount £'000
Original Investment	2,000
Amount Received to 31 December 2013	1,049
Repayment to date as a percentage of the original loan	52%
Expected future repayments	951
Total Repayments as a percentage of the original loan	100%

The Council expects to receive back 100% of its original investment under the current arrangement plus interest, however, as explained in the Council's 2012-13 statutory accounts, the remaining payments of £1.053m are due to be made in annual instalments between now and December 2019.

The Council is currently considering, along with a majority of other relevant local authorities, an offer by a major bank to purchase local authorities investments in Landsbanski at a discount. The discount reflects both the risks to the bank purchasing the loans, and the benefit to the council of receiving all of its investment, less discount, in 2013-14 rather than spread out until 2019-20, with all the attendant extra risks including foreign currency adjustments which that would involve. The offer will be by auction and the council will not enter into any arrangement that is not considered to be good value taking account of all the circumstances. The discount is not expected to be significant compared to the original investment, and can be funded within the 2013-14 statutory accounts.

4.7 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

4.8 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.

4.9 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 Director of Finance and Resources.

The table below shows a breakdown fund managers and sums invested in them..

Investments with Fund Managers	2012/13 Actual £'000	2013/14 Actual @ 31/12/13 £'000
Royal London Asset Management (Rlam)	22,713	22,780
Scottish Widows Investment Partnership (SWIP).	19,320	14,405
Total	**42,033**	**37,185**

5 Appendices

1. Interest rate forecasts
2. Treasury management practice 1 – credit and counter [party risk management
3 The treasury management role of the section 151 officer
4 Capita Asset Services Forward View
5 Graphical Overview of Capital & Borrowing
6. Glossary of Terms (This explains the key technical phrases in the document)