TREASURY MANAGEMENT REPORT

1.1 The Local Government Act 2003 requires the Council to “have regard to” the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

1.2 This report outlines the Council’s prudential indicators for 2013/14 – 2015/16 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

- The reporting of the prudential indicators setting out the expected capital activities at Annex A(i) (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities).
- The Council’s Minimum Revenue Provision (MRP) Policy at Annex A(ii), which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007);
- The Treasury Management Strategy Statement which sets out how the Council’s treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003 and shown at Annex A(iii);
- The Annual Investment Strategy which sets out the Council’s criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance and is shown in Annex A(iv).

The Capital Prudential Indicators 2013/14 – 2015/16

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Council's underlying capital appraisal systems.

Within this overall prudential framework there is an impact on the Council's treasury management activity – as it will directly impact on borrowing or investment activity and as such the Treasury Management Strategy for 2013/14 to 2015/16 complements these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Expenditure Plans

The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax);
- Practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to the impact of the recession on the property market, similarly the proceeds from the Right-to-Buy sharing agreement with Bracknell Forest Homes will also be impacted on by the wider economy.

The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

Capital Expenditure	**2013/14 Estimate £000**	**2014/15 Estimate £000**	**2015/16 Estimate £000**
Capital Expenditure	23,462	19,242	12,939
Financed by:			
Capital receipts	5,000	3,000	3,000
Capital grants & Contributions	11,272	10,239	6,008
Revenue	1,100	0	0
Net financing need for the year	**6,090**	**6,003**	**3,931**

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 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. The capital expenditure above which has not immediately been paid for will increase the CFR. Due to the nature of some of the capital expenditure identified above (ie grant), an element will be immediately impaired or will not qualify as capital expenditure for CFR purposes. As such the net financing figure above may differ from that used in the CFR calculation.

The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP). No additional voluntary payments are planned.

The Council is asked to approve the CFR projections below:

	2013/14 Estimate £000	**2014/15 Estimate £000**	**2015/16 Estimate £000**
Capital Financing Requirement			
Total CFR	**55,413**	**59,641**	**61,691**
Movement in CFR	**5,009**	**4,244**	**2,066**

Movement in CFR represented by			
Net financing need for CFR purposes #	6,620	6,003	3,931
Less MRP/VRP and other financing movements	-1,612	-1,759	-1,865
Movement in CFR	**5,009**	**4,244**	**2,066**

 # 2013/14 includes impact of carry-forward from 2012/13

CLG Regulations have been issued which require full Council to approve an MRP Statement in advance of each year. The Council is recommended to approve the MRP Statement attached in Annex A(ii)

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:

Estimates of the 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.

	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Ratio	-0.56%	+0.07%	+0.26%

The estimates of financing costs include current commitments and the proposals in the Capital Programme Budget report.

Incremental impact of capital investment decisions on the Council Tax
This indicator identifies the revenue costs associated with proposed changes to the three year capital programme 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.

	Forward Projection 2013/14	Forward Projection 2014/15	Forward Projection 2015/16
Council Tax - Band D	£1.35	£1.32	£1.70

<u>Minimum Revenue Provision (MRP) Policy Statement</u>

The concept of the Minimum Revenue Provision (MRP) was introduced when the Local Government Capital Finance System was changed on 1 April 1990. This required local authorities to assess their outstanding debt and to make an annual charge to the General Fund of 4% of the General Fund Debt.

These regulations have now been amended and Department for Local Government & Communities (DCLG) issued new regulations in 2008 which require a local authority to calculate for the current financial year an amount of MRP which it considers "prudent". The broad aim of a prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits or in the case of borrowing supported by government, reasonably commensurate with the period implicit in the determination of the grant. The Council can choose to charge more than the minimum.

It is a requirement of these new regulations that full Council approve an annual MRP Statement of its policy on making MRP.

As capital expenditure is incurred which cannot be immediately financed through capital receipts or grant the Council's borrowing need (its Capital Financing Requirement) will be positive and an MRP will be required. In practice the Council is unlikely to need to borrow externally in the medium term as it has sufficient revenue investments, arising from the Council's reserves and balances to cover this expenditure. However it will still need to make a charge to revenue for this "internal borrowing".

