WOKINGHAM BOROUGH COUNCIL

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TREASURY MANAGEMENT

STRATEGY REPORT 2016/17

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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 (this report), the mid-year Treasury Management report and finally the Annual Treasury report:

Treasury management strategy:

The first and most important report covers:

- 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***
- The capital plans (including Prudential Indicators)
- A minimum revenue provision (MRP) policy ***-How outstanding borrowing in respect of capital expenditure is repaid by charges to revenue over time***

Mid-year Treasury management report

This Report 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.

Annual Treasury report

This report provides details of a selection of actual Prudential and Treasury indicators and actual Treasury operations compared with 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 2016/17

The strategy for 2016/17 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, Department for Communities and Local Government (DCLG) 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. Training will be arranged in the financial year 2016-17 for members. The training needs of the Treasury management officers are regularly reviewed.

1.5 Treasury management advisors

The Council uses Capita Asset Services, Treasury Solutions 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 2016/17-2018/19

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's capital expenditure plans, both of these agreed previously, and those forming part the budget cycle.

	2014/15 Actual £'000	2015/16 Forecast Outturn £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
Chief Executive	4,045	3,816	25,286	24,654	18,952
Children's Services	10,724	17,115	37,529	20,765	11,654
Environment	18,658	12,572	32,659	28,448	36,322
Finance & Resources	1,968	3,410	11,103	6,742	7,469
Health & Wellbeing	6,531	6,134	29,050	13,630	13,450
Sub-total	**41,926**	**43,047**	**135,627**	**94,239**	**87,847**
Housing Revenue Account	3,409	5,281	5,050	5,000	5,000
Total	**45,335**	**48,328**	**140,677***	**99,239**	**92,847**

*Note: The budget for 2016/17 includes £56m of carry forwards from 2015/16

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

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

Funding Source	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
General Fund					
Developer contribution (S106 & CIL)	3,188	7,135	33,988	17,581	21,026
Grants & Contributions (Note 1)	25,569	19,062	25,300	7,046	3,888
Reserves & Capital Receipts	2,614	2,163	1,780	7,447	8,155
Borrowing need for the year (Note 2)	10,556	14,687	73,103	52,811	37,872
Housing Revenue Account (HRA)					
Major repairs reserve	3,409	0	2,703	4,860	3,455
Grants & Contributions		5,281	3,844	140	1,545
Borrowing need for the year (Note 2	0	0	0	0	0
Grand Total	**45,336**	**48,328**	**140,717**	**89,885**	**75,941**
(Surplus)/Deficit	**0**	**0**	**(40)**	**9,354**	**16,906**

Note 1 Capital grants in 15/16 and 16/17 include carry forwards from previous allocations. 17/18 and 18/19 allocation assumes no Carry forwards.
Note 2. 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 necessarily increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's 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 £8.9m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement (CFR)	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
CFR (Non HRA)					
	101,948	113,397	182,886	232,011	265,902
CFR (HRA)					
	93,876	93,876	90,400	88,650	85,552
Total	**195,824**	**207,273**	**273,286**	**320,661**	**351,454**

Movement in CFR represented by	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
Net financing need for year*	10,556	14,687	73,103**	52,811	37,872
less Minimum revenue provision (MRP)	(3,271)	(3,239)	(3,613)	(3,686)	(3,981)
less repayment of HRA principal	0	0	(3,476)	(1,750)	(3,098)
In year movement	**7,285**	**11,448**	**66,013**	**47,375**	**30,793**

*Note: This includes internal borrowing.
**Note: The budget of £73m consists of:

£23.5m Town centre regeneration
£14.5m Wokingham Housing Ltd
£23.0m Forward funding borrowing
£10.3m General borrowing (including Carry forwards)
£1.8m Led Street Lighting borrowing

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), and it is also allowed to undertake additional voluntary payments (voluntary revenue provision - VRP).
Department for Communities and Local Government (DCLG) regulations have been issued which require the full Council to approve a MRP Statement in advance of each financial 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, the MRP policy will be:

- 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 borrowing (including PFI and finance leases) the MRP policy will be

- 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	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
Non - HRA (Percentage of financing cost against Net Expenditure	3.25%	3.45%	4.55%	5.39%	6.08%
HRA (percentage of financing cost against gross income)	18.21%	18.16%	18.74%	18.62%	18.60%

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

2.6 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs of capital financing borrowing costs associated with proposed changes to the three year capital programme recommended in this 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 council tax	2014/15 Actual £	2015/16 Estimated £	2016/17 Budget £	2017/18 Budget £	2018/19 Budget £
Council tax - band D	29	29	38	39	41

The increase is due to the increase in value of the capital programme

2.7 Housing Revenue Account (HRA) ratios

HRA	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
HRA Debt	93,892	93,892	93,892	90,416	89,377
Number of dwellings	2,616	2,610	2,598	2,586	2,574
Debt per dwellings	**36**	**36**	**36**	**35**	**35**

Assumed sales of 12 councils house per year in line with the last few years actual sales

2.8 Flexible use of Capital Receipts

As part of the Local Government Spending Review announced on the 17th December 2015, the Government has provided local authorities with the flexibility of utilising Capital Receipts for qualifying expenditure. This is to enable authorities to fund transformation and cost reduction programmes from capital receipts rather than revenue expenditure.

