WARWICK DISTRICT COUNCIL	Executive – 11th February 2015	Agenda Item No. **4**

Title:	Treasury Management Strategy Plan for 2015/2016
For further information about this report please contact	Roger Wyton 01926 456801 roger.wyton@warwickdc.gov.uk Karen Allison 01926 456334 karen.allison@warwickdc.gov.uk
Wards of the District directly affected	All
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management in the Public Services – A Code of Practice and associated guidance notes– CIPFA The Prudential Code for Capital Finance in Local Authorities - CIPFA Treasury Management file L1/9 Treasury Management information via External Advisors, Brokers etc.

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	Yes
Included within the Forward Plan? (If yes include reference number)	Yes - 666
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval

Officer Approval	**Date**	**Name**
Chief Executive/Deputy Chief Executive	09/01/2015	Andy Jones
Head of Service	14/01/2015	Mike Snow
CMT	19/01/2015	N/A
Section 151 Officer	14/01/2015	Mike Snow
Monitoring Officer	N/A	N/A
Finance	13/01/2015	Roger Wyton

Portfolio Holder(s)	20/01/2015	Cllr. Stephen Cross
Consultation & Community Engagement		
None		
Final Decision?		Yes
Suggested next steps (if not final decision please set out below) N/A		

1. SUMMARY

1.1 This report details the strategy for 2015/16 that the Council will follow in carrying out its Treasury Management activities including the Annual Investment Strategy and Minimum Revenue Provision (MRP)Policy Statement.

1.2 The report consists of a number of Appendices:-

Appendix A - Annual Treasury Management Strategy Plan 2015/16
Appendix B – 2015/16 Annual Investment Strategy Including Annex 1
Appendix C – Minimum Revenue Provision Policy Statement
Appendix D – An Explanation of Credit Rating Terms
Appendix E – Economic Background
Appendix F – Glossary of Terms

2. RECOMMENDATIONS

2.1 That the Executive notes:-

The changes to the various Treasury Management Practices as detailed in paragraph 3.2 below.

2.2 That the Executive recommends to Council:-

a) The Treasury Management Strategy for 2015/16 as outlined in paragraph 3.1 below and detailed in Appendix A,

b) The 2015/16 Annual Investment Strategy as outlined in paragraphs 3.3 and 3.4 below and detailed in Appendix B together with Annex 1 including the following changes:-

1. That as per paragraph 2.9 of Appendix B. Covered Bonds are added to the list of Specified and Non Specified investment vehicles that the Council can use.

2. That as per Annex 1 the individual counterparty limit for Covered Bonds issued by a) private sector financial institutions be £5 million b) private sector financial institutions wholly or part owned by the UK Government £9 million and c) Corporates £3 million.

3. That the Municipal Bond Agency be included in the list of organisations that the Council is permitted to borrow from as per Appendix A paragraph 4.4.

c) The Minimum Revenue Provision Policy Statement as outlined in paragraph 3.5 below and contained in paragraphs 4.1 to 4.4 of Appendix C.

d) The Prudential Indicators as outlined paragraph 3.6 below and contained in paragraphs 5.1 to 5.5 of Appendix A.

3. REASONS FOR RECOMMENDATIONS

3.1 The Council is required to have an approved Treasury Management Strategy, including an Annual Investment Strategy and Minimum Revenue Provision Policy within which its Treasury Management operations can be carried out. The Council will be investing approximately £19.939 million in new capital in 2015/16 and will have average investments of £50 million (2013/14 actual £53m). This level of investments arises from the Council's reserves and provisions, the General Fund and Housing Revenue Account balances, and accumulated capital receipts as well as cashflow.

3.2 The Council's treasury management operations are also governed by various Treasury Management Practices (TMP's), the production of which is a requirement of the CIPFA code and which must be explicitly followed by officers engaged in treasury management. These have previously been reported to the Executive and approved. There have been the following changes to various Treasury Management Practices (TMP's) and these changes are outlined below

TMP 1 Risk Management.

Paragraph 2.1(s) – inclusion of Covered Bonds issued by Financial Institutions and Corporates with a minimum Fitch Long Term credit rating of A+ or A where the Financial Institution is wholly or partly owned by the UK Government.

Paragraph 2.2 – setting of counterparty limits for new investment vehicle:-

i) Covered Bonds issued by Corporates £3 million
ii) Covered Bonds issued by Financial Institutions £5 million or £9 million if wholly or part owned by UK Government

TMP4 Approved Instruments, Methods and Techniques.

Paragraph 2.1 (s) – introduction of Covered Bonds up to a maximum of 2 years issued by Financial Institutions or Corporates with a minimum Fitch Long Term credit rating of A+ or A where the Financial Institution is wholly or partly owned by the UK Government.

Paragraph 3.1 (n) – inclusion of Municipal Bond Agency in list of permitted organisations that the council may borrow from.

Paragraph 3.3 - recognition that the Council may only borrow in sterling from the Municipal Bond Agency.

TMP5 Organisation, Clarity and Segregation of Responsibilities and Dealing Arrangements.

Paragraph 1.1 – Amended to reflect the fact that the Annual Treasury Management Strategy has to be approved by full Council rather than the Executive.

TMP 9 Money Laundering.

Paragraph 9.1.2 (a) – amended to show the current web address for the Financial Conduct Authority.

TMP 11 Use of External Service Providers

Paragraph 1.4 - amended to reflect that the ODPM is now DCLG.

Paragraph 1.4 (o) – addition of Covered Bonds up to a maximum of 364 days issued by Financial Institutions or Corporates with a minimum Long Term Fitch rating of A+ or A where the Financial Institution is wholly or partly owned by the UK Government.

Paragraph 2.1 – Updated to reflect the fact that Capita Asset Services – Treasury Solutions Ltd has been re-appointed as the Council's Treasury Management Advisors for another three years.

Paragraph 3.2 - Updated to reflect the fact that HSBC has been re-appointed as the Council's bankers for five years with effect from March 2015 with an option to extend for a further five years.