The move to International Financial Reporting Standards (IFRS) in local government is expected to bring more PFI schemes on balance sheet and to result in some leases (or parts of leases) being reclassified as finance lease instead of operating leases. These contracts would become subject to the requirement to provide MRP. IFRS requires these changes to be accounted for retrospectively. With the result that an element of the rental or service charge payable in previous years will be taken to the balance sheet to reduce the liability. On its own this change would result in a one-off increase to the capital financing requirement, and an equal increase in revenue account balances. This is not seen as a prudent course of action and as such the guidance recommends the inclusion in the annual MRP charge of an amount equal to the amount that has been taken to the balance sheet to reduce the liability, including the retrospective element in the first year.

The guidance sets out four options for making MRP. It envisages that authorities can distinguish between borrowing that is "supported" (through the RSG system) and other "unsupported or prudential" borrowing. The first two methods should only be used for "supported" borrowing

1) The regulatory method. This involves following the existing practice outlined in the former DCLG regulation. For the Council this is essentially the same as the CFR method.
2) The CFR Method. This involves setting the MRP equal to 4% of the Capital Financing Requirement at the end of the preceding year.
3) The Asset Life Method. This method requires MRP to be charged over the asset life. The asset life is determined in the year MRP commences and is not changed. MRP will not be charged until the asset becomes operational.

Therefore it will be possible to take an MRP holiday for those assets in construction.

4) The Depreciation Method. This requires the MRP to equal the actual depreciation based on standard accounting procedures.

Recommended Policy

In setting the 2013/14 budget and beyond the following policy is recommended:

1) There will be a presumption that capital receipts will be allocated to the appropriate assets in relation to the constraints of the medium term financial strategy.
2) The Council will identify the level of "supported borrowing" and use the CFR Method i.e. 4% of this figure as part of the MRP charge. The supported borrowing will be used in full irrespective of the service block the funding was allocated in the grant settlement and will also be allocated to the appropriate assets in relation to the constraints of the medium term financial strategy. For the remaining "unsupported borrowing" the Council will use the asset life method.

The actual charge made in the year will be based on applying the above policy to the previous year's actual capital expenditure and funding decisions. Therefore the 2013/14 charge will be based on 2012/13 capital out-turn.

TREASURY MANAGEMENT STRATEGY STATEMENT

The Treasury Management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Annex A(i) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The Treasury Management service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice - 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This Council adopted the Code of Practice on Treasury Management in March 2002, and will adopt the revised Code.

As a result of adopting the Code the Council also adopted a Treasury Policy Statement. This adoption is the requirement of one of the prudential indicators.

The Code of Practice requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

This strategy covers:

The Council's debt and investment projections;
The Council's estimates and limits on future debt levels;
The expected movement in interest rates;
The Council's borrowing and investment strategies;
Treasury performance indicators;
Specific limits on treasury activities;

Debt and Investment Projections 2013/15 – 2015/16
The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The Council does not anticipate any external borrowing over 2013/14, but projects that it may require to borrow externally from 2014/15 onwards, however the timing of this very much depends on progress made in delivering on the Capital Programme in 2013/14 and the level of capital receipts achieved in the next 18 months. As such there is some uncertainty as to when exactly the Council will be required to undertake borrowing. The table below highlights the expected change in investment balances.

£'000	2013/14 Estimated	2014/15 Estimated	2015/16 Estimated
External Debt			
Debt at 31 March	0	5,000	12,000
Investments			
Investments at 31 March	5,000	0,000	0

Limits to Borrowing Activity
Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits. For the first of these the Council needs to ensure that its total borrowing net of any investments, 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 Borough Treasurer reports that the Council has 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.

The Authorised Limit for External Debt
A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by 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.

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 no control has yet been exercised.

The Council is asked to approve the following Authorised Limit:

Authorised limit £000	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Borrowing	45,000	48,000	51,000
Other long term liabilities	16,000	16,000	16,000
Total	61,000	64,000	67,000

Operational Boundary for External Debt
The Authority is also recommended to approve the Operational Boundary for external debt for the same period. The proposed Operational Boundary is based on the same estimates as the Authorised Limit but reflects directly the estimate of the most likely but not worst case scenario, without the additional headroom included within the Authorised Limit to allow for unusual cash movements.

Operational Boundary £m	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Borrowing	40,000	44,000	47,000
Other long term liabilities	16,000	16,000	16,000
Total	56,000	60,000	63,000

Borrowing in advance of need.
The Borough Treasurer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Borough

Treasurer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism. However given the finely balanced projected position in 2014/15 any borrowing in advance of need will be kept under review on a monthly basis.