The guidance recommends that a strategy should be prepared that includes separate disclosure of the individual projects that will be funded or part funded through capital receipts flexibility and that the strategy is approved by full council.

Qualifying expenditure

The Government has termed qualifying expenditure per the below. On the following page there are some of the suggestions from Government, but these are not exhaustive.

Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs or to improve the quality of service delivery in future years. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility. Set up and implementation costs of any new processes or arrangements can be counted as qualifying expenditure. The ongoing revenue costs of the new processes or arrangements cannot be classified as qualifying expenditure.

Requirements of the Strategy

As part of the Strategy, Government have set out that the following must be included:

- list each project that plans to make use of the capital receipts flexibility, that it details the split of up front funding for each project between capital receipts and other sources, and that on a project by project basis, a cost benefit analysis is included to highlight the expected savings.
- The Strategy should report the impact on the local authority's Prudential Indicators for the forthcoming year and subsequent years
- From the 2017-18 Strategy and in each future year, the Strategy should contain details on projects approved in previous years, including a commentary on whether the planned savings or service transformation have been/are being realised in line with the initial cost/benefit analysis

Timescales

The flexibilities for using capital receipts are due over the period April 2016 to March 2019.

Key projects

For 2016/17 there are currently no programmes that have been identified for flexible use of capital receipts. This will be reviewed during 2016/17 and if schemes are identified which meet the criteria from the Department for Communities and Local Government, these will be brought to the council for approval via the mid-year treasury management report.

When project have been identified they would be included in the report in the following format:

Project	Capital Receipts funded / £m	Other sources / £m	Expected Savings / £m
*			

*Note currently there are no revenue schemes identified to be funded in this way.

Capital receipts expected in 2016-17

	2016/17 £'000	2017/18 £'000	2018/19 £'000
Capital receipts (Non Wokingham Town Centre Regeneration)	150	150	150

Since capital receipts are only expected to be approx. £150k each year for the next three years, it is projected that the number of projects that can be funded is very limited.

Town centre receipts cannot be considered as part of this scheme as they are clearly earmarked to fund further element of the town centre regeneration.

Suggested qualifying expenditure for flexible use of Capital receipts

- Sharing back-office and administrative services with one or more other council or public sector bodies
- Investment in service reform feasibility work, e.g. setting up pilot schemes
- Collaboration between local authorities and central government departments to free up land for economic use
- Funding the cost of service reconfiguration, restructuring or rationalisation (staff or non-staff), where this leads to ongoing efficiency savings or service transformation

- Sharing ChiefExecutives, management teams or staffing structures
- Driving a digital approach to the delivery of more efficient public services and how the public interacts with constituent authorities where possible
- Aggregating procurement on common goods and services where possible, either as part of local arrangements or using Crown Commercial Services or regional procurement hubs or Professional Buying Organisations
- Improving systems and processes to tackle fraud and corruption in line with the Local Government Fraud and Corruption Strategy – this could include an element of staff training
- Setting up commercial or alternative delivery models to deliver services more efficiently and bring in revenue (for example, through selling services to others)
- Integrating public facing services across two or more public sector bodies (for example children's social care, trading standards) to generate savings or to transform service delivery.

3 BORROWING

The capital expenditure plans set out in Section 2.1 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is managed 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 2015, 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.

	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
As at 1st April					
External debt	131,602	131,602	149,602	197,119	231,446
Expected change in debt (note 1)	0	18,000	47,517	34,327	24,617
Other long-term liabilities (OTL)	9,000	8,976	8,952	8,928	8,904
Expected change in (OTL)	(254)	(24)	(24)	(24)	(24)
As at 31st March					
Actual gross debt	140,348	158,554	206,047	240,350	264,943
The capital financing requirement	195824	207,273	273,286	320,661	351,454
Under / (over) borrowing	**55,476**	**48,719**	**67,239**	**80,311**	**86,512**

Note 1: An £18m loan is anticipated to be taken out in March 2016 as part of the forward funding of the new school in south west.

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 2015/16 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.

	14/15 Actual £'000	15/16 Estimated £'000	16/17 Budget £'000	17/18 Budget £'000	18/19 Budget £'000
Operational boundary					
Debt	131,602	149,602	216,000	252,000	278,000
Other long term liabilities	9,000	8,976	10,000	10,000	10,000
Operational boundary limit	**140,602**	**158,578**	**226,000**	**262,000**	**288,000**

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.
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- 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.