3.3 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public. The Annual Investment Strategy for 2015/16 is contained within Appendix B and its Annex.

3.4 The current low interest rate environment is expected to continue for the foreseeable future as whilst interest rates are expected to start rising from the December quarter of 2015 it will be from a very low base and consequently investment returns will continue to be depressed for some time to come. Counterparty credit rating constraints and continuing high investment balances mean that it has become necessary once again to look at alternative investment vehicles in order to ensure that the Council can continue to invest its funds with the highest possible security whilst obtaining a reasonable rate of return. This means that the Council can diversify its risk rather than just increasing the limits for existing counterparties. The change being recommended is described in more detail in Appendix B but essentially involves the addition of Covered Bonds.

3.5 The Council has to make provision for the repayment of its outstanding long term debt and other forms of long term borrowing such as Finance Leases. Statutory guidance from the DCLG requires that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates and this is contained in Appendix C.

3.6 The Prudential Code for Capital Finance in local authorities which was revised in 2009 introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy. The Prudential Code requires the Council to set a number of Prudential Indicators and this report does therefore incorporate within section 5 of Appendix A the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.

4. POLICY FRAMEWORK

4.1 **Policy Framework** - This report is in accordance with the Council's established Treasury Management Policies, Code of Financial Practice and provides a framework within which it will conduct its Treasury Management Operations in 2015/16.

4.2 **Fit for the Future** – The Treasury Management function enables the Council to meet its vision of a great place to live, work and visit as set out in the Sustainable Community.

4.3 **Impact Assessments** – No impacts of new or significant policy changes proposed in respect of Equalities.

5. BUDGETARY FRAMEWORK

5.1 The Treasury Management Strategy has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income whilst minimising the risk of the loss of the Council's funds and minimise its borrowing interest payable which is of particular importance to the HRA under the Self Financing regime. This also helps to underpin the Council's Corporate Objectives and delivery of its Fit For the Future projects. The performance of the Treasury Management function is reported half-yearly to the Finance & Audit Scrutiny Committee which is the body charged by the Council with overseeing the treasury management activities of the council. Also an annual report for the Finance & Audit Scrutiny Committee is prepared at the end of the financial year on Treasury Management and compliance with the strategy and the Treasury Management Practices are reviewed as part of the annual Treasury Management audit.

5.2 Treasury Management is an evolving process and whilst it is not possible to compare investment returns from year to year due to differing economic climates, the previous year's performance together with feedback on our current performance from the Council's involvement in Capita Asset Services' Treasury Management Benchmarking Club is reviewed to see what lessons can be learnt that would help improve the current and future years investment returns and/or the security of the investments. For instance, this may take the form of new investment vehicles as is being recommended in this report.

6. RISKS

6.1 Treasury Management is essentially about the management of risk, e.g. the risk to the security of our investments should a counterparty fail, liquidity risk in that we need to ensure that we have sufficient cash available to meet our debts as and when they become due and interest rate risk in that we may be "locked" into low interest yielding investments at the time that interest rates are rising and therefore missing out on opportunities to maximise our interest receipts. These risks are mitigated by the use of credit rating criteria and market intelligence in order to ensure we invest with only the best quality counterparties, good cash flow forecasting both short and long term and the use of interest rate forecasts published by our treasury consultants.

6.2 The use of different investment vehicles also has its risks, for instance the introduction of Variable Net Asset Money Market Funds into the portfolio in 2014/15 has potentially increased capital risk. This is through potential capital loss due to market price fluctuations, for instance if investments have to be withdrawn early. This is mitigated by good cash flow management ensuring that investments are available for the necessary length of time to ensure that there is no negative impact on the capital value of the fund. In addition, mitigation is achieved by having a lower investment limit than for Constant Net Asset Value Money Market Funds in which there is no risk of capital loss.

6.3 The risks involved in not adopting the recommendations are outlined in paragraphs 7.2 and 7.3 below.

6.4 By engaging Treasury Management Consultants, the Council is able to mitigate the risks described in paragraphs 6.1 and 6.2. These Consultants provide regular briefings, alerts and advice in respect of the Council's portfolio. The contract also includes training both in-house and by way of seminars so officers responsible for the Council's Treasury Management Function are fully competent. Adequate cover (fully trained) is provided within the Finance Department should there be a risk of staff shortages and procedure notes are under review.

7. ALTERNATIVE OPTIONS CONSIDERED

7.1 The approval of an annual Treasury Management Strategy is a requirement of the CIPFA Treasury Management in the Public Services Code of Practice, the latest version of which was adopted by the Council in 2011/12.

7.2 An alternative to the strategy being proposed for 2015/16 would be to vary the counterparty limits and investment periods from those currently in force in order to increase investment returns but this would expose the Council to increased credit risk and is not recommended.

7.3 The Council could also choose to reduce the minimum credit rating criteria instead. However, whilst this would achieve the stated aim of enhancing investment returns it would significantly increase credit risk within the investment portfolio leading to potential loss of capital.

APPENDIX A ANNUAL TREASURY MANAGEMENT STRATEGY PLAN 2015/16

1. GENERAL

1.1 This part of the report outlines the strategy that the Council will follow during 2015/16. Its production and submission to the Council is a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services.

1.2 The suggested strategy for 2015/16 in respect of the treasury management function is based upon the officers view on interest rates supplemented with forecasts provided by Capita Asset Services – Treasury Solutions (formerly known as Sector Treasury Services) who are the Council's treasury advisers.

1.3 It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from a) increases in interest charges caused by increased borrowing to finance additional capital expenditure b) any increases in running costs from new capital projects and c) the loss of interest on balances or reserves arising from their use in financing the capital expenditure are limited to a level which is affordable within the projected income of the council for the foreseeable future. This is covered by the Prudential Indicator calculating the Incremental Impact on the Council Tax or Housing Rent in paragraph 5.3 below.