Expected Movement in 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 on the future levels of the Bank Rate

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	PWLB Rates*		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
Mar 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.70	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50

* Borrowing Rates

After a very uncertain and economically challenging start to the year, there are the initial signs that economic growth may have returned after three quarters of recession. However the normal economic indicators used to evaluate the financial health of the country have been impacted by a range of unique circumstances, including the Queen's Jubilee and associated additional bank holidays followed closely by the London 2012 Olympics, which combined with the climatic challenges faced by the country this summer have clouded many of the economic forecasts.

3rd quarter GDP growth was positive for the first quarter in a year, and both industrial production and the overall trade deficit have posted some encouraging numbers. This return to growth has also been supported by a continuing recovery in the jobs market whilst pay growth has remained modest.

Inflation has struggled to make further downward progress in the last quarter, and whilst inflation should continue to drop to around 2% in the latter half of this year, further falls over the remaining part of the year look unlikely.

As a result of the above, GDP posted a healthy quarterly rise of 1% in Quarter 3, however this is unlikely to contribute enough to generate positive growth for the year as whole and as such 2012 is likely to be seen as adding to the worst and slowest recovery from recession of any of the five recessions since 1930.

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the impact of the Euro-zone crisis on financial markets and the banking sector
- the impact of the UK Government's austerity plan on confidence and growth
- Monetary policy action failing to stimulate growth in western economies
- the potential for weak growth or recession in the UK's main trading partners – the EU and the US

The overall balance of risks remains weighted to the downside. Given the weak outlook for economic growth, the prospect for any interest rate changes before the end of 2014 are very limited.

Borrowing Strategy 2013/14

Given the level of current investments, the Council does not envisage any long-term borrowing in 2013/14 although the Authorised Limit for External Debt has been set to enable the Council to manage its cash flow effectively through the use of temporary borrowing, in the unlikely event that this should be necessary.

Investment Strategy 2013/14 – 2015/16

Investment Policy
The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

Key Objectives
The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. Following the economic background outlined in the Treasury Management Strategy, the current investment climate has one over-riding risk consideration that of counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which maintains the tightened controls already in place in the approved investment strategy.

Investment Counterparty Selection Criteria
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:

- 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.
- 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.

In accordance with the Investment Guidance, the Council will, in considering the security of proposed investments, follow different procedures according to which of two categories, Specified or Unspecified, the proposed investment falls into.

Specified Investments offer high security and high liquidity and are:

- ♦ Denominated, paid and repaid in sterling;
- ♦ Not long term investments, i.e. they are due to be repaid within 12 months of the date on which the investment was made;
- ♦ Not defined as capital expenditure; and
- ♦ Are made with a body or in an investment scheme which has been awarded a high credit rating by a credit rating agency or are made with the UK Government or a Local Authority in England, Wales, Scotland or Northern Ireland.

Non-Specified Investments are those which do not meet the definition of Specified Investments.

The authority employs a counterparty selection criteria approved annually by Council that sets out the financial institutions that the organisation can deposit funds with. The key criteria used are the credit ratings supplied by the three main credit rating agencies. The Council maintains a low risk approach to counterparty selection and there is no intention on diverging from this, however over recent years there has been a shift in the reliance placed purely in credit-ratings on counterparty selection. As such it is considered appropriate to review the current methodology and to adopt a more sophisticated model of counterparty selection.

As a result of the financial crisis following the Lehman's collapse and the recent sovereign credit-worthiness difficulties, almost all financial institutions, and indeed countries, have experienced a substantial cut in their credit-ratings. The Council's 2012/13 criteria limits investments in only two UK financial institutions willing to deal in the size of transactions available to the Council. This list was supplemented in 2011/12 with the inclusion of part-nationalised banks, which whilst not meeting the Council's strict credit-rating criteria are seen to offer low levels of risk given the support they are afforded through the UK Government. Whilst such a criteria mitigates a particular level of risk, it increases the risk associated with lack of diversification, resulting in a much higher weighting in low-yielding AAA rated overnight deposits.

In addition it has been widely acknowledged that credit-ratings on their own are not sufficient in capturing and evaluating the relative levels of risk attached to a single counterparty. The CIPFA code recommends that Councils do not place sole reliance on credit-rating scores but use other techniques and financial analysis to evaluate credit-worthiness. There is a wide range of such information, much of which is provided by the Council's Treasury Management advisers.