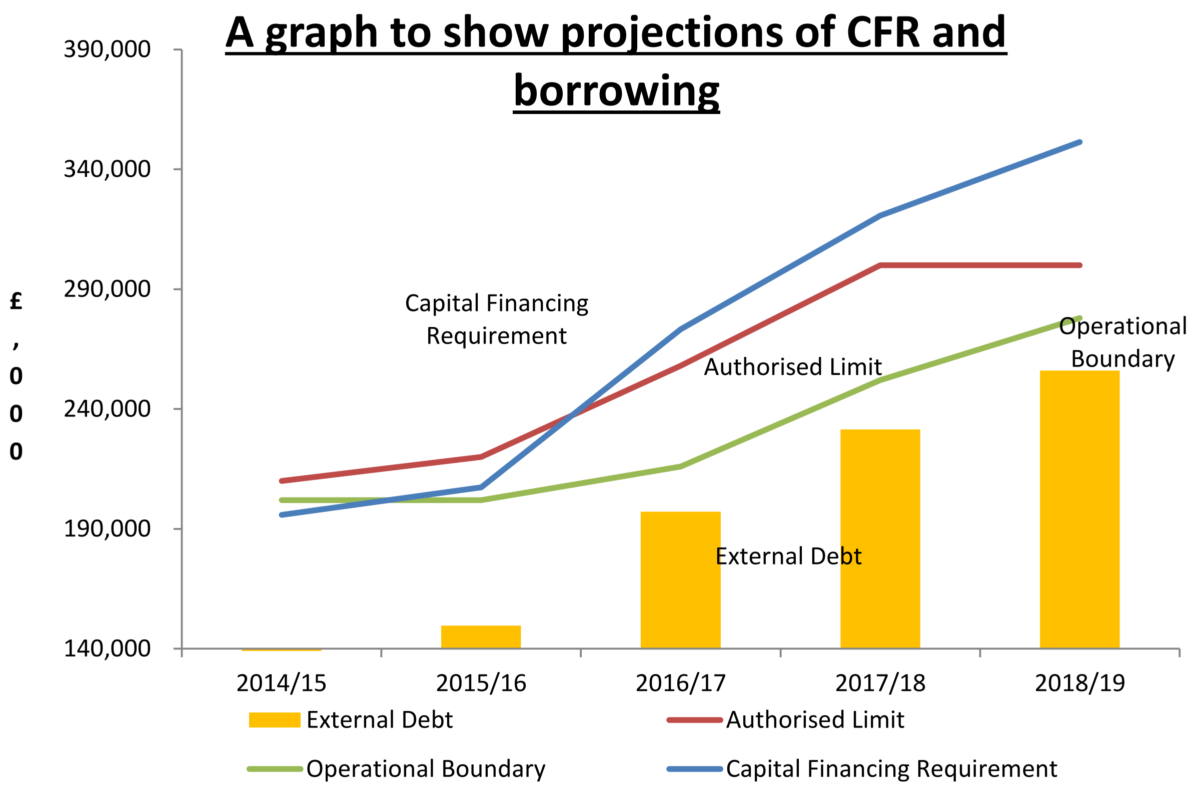
- The Council is asked to approve the following authorised limit:

	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
Authorised limit					
Debt	131,602	149,602	258,000	300,000	331,000
Other long term liabilities	9,000	8,976	10,000	10,000	10,000
Authorised limit	**140,602**	**158,578**	**268,000**	**310,000**	**341,000**

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

The Table below demonstrates that the HRA CFR is reducing as the council repays the debt it took out to achieve self-financing

HRA Debt limit	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
HRA Debt Cap	102,000	102,000	102,000	102,000	102,000
HRA CFR	93,876	93,876	90,400	88,650	85,552
HRA head room	**8,124**	**8,124**	**11,600**	**13,350**	**16,448**



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	10 Year	50 year
Qtr. 4 2015/16	0.50	2.3	2.9	3.5
Qtr. 1 2016/17	0.50	2.4	3.0	3.6
Qtr. 2 2016/17	0.75	2.6	3.1	3.7
Qtr. 3 2016/17	0.75	2.7	3.2	3.8
Qtr. 4 2016/17	1.00	2.8	3.3	3.9
Qtr. 1 2017/18	1.00	2.8	3.4	4.0
Qtr. 2 2017/18	1.25	2.9	3.5	4.0
Qtr. 3 2017/18	1.50	3.0	3.6	4.1

The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel prices will now delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% in the second half of 2016 and not get to near 2% until 2017, though the forecasts in the Report itself were for an even slower rate of increase. There is considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically very low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which 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 on the next page illustrates the estimated internal borrowing of the Council over the next three years.