1.4 A Glossary of Terms is included as Appendix F in order to aid Member's understanding of technical terms used in the field of Treasury Management.

2 INTEREST RATE FORECASTS FOR 2015/16

2.1 The ability to forecast the movement of interest rates is fundamental to successful investment and borrowing strategies. The Council employs Capita Asset Services – Treasury Solutions to provide interest rate forecasts and their latest view on both short and long term rates is shown in 2.2 overleaf. Their view on Bank Rate has been used to formulate the investment interest estimates for 2015/16 and future years and the PWLB rates are of particular interest in respect of the £136.157m PWLB debt taken out in late 2011/12 to finance the HRA Self Financing debt settlement as they will form the basis for any debt restructuring decisions that may be taken during 2015/16 although none are currently planned. The PWLB rates are also germane to any take up of the £13.843m borrowing headroom that the HRA has under the Self Financing regime.

2.2 The PWLB forecasts below, provided by Capita Asset Services, are based on the PWLB Certainty Rate.

Quarter	**Bank Rate**	**5 yr PWLB Rate**	**10 yr PWLB Rate**	**25 yr PWLB Rate**	**50 yr PWLB Rate**
Dec 2014	0.50%	2.00%	2.60%	3.30%	3.30%
Mar 2015	0.50%	2.20%	2.80%	3.40%	3.40%
Jun 2015	0.50%	2.20%	2.80%	3.50%	3.50%
Sep 2015	0.50%	2.30%	3.00%	3.70%	3.70%
Dec 2015	0.75%	2.50%	3.20%	3.80%	3.80%
Mar 2016	0.75%	2.60%	3.30%	4.00%	4.00%
Jun 2016	1.00%	2.80%	3.50%	4.20%	4.20%
Sep 2016	1.00%	2.90%	3.60%	4.30%	4.30%
Dec 2016	1.25%	3.00%	3.70%	4.40%	4.40%
Mar 2017	1.25%	3.20%	3.80%	4.50%	4.50%
Jun 2017	1.50%	3.30%	3.90%	4.60%	4.60%
Sep 2017	1.75%	3.40%	4.00%	4.70%	4.70%
Dec 2017	1.75%	3.50%	4.10%	4.70%	4.70%
Mar 2018	2.00%	3.60%	4.20%	4.80%	4.80%

2.3 The Monetary Policy Committee (MPC) utilises Bank Rate as one of its tools to control inflation in the economy and meet its target rate of 2% Consumer Prices Inflation (CPI).

2.4 Recent changes in market sentiment and outlook has led to Capita Asset Services revising their view of when Bank Rate might start to rise with the first rise being postponed from the June quarter of 2015 to the December quarter.These changes are:-

- The plunge in the price of oil has been the major surprise of the last three months.

This will reduce inflation and stimulate the economies of oil importing countries.

- There is a downside to the plunge in oil prices in terms of a sharp increase in the risk of emerging country debt default and emerging country oil producing corporate defaults. This could have a knock on effect on western banks who have lent to these areas and to hedge, pension and investment funds which have been wrong footed by holding debt or equities in these areas.
- There is still uncertainty around a potential Greek exit from the Euro should the anti EU and austerity party win the forthcoming general election. If they were to win it be likely to strengthen support for anti EU and austerity political parties in many EU countries. Italy is the greatest risk as it has the third biggest debt mountain in the world and has shown little progress so far in undertaking fundamental reforms to improve the competitiveness of the economy.
- UK GDP growth forecasts have recently been more subdued. The surge in UK growth during 2014 appears to have diminished and the year on year rate has subsided from 3.2% in Q2 to 2.6% in Q3. Forward indicators are also revealing some cooling of prospects going forward although growth will still remain strong, but not as strong as previously expected.

- The political risks around the UK general election in May 2015 have increased with the likely result now being very hard to predict.Whichever political party or coalition comes to power after the general election in May 2015 will still have to decide what balance of government spending cuts and/or tax increases will be needed to bring the public sector net borrowing deficit down

2.5 Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates. 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.

2.6 A more detailed economic analysis by Capita Asset Services – Treasury Solutions is included at Appendix E.

3 CAPITAL BORROWING AND CAPITAL PROGRAMME FINANCING STRATEGY

3.1 The Council is able to finance its capital programmes in the following ways:-

a) By the use of Prudential Borrowing. Currently it is anticipated that there will be no need to borrow in order to finance the Council’s 2015/16 capital programmes. However, should there be a need to borrow during the year it is likely, given that investment interest rates are forecast to be below long term borrowing rates for the year, that any borrowing will be of an internal nature i.e. from the Council’s cash balances.

b) From Usable capital receipts. With regard to the General Fund capital programme it is anticipated that it will be part funded by the balance of unused capital receipts carried forward to 2015/16 primarily arising from the sale of Wilton House in 2011/12.These will be supplemented by receipts arising from the expected sale of 10-14 Chapel Street, Warwick (£400,000) in 2015/16. The Housing Investment Programme anticipates 22 council house sales during 2015/16 resulting in £700,000 being available to part finance current and future expenditure alongside receipts in hand from previous years.

c) From revenue or reserves.

d) From external contributions and grants. With regard to the General Fund capital programme, it is anticipated that external contributions will be used to part finance the 2015/16 expenditure on Green Farm Play Equipment and Jubilee House. With regard to the Housing Investment Programme it is expected that grants and contributions amounting to £365,400 will be utilised to finance General Fund Housing RSL projects and Improvement Grants.

e) From Leasing or other similar means of capital finance.

3.2 With the exception of dedicated external grants and contributions, before deciding which of the above means of capital financing will be utilised to finance capital expenditure, the Council will conduct an options appraisal exercise where appropriate.