One such technique is the use of a Credit Default Swap (CDS) which is a marketable instrument or agreement whereby the seller of the CDS will compensate the buyer in the event of a loan default. In simple terms the buyer of the CDS makes a payment to the seller and in exchange receives a payoff if the company defaults. However CDS are tradable and a huge market exists ($25tn) and they are actively used to monitor how the market views the credit risk of any entity for which a CDS is available. On their own, the risk reflected by the level of a CDS is complex to evaluate however they can be used in tracking their relative movement and more importantly their movement against an index of industry peers.

In light of the changing economic backdrop, the shift in the relative importance of credit-ratings and the sector's requirement for a more sophisticated approach to counterparty selection, the Council's Treasury Management advisers have developed a modelling approach utilising credit ratings from the three main credit rating agencies supplemented with overlays of credit watches and outlooks in a weighted scoring system which is then combined with CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. This service 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.

The minimum credit rating that the Council will use will be a short term rating of F1 and a long term rating of A-, with Viability ratings of BB+ and a Support rating of 3. The existing criteria differs only in the Support Rating where the current limit is 2 and as such the recommended change in criteria represents a slight increase in risk.

The definition as provided by Fitch for a support level 2 compared to a support level 3 is documented below;

- Support Level 2: A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question.
- Support Level 3: A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so.

The Support Rating is an assessment of a potential supporter's propensity to support a bank and of its ability to support it and as such does not assess the intrinsic credit quality of a bank, but rather communicates the agency's judgement on whether the bank would receive support should this become necessary. Support ratings have been significantly impacted by both the large number of sovereign rating cuts and the acceptance that sovereign nations will be unable to support all banks should the global economic conditions deteriorate substantially.

However this minor lowering of the support level is offset to a large extent through the additional use of CDS spreads which adds an additional level of risk evaluation not currently used by the Council. All credit ratings will be monitored weekly and the Council will be alerted to changes in ratings through the use of its adviser's creditworthiness service. Furthermore sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and information on government support for banks and the credit ratings of that government support.

The Council's investment criteria will continue to limit deposits in only UK banks, up to a limit of £7m, and whilst it will continue to limit investments to less than 1Year it will make use of the more sophisticated model provided by its advisers to limit individual institutions by duration.

The suggested adoption of this new model has many positive attributes; it broadly maintains the Council's risk exposure and explicitly identifies a clear list of approved counterparties. However a major benefit of this sophisticated model is that it provides a robust and methodical approach to the quantification of risk through both credit-ratings and market-generated risk assessment that can be clearly followed and communicated.

In addition to the criteria above part nationalised UK Banks (Lloyds Bank and Royal Bank of Scotland) will also be included within the Council's counterparty list. These banks can be included if they continue to be part nationalised or they meet the ratings above. The Council will also continue to invest in the following highly rated investment instruments

- Money Market Funds – AAA Rating Sterling Denominated
- UK Government (including gilts and Debt Management Account Deposit Facility (DMADF))
- UK Local Authorities

Country and sector considerations.
Due care will be taken to consider the country, group and sector exposure of the Council's investments. The current investment strategy limits all investments to UK Banks and Building Societies.

Time and Monetary Limits applying to Investments.
The maximum time and monetary limits for institutions on the Council's Counterparty List are as follows and will be supplemented on an individual institutional basis by the SECTOR criteria model referred to above (the monetary limits will cover both Specified and Non-Specified Investments):

	Money Limit	Time Limit
UK Banks and Building Societies	£7m	364 days
Money Market Funds	£7m	n/a
UK Government	unlimited	364 days
UK Local Authorities	£7m	364 days

The proposed criteria for Specified and Non-Specified investments are attached to this document.

In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded however the current investment limits for 2013/14 restrain all investments to less than 1 year. Any amendment to this strategy will require the credit-criteria to be amended to include a long-term rating. This will be addressed through the formal approval by Council of a revised Treasury Management Strategy and Annual Investment Strategy.

Economic Investment Considerations

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates. The UK Bank Rate is forecast to remain unmoved through to late 2014. However, should the pace of growth pick up more than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the 2% inflation target.

The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Borough Treasurer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (a Government body which accepts local authority deposits), Money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

Icelandic Bank Investments
The Council had deposited £5m in Icelandic Banks at the time of the collapse of the Icelandic banking system, being £2m with Heritable Bank and £3m with Glitnir Bank.