Internal Borrowing	2014/15 Actual £'000	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
CFR (Year-end position) (A)	195,824	207,273	273,286	320,661	351,454
Less External borrowing	(131,602)	(149,602)	(197,119)	(231,446)	(256,063)
Less other long term liabilities	(9,000)	(8,976)	(10,000)	(10,000)	(10,000)
Internal borrowing (B)	**55,222**	**48,695**	**66,167**	**79,215**	**85,392**
% of internal borrowing to CFR (B % of A)	**28%**	**23%**	**24%**	**25%**	**24%**
Movement	9,772	(6,528)	17,473	13,048	6,177

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	2015/16 Budget £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
Limits on fixed interest rates:				
· Debt only	212,000	268,000	310,000	341,000
· Investments only	(80,000)	(80,000)	(80,000)	(80,000)
Total	**132,000**	**188,000**	**230,000**	**261,000**
Limits on variable interest rates				
· Debt only	40,000	40,000	40,000	40,000
· Investments only	(40,000)	(40,000)	(40,000)	(40,000)
Total	**0**	**0**	**0**	**0**

Estimated Maturity structure of fixed interest rate borrowing 2016/17 as at 31-03-2017

Under 12 months	6.45%
1 to 2 years	3.23%
3 to 5 years	6.45%
6 to 10 years	22.58%
11 years and above	61.29%

Estimated Maturity structure of Variable interest rate borrowing 2016/17 as at 31-03-2017

Under 12 months	100.00%
1 to 2 years	0.00%
3 to 5 years	0.00%
6 to10 years	0.00%
11 years and above	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 significantly lower than rates paid on current debt.

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

3.7 Municipal Bond Agency

The Municipal Bond Agency, currently in the process of being set up, is intending to offer loans at a competitive rate for loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority will consider making use of this new source of borrowing as and when appropriate

4 ANNUAL INVESTMENT STRATEGIES

Introduction: changes to credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria; the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AAA. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have a major influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

4.1 Investment policy

The Council's investment policy has regard to the DCLG'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 applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and 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 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.

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 ; 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, and then the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services, our treasury advisors, 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 – AA (Fitch), Aa2 (Moody's), AA (Standard and Poors)

ii.Long term – AA (Fitch), Aa2 (Moody's) , AA (Standard and Poors)

• Banks 2 – Part nationalised UK banks – . This bank can be included if it continues 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)

• 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**	**364 days**
Banks 1 medium quality	***F1+/AA-***	***P-1Aa3***	***A-1+/AAA***	**£3m**	**364 days**
Building Societies				**£2m**	**6 Months**
Debt Management Office Account (DMADF)	**-**	**-**	**-**	**£20m**	**3 Months**
Guaranteed Organisations	**-**	**-**	**-**	**£2m**	**3 Months**
Other Institution Limits (other local authorities, Money Market Funds, Gilts and Supranational investments)	**-**	**-**	**-**	**£5m**	**364 days**
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 approve counterparties from countries with a minimum sovereign credit rating of AAA. The exception will be the UK, which currently has an AA+ sovereign rating.

A Non UK counterparty will need to meet all above mentioned criteria in 4.2 & 4.3 and have a sovereign rating AAA as a minimum. Countries with a sovereign rating of AAA (based on lowest available rating @ Jan 2016) are Australia, Canada, Denmark, Germany, Luxembourg, Norway, Singapore, Sweden & Switzerland

4.5 Investment strategy

Investment returns expectations. The Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.6%
- 2017/18 1.25%
- 2018/19 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

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

2016/17 0.90%
2017/18 1.50%
2018/19 2.00%
2019/20 2.25%
2020/21 2.50%
2021/22 3.00%
2022/23 3.00%
Later years 3.00%

Investment treasury indicator and limit

This is the 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: -

Principal sums invested > 364 Days	2015/16 Estimated £'000	2016/17 Budget £'000	2017/18 Budget £'000	2018/19 Budget £'000
In house	0	0	0	0
Fund managers	10,000	10,000	10,000	10,000

Review of investment strategy

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. The council has adapted a risk adverse approach to investment following the collapse of Icelandic banks. This has resulted in a low level of investment returns. In general the safer the investment the lower the interest rate paid.
A review of the economic situation and the council approach to risk and returns is being undertaken to enable executive to consider it counterparty parameters.

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 - £0.5m
- 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

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. The performance of each manager is reviewed at least quarterly by the Director of Finance and Resources.

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

Investments with fund managers	2014/15 @ 31/03/15 Actual £'000	2015/16 @ 31/03/16 Estimated £'000
Royal London Asset Management (Rlam)	11,867	11,936
Aberdeen Asset Management (Formally SWIP).	9,546	9,612

5 Appendices

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

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