3.3 The financing of the Council’s proposed 2015/16 capital programmes (at January 2015) is shown in the table below:-

Financing Method	**General Fund £**	**Housing Investment Programme £**
Prudential Borrowing	0	0
Leasing	0	0
Capital Receipts	682,100	772,700
External Contributions	613,700	365,400
Revenue Contributions	0	256,700
Reserve Contributions	2,207,100	15,040,900
TOTAL	**3,502,900**	**16,435,700**

4. LONG TERM AND TEMPORARY BORROWING

4.1 The Council’s current long term borrowing portfolio consists of £136.157m PWLB debt. These loans were taken out to finance the HRA Self Financing settlement and the interest paid on this debt is entirely borne by the Housing Revenue Account and is provided for as part of the HRA Business Plan.

The first of these loans is scheduled to be repaid on 28th March 2053 with the final loan being repaid on 28th March 2062.

4.2 As part of their ongoing services, Capita Asset Services will monitor the debt portfolio during 2015/16 identifying, where appropriate, any opportunities for debt restructuring although these are expected to be minimal, if at all.

4.3 Should the Council engage in any long term borrowing during 2015/16, if deemed to be advantageous due to the expected path of interest rates, the Council may borrow in advance of need subject to prior appraisal of the risk and the borrowing must not take place in excess of 18 months before the anticipated need.

4.4 The major source of long term borrowing for local authorities is the Public Works Loans Board (PWLB) which is part of HM Treasury. However, the Local Government Association is in the process of creating an alternative called the Municipal Bond Agency. It is likely that this agency will be offering 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). Should this Council consider long term borrowing in the future then it will make use of this new source of borrowing as and when appropriate.

4.5 The Council will continue to engage in short term borrowing (up to 364 days) when necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. In each case, wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable. To date in 2014/15 the Council has not incurred any short term borrowing and is not expected to do so in 2015/16 either.

5. TREASURY LIMITS AND PRUDENTIAL INDICATORS FOR 2015/16 TO 2017/18

5.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Limit". The Council must have regard to the Prudential Code when setting its Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax / rent levels is acceptable. Whilst termed an Authorised Limit, the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements e.g. finance leases. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. The limits shown in the table in paragraph 5.2 include the impact of the HRA Self Financing debt settlement which took place on the 28th March 2012. It also includes the HRA "Headroom" which is the amount that the HRA can borrow between the debt settlement and the Debt Cap set under the Self Financing regime and also an allowance for potential land purchases within the HRA and the proposed new offices.

5.2 The Authorised Limits to be recommended to Council by the Executive were included in the Budget report presented to the Executive on 11th February and need to be ratified by the Council at its meeting on 25th February. They are also displayed in the table below :-

Authorised Limit	2014/15 (For Comparison) £,000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Debt	15,050,000	34,050,000	34,050,000	39,050,000
Add HRA Settlement	136,157,000	136,157,000	136,157,000	136,157,000
HRA Head Room	13,843,000	13,843,000	13,843,000	13,843,000
Other Long Term Liabilities	1,077,000	1,045,000	1,012,000	1,007,000
Total	166,127,000	185,095,000	185,062,000	190,057,000

5.3 The Prudential Indicators required by the code are explained in more detail in the report on the budget and those relevant to an integrated treasury management strategy are reproduced overleaf:-

That the Council has adopted the revised CIPFA Treasury Management Code of Practice which it did in February 2011.

<u>Capital Financing Requirement</u>

Year	General Fund (inc. GF HIP element)	HRA	Overall
2014/15 (for comparison)	-£1,326,896	£135,786,796	£134,459,900
2015/16	-£1,326,896	£135,786,796	£134,459,900
2016/17	-£1,326,896	£135,786,796	£134,459,900
2017/18	-£1,326,896	£135,786,796	£134,459,900

The Capital Financing Requirement (CFR) as shown in the table above is a measure of the Council's underlying need to borrow in order to meet past capital expenditure. Currently, as the capital programmes are expected to be fully funded from sources other than borrowing (including leases) no increase is forecast to the CFR's. The CFR would normally be reduced by any provision for the repayment of debt each year. As the GF CFR is negative this is not required and in the case of the HRA debt redemption is not scheduled to start until year 41 (2052/53) of the current Business Plan.

Incremental Impact on Council Tax / Housing Rents

Year	Council Tax	Housing Rent
2014/15 (for comparison)	£3.83	£0.00
2015/16	£3.93	£0.51
2016/17	£2.94	£0.77
2017/18	£4.81	£1.13

Operational Boundary for External Debt

Operational Boundary	2014/15 (For Comparison) £,000	2015/16 Estimate £,000	2016/17 Estimate £,000	2017/18 Estimate £,000
Debt	1,050,000	1,050,000	1,050,000	1,050,000
Add HRA Settlement	136,157,000	136,157,000	136,157,000	136,157,000
HRA Head Room	13,843,000	13,843,000	13,843,000	13,843,000
Other Long Term Liabilities	79,000	45,000	12,000	9,000
Total	151,129,000	151,095,000	151,062,000	151,059,000

As a result of HRA Self Financing, the Council is also limited to a maximum HRA CFR. This limit is currently:-

HRA Debt Limit	2014/15 (for comparison)	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Total	150.00	150.00	150.00	150.00

5.4 In addition certain indicators that used to be part of the Prudential Code are now part of the Treasury Management Code of Practice and are shown below :-

Upper limits to fixed interest rate and variable interest rate exposures on borrowing

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2015/16	100%	30%
2016/17	100%	30%
2017/18	100%	30%

Upper and Lower Limits respectively for the Maturity Structure of Fixed Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	6%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	20%	0%
10 years and above	94%	0%

Upper and Lower Limits respectively for the Maturity Structure of Variable Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

5.5 **Principal sums invested for periods longer than 364 days**

The total maximum sum that can be invested for more than 364 days is 60% of the core investment portfolio subject to a maximum of £15 million at any one time. However, where investments which originally were for periods of more than 364 days have 364 days or less to maturity at the 1st April each year they shall be classed from that date as short term i.e. less than 364 day investments and will not count against the 60% or £15 million limit.