Heritable Bank
Heritable Bank was put into administration in the UK. The receiver (Ernst & Young) has followed a strategy of managing the outstanding debts of the bank (mostly mortgages) and paying a dividend every 6 months to the creditors as monies are recovered. To date the Council has received £1,530,379, the total claim admitted by the Council was for £2,052,490 (being £2m principal and interest of £52,490). The total recovered represents 75 pence in the pound. The administrator believes the final recovery amount to be in the region of 86 to 90 pence in the pound, however no time scale has been proposed for the final recovery. At 86p/£ the total recovery would be £1.765m

Glitnir Bank
The administration of Glitnir has been undertaken in Iceland and has been significantly more complex than that associated with Heritable. However, following the Icelandic Supreme Court's decision in December 2011 to recognise the Council as a priority creditor, the Winding-Up-Board undertook the process of distributing deposits to creditors.

The total owed to the Council amounts to £3,192,371 (being £3m principal and £192,371 interest). However at the date of administration the amount due was converted into Icelandic Krona at the existing exchange rate – amounting to some 609,998,348Kr. This has been used as the amount to be redistributed in all future decisions by the Bank's Winding-Up-Board.

The recovery has been complicated by current Icelandic legislation covering currency transactions and the fact that the Bank held deposits in a wide variety of currencies. The result of this has been that approximately 80% of the Council's deposit was paid to the Council in a basket of currencies on the 14th March 2012. Once these had been exchanged into Sterling, the Council received a total of £2,521,455. This leaves an outstanding balance of 116,387,685Kr (£450,000 approx) which the bank is currently holding in an escrow account. Unexpectedly, on the 13th March, the Icelandic Parliament enacted further Currency Control legislation covering the movement and exchange of Icelandic Krona and all other foreign currencies. Fortunately this did not impact on the distribution on the 14th March 2012, however it will impact on the monies held in the escrow account. We are currently working alongside our legal representatives and the LGA to facilitate the recovery of these monies as efficiently and effectively as possible. The final value of this amount is uncertain given the currency controls and the weakness of the Icelandic currency at present.

Sensitivity to Interest Rate Movements
Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% change in interest rates to the estimated treasury management income for next year. That element of the investment portfolio which is of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2013/14 Estimated + 1%	2014/15 Estimated - 1%
Revenue Budgets	**£'000**	**£'000**
Investment income	+225	-225

Treasury Management Limits on Activity
There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an 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 – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

Maturity structures 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.

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 limits:

	2013/14	2014/15	2015/16
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	£40m	£40m	£41m
Limits on variable interest rates based on net debt	£16m	£20m	£21m
Maturity Structure of fixed interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	0%
2 years to 5 years		0%	0%
5 years to 10 years		0%	0%
10 years and above		0%	0%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£m 0	£m 0	£m 0

Performance Indicators
The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. For 2013/14 the Council does not expect to enter into any borrowing and as such the relevant benchmark will relate only to

investments and will be the “7 Day LIBID Rate”. The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers
The Council uses Sector as its treasury management consultants. The Council recognises that responsibility for treasury management decision 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 subject to regular review.

Member and Officer Training
The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. Following the nomination of the Governance and Audit Committee to examine and assess the effectiveness of the Treasury Management Strategy and Policies, initial training was provided and additional training was given to the Committee in 2012. Officer training is carried out in accordance with best practice and outlined in TMP 10 Training and Qualifications to ensure that all staff involved in the Treasury Management function are fully equipped to undertake the duties and responsibilities allocated to them

SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated.

Investment	**Share/ Loan Capital?**	**Repayable/ Redeemable within 12 months?**	**Security / Minimum Credit Rating ****	**Circumstance of use**	**Maximum period**
Debt Management Agency Deposit Facility* (DMADF) * this facility is at present available for investments up to 6 months	No	Yes	Govt-backed	In-house	364 Days
Term deposits with the UK government or with Local Authority in England, Wales, Scotland or Northern Ireland with maturities up to 364 Days	No	Yes	High security although LAs not credit rated.	In-house and by external fund managers subject to the guidelines and parameters agreed with them	364 Days
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 364 Days	No	Yes	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them	364 Days
Certificates of Deposit issued by credit-rated deposit takers (banks and building societies) : up to 364 Days. *Custodial arrangement required prior to purchase*	No	Yes	*See SECTOR list*	To be used by external fund managers only subject to the guidelines and parameters agreed with them	364 Days
Gilts : up to 364 Days	No	Yes	Govt-backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	364 Days