6. BEST VALUE

6.1 The Council participates in Capita Asset Services' investment risk management benchmarking service in order to provide benchmarks against which the in house function could monitor its performance. The Council is part of a local group comprising both District and County Councils and our investment rate of return is benchmarked on a weighted average basis against the Capita Asset Services Model Portfolio and the returns experienced by the other club members. In 2015/16, the Council will seek to achieve a weighted average rate of return in line with the Capita Asset Services Model Portfolio which is based upon the best possible return whilst providing the maximum security for the capital invested.

6.2 The internal treasury function will also seek to achieve an average rate of return on its Money Market investments of 0.0625% over the LIBID (London Inter Bank Bid Rate) average for comparable investment periods (e.g. up to 7 day, 1 to 3 months, 3 to 6 months and over 6 months).

6.3 Should the Council employ external investment agents during 2015/16 suitable performance indicators will be agreed with the agents similar to that which operated under the previous Invesco agreement e.g. the fund will be required to outperform the Financial Times 7 day LIBID rate compounded weekly with a target return of 110% of the benchmark over a 3 year rolling period.

6.4 The Council's performance is reported half-yearly to the Finance and Audit Scrutiny Committee.

7. EXTERNAL TREASURY MANAGEMENT ADVISERS

7.1 The Council employs Capita Asset Services – Treasury Solutions as its Treasury Management advisers. Their current contract expired on 5th January 2015 and following a procurement exercise they have been re-appointed for another three years with an option to extend the contract for a further two years.

8. BANKING SERVICES

8.1 The Council currently employs HSBC Bank to provide its banking services and. the current contract expires on 1st March 2015. Following a procurement exercise, HSBC has been re-appointed as the Council's bankers for a further term of 5 years with the option to extend the contract for a further 5 years.

9. TRAINING

9.1 The CIPFA Code requires that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Following the 2015 Council elections, our treasury consultants will deliver in house training to the members of the new Finance & Audit Scrutiny Committee to ensure that they fully appreciate their role in the Council's Treasury Management function.

9.2 Those officers currently involved in treasury management have received training from the Council's treasury consultants and this has been and will be kept up to date by regular attendance at seminars held by our consultants and also through other sources such as CIPFA pubilcations and market intelligence.

10. OTHER ISSUES

10.1 The Council has entered into a joint venture with Waterloo Housing Association in which Council land will be sold on a deferred basis to the Housing Association in order to provide resources for additional social housing. During 2012/13, Kingsway Community Centre was sold to Waterloo on this basis and similar disposals have taken place in 2014/15 in respect of Bourton Drive and Henley Road garage sites. Executive approval has also been given to dispose of part of West Rock car park and land at Market Street in Warwick under the same arrangement. Local Authority accounting requires that a certain portion of the deferred capital receipt has to be treated as investment income and the Treasury Management function will be advising on the accounting transactions involved.

10.2 Should the Council explore other initiatives with treasury management implications e.g. the creation of a wholly owned Council Housing company the Treasury Management function will advise as necessary.

APPENDIX B 2015/16 ANNUAL INVESTMENT STRATEGY

1. BACKGROUND

1.1 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. Section 15(1) of the 2003 Local Government Act requires councils to have regard to such guidance as the Secretary of State may issue. Guidance was issued in 2004 and has subsequently been updated with the last major change being that Local Authorities who invest in Corporate Bonds no longer need to account for these as capital transactions i.e. capital expenditure. The general policy objective is that local authorities should invest prudently the temporarily surplus funds held on behalf of their communities. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public.

2. INVESTMENT VEHICLES AND CREDITWORTHINESS POLICY

2.1 In line with the guidance, this Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the headings of Specified and Non Specified Investments. These are listed in paragraph 2.11 and detailed in Annex 1.

2.2 Specified investments are defined as those with a high credit rating, as outlined in the table below for each type of investment institution or vehicle. For deposits with Banks this is a Fitch sovereign rating at least equal to that of the United Kingdom at the point at which the investment was taken out, at least F1 short term and A+ long term (except in the case of a part or fully nationalised UK bank where the debts are guaranteed by the UK Government in which case the minimum long term rating will be A) , In addition, in order to be on the Council's counterparty list, currently the institution must also have a Fitch Viability rating of at least BBB and a support rating of 1. An explanation of credit rating terms appears in Appendix D.

2.3 However, the main rating agencies (Fitch, Moody's and Standard & Poor's) have, been reviewing the use of the Viability and Support ratings (or their equivalent) which through much of the financial crisis, provided some institutions with a ratings "uplift" based on their ability to stand alone or implied levels of sovereign support. More recently, in response to the evolving regulatory regime e.g. the proposed requirement for investors to "bail in" and support an institution rather than for the Government to bail it out , the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion so at present no changes are being proposed to our minimum credit rating criteria but at some point we may need to amend our credit rating criteria to reflect the discontinuation of the Viability and Support ratings and approval for this will be sought from the Executive.

2.4 It is important to stress that the potential rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

2.5 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

2.6 Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

2.7 In addition to the Fitch ratings, the Council will also have regard to the ratings published by the other 2 main agencies, Moody's and Standard & Poors together with any ratings watch notices issued by the 3 agencies as well as articles in the Financial press and market data. In addition to credit ratings the Council will also use Credit Default Swap data as supplied by Capita Asset Services – Treasury Solutions to determine the suitability of investing with counterparties. Credit Default Swaps (CDS) are a form of "insurance premium" against defaulting taken out by investors when making investments and if the Market perceives problems with the counterparty then the margin on the CDS will widen (i.e. the insurance premium will increase) thus providing warnings for future investors with that counterparty that it might have problems repaying their investment. The Council will monitor the CDS's on the counterparties within its lending list and if there are significant movements on a counterparty such as it moves out of a pre-determined range which will be determined with the aid of the Councils Treasury Consultants then that counterparty will be removed from the list until such time as it moves back within range.

2.8 For 2015/16, it is proposed to add a new investment vehicle, Covered Bonds, to the list of Specified and Non Specified Investments. Covered Bonds are issued by the same sorts of institutions as issue Corporate Bonds and are a type of secured bond that is usually backed by mortgages or public sector loans. In the UK, the assets backing the bond are transferred to a separate legal entity (a Special Purpose Vehicle or SPV) and form collateral for the bonds. The asset pool of a covered bond is dynamic in that mortgages that are refinanced or which fall into arrears can be replaced with new mortgages of similar credit quality and characteristics and this continues for as long as the issuer of the bond remains solvent. This ensures that in normal circumstances there are always sufficient funds in the SPV asset pool to cover the capital value of the bond and the interest payments. If the issuer of the bond defaults on either capital or interest payments for any reason i.e. becomes insolvent then the SPV takes responsibility for administering the bond and ensures that payments are made to bondholders on the agreed dates. In the event that there are insufficient assets in the SPV's asset pool to meet all the obligations then for the residual amount the Council would become an unsecured creditor of the failed issuer.

2.9 Covered Bonds are rated with the ratings being linked to the underlying position of the issuer as well as the dynamics of the bond itself. Typically these bonds are rated AAA by the rating agencies and thus are more secure than ordinary Corporate Bonds which usually reflect the credit quality of the issuer alone rather than the bond itself. The Council's minimum long term rating for investing in Corporate Bonds is A+ (A for financial institutions wholly or partly owned by the UK Government) and therefore it seems appropriate to specify that the minimum credit rating for investing in a Covered Bond will be the same as applies for Corporate Bonds. As already mentioned, the vast majority of sterling denominated bonds are rated AAA so their credit quality is well in excess of our minimum requirement and this also provides a buffer should a bond to be downgraded which can happen although rarely. This will avoid the necessity to sell the bond prematurely and potentially incur a capital loss merely because the bonds long term rating has fallen below our minimum requirement. The Council will buy covered bonds on a "buy to hold" basis, that is, the bond will be held until it matures therefore although a bond may be downgraded which will affect its marketability and trading price, it will not affect the capital value of the bond when it matures and the Council will receive the full value of its investment.

2.10 The sterling denominated bond market is not large and these bonds can be difficult to obtain so their use by the Council is likely to be limited but they do provide another investment vehicle that can be used to spread our counterparty risk and possibly pick up some long term yield whilst still being of the highest credit quality.

2.11 The types of investment that the council can use are listed below and described in more detail in Annex 1. These are split under the headings of specified and non-specified in accordance with statutory guidance.

Specified Instruments (maximum period 364 Days)

- Deposits with banks and building societies
- Deposits with UK Government, Nationalised Industries, Public Corporations, UK Housing Associations and UK Local Authorities
- UK Government Gilts with less than one year to maturity
- Debt Management Agency Deposit Facility (DMADF)
- Constant Net Asset Value Money Market Funds (AAA rated)
- Variable Net Asset Value Money Market Funds (AAAf rated)
- Certificates of deposits issued by banks and building societies
- Corporate Bonds issued by private sector financial institutions
- Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government
- Corporate Bonds issued by corporates
- Covered Bonds issued by private sector financial institutions

- Covered Bonds issued by financial institutions partly or wholly owned by the UK Government
- Covered Bonds issued by corporates
- Supranational Bonds issued by Supranational Institutions or Multi Lateral Development Banks
- Floating Rate Notes issued by private sector financial institutions
- Floating Rate Notes issued by financial institutions partly or wholly owned by the UK Government
- Floating Rate Notes issued by corporates
- Eligible Bank Bills
- Sterling Securities guaranteed by HM Government

Non Specified Investments

- Deposits with unrated building societies
- Deposits with banks and building societies greater than 364 days
- Deposits with UK Housing Associations and UK Local Authorities greater than 364 days
- Certificates of deposits issued by banks and building societies greater than 364 days
- Corporate Bonds issued by private sector financial institutions greater than 364 days
- Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
- Corporate Bonds issued by corporates greater than 364 days
- Covered Bonds issued by private sector financial institutions greater than 364 days
- Covered Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
- Covered Bonds issued by corporates greater than 364 days
- Corporate Bond Funds
- Regulated Property Funds including Real Estate Investment Trusts
- CCLA Property Fund
- Day to Day balances where Council's bankers do not meet the minimum bank credit rating criteria
- UK Government Gilts with over 364 days to maturity
- Supranational Bonds issued by Supranational Institutions or Multi Lateral Development with over 364 days to maturity

2.12 It is necessary to outline the reasons why the Council would use non specified investments and also the risks involved. The use of unrated building societies alongside Business Reserve and Call Accounts and Money Market Funds forms a useful tool for investing relatively small amounts of money for short periods of time (up to 3 months) and obtaining a decent return on the investment. There is of course a risk that the Building Society may fail during the maximum 3 month duration of an investment but this is not considered likely. As an additional safeguard, the Council will only invest in Category C i.e. unrated Building Societies with an asset value of £500m and over. In addition, investments in category C building societies are restricted to a group limit of £8m. With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime which is unlikely in the timeframe of the 2015/16 strategy. The current limit for investments longer than 364 days is 60% of the core investment portfolio subject to a maximum of £15 million at any one time and the maximum duration is 10 years for Property and Corporate Bond Funds, 5 years for investments with other Local Authorities and 2 years for all other counterparties. There are no plans to change these limits for 2015/16.

2.13 No investments for more than 364 days excluding any forward deal periods will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment and any investments over 364 days with building societies will be limited to £1m per counterparty**.**

2.14 Although the Council does not expect to use external investment agents in 2015/16, they are included in the circumstance of use column in the previous tables to allow for their possible use should it be appropriate to do so.

2.15 As a means of further diversifying risk whilst obtaining a reasonable return for cash flow derived investments, the Council uses the SunGard Money Market Funds Portal which will enable it to open further Money Market Funds as necessary and to be able to see on a daily basis before deciding with whom to invest, which funds are offering the best rates.