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating **	Circumstance of use	Maximum period
Money Market Funds *These funds do not have any maturity date*	No	Yes	*AAA Rating by Fitch, Moodys or S&P*	In-house and by external fund managers subject to the guidelines and parameters agreed with them	The period of investment may not be determined at the outset but would be subject to cash flow and liquidity requirements
Forward deals with credit rated banks and building societies < 1 year (i.e. negotiated deal period plus period of deposit)	No	Yes	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them. Tracking of all forward deals to be undertaken and recorded.	1 year in aggregate
Commercial paper *[short-term obligations (generally with a maximum life of 9 months) which are issued by banks, corporations and other issuers]* *Custodial arrangement required prior to purchase*	No	Yes	*See SECTOR list*	To be used by external fund managers only subject to the guidelines and parameters agreed with them	9 months
Treasury bills [*Government debt security with a maturity less than one year and issued through a competitive bidding process at a discount to par value*] *Custodial arrangement required prior to purchase*	No	Yes	Govt-backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	1 year

<u>NON-SPECIFIED INVESTMENTS</u>

All investments listed below must be sterling-denominated.

<u>Investment</u>	**<u>(A) Why use it?</u> <u>(B) Associated risks?</u>**	**<u>Share/ Loan Capital?</u>**	**Repayable/ Redeemable within 12 months?**	**Security / Minimum credit rating ****	**Circumstance of use**	**Maximum maturity of investment**
Deposits with Authority's Banker where credit rating has dropped below minimum criteria	Where the Council's bank no longer meets the high credit rating criteria set out in the Investment Strategy the Council has little alternative but to continue using them, and in some instances it may be necessary to place deposits with them, these deposits should be of a very short duration thus limiting the Council to daylight exposure only (i.e. flow of funds in and out during the day, or overnight exposure).	No	Yes	n/a	In-House	*364 Days*
Term deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A) (i) Certainty of rate of return over period invested. (ii) No movement in capital value of deposit despite changes in interest rate environment. (B) (i) Illiquid : as a general rule, cannot be traded or repaid prior to maturity. (ii) Return will be lower if interest rates rise after making the investment. (iii) Credit risk : potential for greater deterioration in credit quality over longer period	No	No	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them	*5 Years*
Certificates of Deposit with credit rated deposit takers (banks and building societies) with maturities greater than 1 year *Custodial arrangement required prior to purchase*	(A) (i) Although in theory tradable, are relatively illiquid. (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of CD which could negatively impact on price of the CD.	No	Yes	*See SECTOR list*	To be used by external fund managers only subject to the guidelines and parameters agreed with them	*5 years*

Investment	**(A) Why use it?** **(B) Associated risks?**	**Share/ Loan Capital?**	**Repayable/ Redeemable within 12 months?**	**Security / Minimum Credit Rating?**	**Circumstance of use**	**Maximum maturity of investment**
Callable deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A) (i) Enhanced income ~ Potentially higher return than using a term deposit with similar maturity. (B) (i) Illiquid – only borrower has the right to pay back deposit; the lender does not have a similar call. (ii) period over which investment will actually be held is not known at the outset. (iii) Interest rate risk : borrower will not pay back deposit if interest rates rise after deposit is made.	No	No	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them	*5 years*
UK government gilts with maturities in excess of 1 year *Custodial arrangement required prior to purchase*	(A) (i) Excellent credit quality. (ii)Very Liquid. (iii) If held to maturity, known yield (rate of return) per annum ~ aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.	No	Yes	Govt backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	*10 years including but also including the 10 year benchmark gilt*

Investment	**(A) Why use it?** **(B) Associated risks?**	**Share/ Loan Capital?**	**Repayable/ Redeemable within 12 months?**	**Security / Minimum credit rating ****	**Circumstance of use**	**Maximum maturity of investment**
Forward deposits with credit rated banks and building societies for periods > 1 year (i.e. negotiated deal period plus period of deposit)	(A) (i) Known rate of return over period the monies are invested ~ aids forward planning. (B) (i) Credit risk is over the whole period, not just when monies are actually invested. (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period.	No	No	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them. Tracking of all forward deals to be undertaken and recorded.	*5 years*
Deposits with unrated deposit takers (banks and building societies) but with unconditional financial guarantee from HMG or credit-rated parent institution : any maturity	(A) Credit standing of parent will determine ultimate extent of credit risk	No	Yes	*See SECTOR list*	In-house and by external fund managers subject to the guidelines and parameters agreed with them	*1 year*