3. INVESTMENT OBJECTIVES

3.1 All investments will be in sterling. The Council's investment priorities are the security and liquidity of its investments. The Council's objective will be to maximise the return whilst safeguarding the capital sum and avoiding cash flow problems. The Council will not engage in borrowing for purely investment purposes.

4. SECURITY OF CAPITAL

4.1 The Council relies on credit ratings published by Fitch Ratings which are supplied to it by its Treasury Advisers, whilst not the principal credit rating service used by the Council, attention will also be paid to credit ratings published by Moody's Investor Services and Standard & Poor's which are also supplied by Capita Asset Services – Treasury Solutions in order to broaden the sources of intelligence from which the Council gathers opinions on the performance of its investment counterparties. These ratings are used to establish the credit quality of counterparties and investment schemes. These institutions also issue regular ratings watch bulletins and where these are negative and affect one of our counterparties this will be taken into account when deciding whether or not to place future investments with them. The Council has also determined the minimum long term (365 days or more), short term (364 days or less) and other credit ratings it deems to be high for each category of investment and these are as shown in paragraph 2.2 above.

4.2 Individual credit ratings will be revised as and when changes are notified to the Council by its Treasury Advisers. If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria then the counterparty / investment vehicle will no longer be used with immediate effect. This also applies to investments placed by fund managers. Similarly if a counterparty is upgraded so that it meets the Council's minimum credit rating requirements then it will be added to the Council's counterparty list.

4.3 The Council will also use the Credit Default Swap (CDS) information supplied by its Treasury Consultants to determine levels of investments with its counterparties once they have been selected using the criteria set out in 2.2 above. Counterparties with an in range CDS (as determined by our consultants) will be invested in as per the limits defined for that particular category of counterparty . Those counterparties with either a monitoring or an out of range status will not be invested in until their CDS returns to within range.

5. INVESTMENT BALANCES / LIQUIDITY OF INVESTMENTS

5.1 Based on its cash flow forecasts, the Council anticipates that its investments in 2015/16 on average will be in the region of £50m of which £24m will be "core" investments i.e. made up of reserves and balances which are not required in the short term**.**

5.2 The maximum percentage of its core investments that the Council will hold in long term investments (365 days or over) is 60%. It follows therefore that the minimum percentage of its overall investments that the Council will hold in short term investments (364 days or less) is 40%. Having regard to the Council's likely cash flows and levels of funds available for investment the amount available for long term investment will be a maximum of 60% of the core investment portfolio subject to a total of £15 million at any one time in line with the proposed Prudential Indicator covering this issue. These limits will apply jointly to the in house team and any fund manager so that the overall ceilings of 60% and £15 million are not breached.

6. INVESTMENT STRATEGY

6.1 The Council will continue to make use of MoneyMarket Funds (MMF's) and the Money Markets to invest cash flow driven money to known dates where large debts such as precepts, NNDR etc. have to be paid out. Based on the cash flow experienced to date in 2014/15 it is unlikely that this will result in the average length of a cash flow investment being more than 3 months in 2015/16 and probably considerably less. Core investments (i.e. investments not needed for payment of debts) will continue to be invested in the best part of the market based on the advice issued by our Treasury Advisers.

6.2 The 2015/16 interest rate outlook is for Bank Rate to rise to 0.75% by the end of 2015/16.Whilst this is welcome, in order to try and maximise the return on our investments whilst fully protecting the security of the capital, the Treasury Function has considered various ideas and it is proposed that Covered Bonds are added to the types of investment vehicles in which the Council is permitted to invest and any such investments will count against the overall limit for each type of counterparty as defined in the table in Annex 1.

6.3 Based on current investment policies and interest rate projections, it is currently estimated that the overall portfolio will achieve a 0.80% return for 2015/16.

7. EXTERNAL CASH FUND MANAGEMENT

7.1 The performance of fund managers will be kept under review using our Treasury Consultants and should it be felt appropriate to do so then the Council may engage a fund manager in order to enhance returns and spread risk. The appointment process will be subject to the Council's procurement rules and handled in conjunction with our Treasury Consultants in order to ensure that the Council secures best value.

8. END OF YEAR INVESTMENT REPORT

8.1 In accordance with the requirements of the Treasury Management Code of Practice, the Treasury Management function reports on its in year activities to the Finance & Audit Scrutiny Committee twice a year i.e. at mid year and at the end of the year.

APPENDIX C

MINIMUM REVENUE PROVISION POLICY STATEMENT

1. BACKGROUND

1.1 Capital expenditure can be financed in a number of ways, not least of which is through borrowing and credit arrangements such as finance leases. The use of these 2 methods involves the Council in setting aside resources each year in order to eventually pay off the liability for example a maturing PWLB loan. Until recently, this set aside was prescribed nationally through Statutory regulations and was set at 4% per annum of the General Fund Capital Financing requirement (CFR). There was no similar requirement within the Housing Revenue Account although Council's could make voluntary provision if they so wished. The statutory regulations were superseded by statutory guidance issued under Statutory Instrument 2008 no.414 which says that "A local authority shall determine for the current financial year an amount of minimum revenue provision (MRP) that it considers prudent" .Where a Council's CFR at the end of the preceding year is nil or negative there is no requirement to charge MRP.

1.2 It is a requirement of the statutory guidance that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. THE FOUR MAIN OPTIONS

Option 1 – Regulatory Method

2.1 This option is the old statutory method of 4% of the CFR and which has to be used in order to calculate MRP on all debt still outstanding at 1/4/08 and it can also be used to calculate MRP on debt incurred under the new system but which is supported through the annual SCE (Supported Capital Expenditure) allocation from DCLG.

Option 2 – Capital Financing Requirement Method.

2.2 This is a variation of option 1 and is based upon 4% of the CFR with certain changes and is appropriate where the borrowing is not linked to a particular asset.

Option 3 – Asset Life Method.

2.3 Under this option, it is intended that MRP should be spread over the useful life of the asset financed by the borrowing or credit arrangement. In future, where borrowing is utilised to finance specific assets it is likely that the period of the loan will match the expected life of the asset and therefore, under this method the annual charge to the Council's accounts is directly related to building up the provision required to pay off the loan when it matures which under options 1 and 2 is not possible.

2.4 There are 2 methods of calculating the annual charge under this option a) equal annual instalments or b) by the annuity method where annual payments gradually increase during the life of the asset.

Option 4 – Depreciation Method.

2.5 This is a variation on option 4 using the method of depreciation attached to the asset e.g. straight line where depreciation is charged in equal instalments over the estimated life and the reducing balance method where depreciation is greater in the early years of an assets life and which is most appropriate for short lived assets e.g. vehicles. In this Council's case assets are depreciated using the straight line method and so option 4 is not materially different from option 3.

3. HRA MINIMUM REVENUE PROVISION.

3.1 Under the Self Financing regime, the HRA Business Plan has to provide resources for the repayment of the £136.157m borrowed from the PWLB on the 28th March 2012. Repayment of this debt is currently provided for commencing in year 41 (2052/53) and continuing through to year 50 year of the Business Plan. Provision will also have to be made for any use made of the £13.843m "headroom" between the Self Financing debt settlement i.e. the PWLB borrowing and the "Debt Cap" imposed by the Government.

4. RECOMMENDATION FOR 2015/2016.

4.1 It is recommended that for any long term borrowing on the General Fund which is incurred in 2015/2016, the following methods of Minimum Revenue Provision be adopted:-

For borrowing which cannot be linked to a particular asset – Option 2.
For borrowing linked to a particular asset – Option 3 based on the annuity method.

4.2 For any borrowing incurred through Finance Leases, the annual principal repayments in the lease are regarded as MRP.

4.3 Although not strictly part of Minimum Revenue Provision requirements, it is also recommended that for internal borrowing (i.e. capital expenditure financed from reserves) , where appropriate, Option 3 based on the annuity method be adopted as a means of replenishing those reserves which financed the capital expenditure.

4.4 With regard to the HRA, annual MRP to be equal to any amounts set aside for debt repayment within the Business Plan which currently is nil for 2015/16.

APPENDIX D

AN EXPLANATION OF CREDIT RATING TERMS

1. Sovereign Credit Rating

1.1 Fitch assigns a long term credit rating to the country in which the financial institution being rated is domiciled. This credit rating assesses the economic health of the country including its ability to service its debt and also its capacity to support the banking system in that country should financial support be required. The assessment follows the normal long term rating scale, the highest rating being AAA with anything below BBB being non investment grade i.e. "junk bond status". The UK has a AA+ Fitch rating and the Council's policy is to invest only in institutions where the state in which they are domiciled has at least the same sovereign rating as the UK at the point in time when the investment was placed.

2. International Long - Term Credit Ratings

2.1 Long - term credit ratings are an attempt to assess the ongoing stability of an institutions prospective financial condition given such factors as sensitivity to fluctuations in market conditions and the capacity for maintaining profitability or absorbing losses in a difficult operating environment. Traditionally they look beyond a 12 month horizon. Investment grade ratings range from BBB to AAA.

2.2 With the exception of those institutions referred to in paragraph 2.3, the minimum rating that WDC will use is A+ which is mid range in the ratings referred to above. A ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. + is used to indicate a better than average status within the category.

2.3 Where an institution is either partly or wholly owned by the UK Government e.g. Lloyds Banking Group, Royal Bank of Scotland the minimum long term rating will be A in recognition of the fact that the UK Government is behind the institution as "lender of last resort".

3. International Short - Term Credit Ratings

3.1 A short - term rating has a timescale of less than 12 months for most obligations and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

3.2 The minimum rating that WDC will use is F1. This indicates the strongest capacity for timely payment of financial commitments. It may have a + added to it to denote any exceptionally strong credit feature.

4. Viability Ratings

4.1 Currently the viability rating represents the capacity of a bank to maintain ongoing operations and to avoid failure in the absence of external e.g. Governmental support , Thus, viability ratings permit an evaluation separate from any consideration of outside support.

4.2 The Council's minimum individual rating is BBB which denotes good prospects for ongoing viability. The bank's fundamentals are adequate such that there is a low risk that it would have to rely on extraordinary support to avoid default. However, adverse business or economic conditions are more likely to impair this capacity rather than say an A rating.

4.3 As per paragraph 2.3 of Appendix B, these ratings are likely to be discontinued at some point either during 2014/15 or 2015/16.

5. Support Indicator

5.1 This indicator gives an indication as to how much external support , predominately from the state, a bank could expect to receive if it were to run into difficulties. The range is from 1 to 5 with 1 being the highest degree of support and 5 the lowest. 1 is assigned only to banks for which there is an extremely high probability of external support e.g. Barclays Bank in the UK. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question e.g. the UK Government which is rated AA+. WDC will only invest in institutions with a Support Indicator of 1.

5.2 As per paragraph 2.3 of Appendix B, these ratings are likely to be discontinued at some point either during 2014/15 or 2015/16.

APPENDIX E

Capita Asset Services' View of the Economic Background

1. The UK Economy.

1.1 After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

1.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

2. The Eurozone (EZ).

2.1 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and

September 2014 to loosen monetary policy in order to promote growth and the ECB embarked on full quantitative easing (purchase of EZ country sovereign debt) in January 2015.

2.2 Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

2.3 The Greek general election took place on 25 January 2015 and resulted in the election of a political party which is anti EU and anti austerity. It is too early to forecast the impact of this election result but already Germany has said that it expects Greece to fully honour its obligation to repay its debt whereas the new Greek Prime Minister has said that such expectations are unrealistic. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

3. Other Economies.

3.1 The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

3.2 The Chinese Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

3.3 Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

4. Capita Asset Services Forward View

4.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

4.2 The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

4.3 The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

4.4 The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

4.5 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK’s main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

4.6 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government

- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.

- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.

- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into equities.

- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

APPENDIX F

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Bank Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a

	swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.

Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.