AGENDA ITEM No.5(ii)

EAST RENFREWSHIRE COUNCIL

AUDIT AND SCRUTINY COMMITTEE

20 February 2020

Report by Head of Accountancy (Chief Financial Officer)

Treasury Management Strategy Report for 2020/21

PURPOSE OF REPORT

1. To advise the Audit and Scrutiny Committee on the treasury management strategy for the financial year 2020/21.

RECOMMENDATIONS

2. It is recommended that Members:-

   (a) consider the content of the Treasury Management Strategy Report for 2020/21; and

   (b) recommend to the Council that the Treasury Management Strategy for 2020/21 be approved, including the amended list of organisations for investment of surplus funds (Annex F); and.

   (c) recommend to the Council that they approve the policy on the repayment of loans fund advances, see section 3.4

BACKGROUND

3. In line with the CIPFA Treasury Management Code of Practice 2017, the Audit and Scrutiny Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. The attached Treasury Management Strategy Report for the financial year 2020/21 is submitted in accordance with this requirement.

TREASURY MANAGEMENT STRATEGY FOR 2020/21 (TMS)

5. The TMS for 2020/21 is attached (see Appendix 1).

EQUALITY IMPACT

6. A screening exercise has revealed that the Treasury Management Strategy has no direct relevance to the Council's equality duties

Report Author

Head of Accountancy (Chief Financial Officer):	Margaret McCrossan
Chief Accountant:	Barbara Clark
Telephone Number:	0141 577 3068
E-mail:	barbara.clark@eastrenfrewshire.gov.uk

Report Date: February 2020

BLANK PAGE

APPENDIX 1

EAST RENFREWSHIRE COUNCIL

TREASURY MANAGEMENT STRATEGY 2020/21

BLANK PAGE

CONTENTS

1 Background

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

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

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

> "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 Reporting Requirements

2.1 The Council is required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimated and actual figures. These reports are as follows:-

a) **Treasury Management Strategy 2020/21** (this report).

This report is the most important of the three reports and covers:

- The capital plans of the Council (including prudential indicators);
- A policy for the statutory repayment of debt (how residual capital expenditure is charged to revenue over time);
- The Treasury Management Strategy (how the investments and borrowings are organised) including treasury indicators, and
- A permitted investment strategy (the parameters on how investments are to be managed).

b) **Mid-Year Treasury Management Report –** This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary and whether any policies require revision.

c) **Annual Treasury Report –** This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimate within the strategy.

2.2 Scrutiny

These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Scrutiny Committee.

2.3 Capital Investment Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital investment strategy report, which will provide the following:

- A high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital investment strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

2.4 Treasury Management Strategy for 2020/21

The treasury management issues covered by this report are:

Capital Issues

- The capital expenditure plans and associated prudential indicators
- The loans fund repayment policy

Treasury management issues

- The current treasury position
- Treasury indicators which will limit the treasury risk and activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy and
- Credit Worthiness Policy

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code (the Prudential Code), the CIPFA Treasury Management Code and Scottish Government Investment Regulations.

2.5 Treasury Management Consultants

The Council uses Link Asset Services Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that it does not rely solely upon information and advice from its treasury advisors.

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

2.6 Council and Subsidiary Organisations

The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations i.e. East Renfrewshire Culture & Leisure Trust).

3 The Capital Prudential Indicators 2020/21 – 2024/25

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

A summary of the indicators can be found in Annex A

3.1 Capital Expenditure (Prudential Indicator PI-1)

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. The indicator also includes expenditure financed by PFI and leasing type arrangements which, for the purposes of financial planning and reporting, must be treated as capital expenditure.

The following capital expenditure forecasts are in line with the general fund capital plan for 2020/21-2027/28 and housing capital plan 2020/21- 2024/25 which will be submitted to Council on 27 February 2020 together with the additional expenditure outlined above:

Capital Expenditure (PI-1) £'000	2018/19 Actual	2019/20 Probable	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund – Capital Programme	32,559	44,186	43,093	50,243	44,567	19,435	15,088
– Other Relevant Expenditure	-	-	-	-	-	-	-
General Fund Subtotal	**32,559**	**44,186**	**43,093**	**50,243**	**44,567**	**19,435**	**15,088**
Housing	**8,628**	**9,551**	**17,589**	**19,620**	**7,867**	**6,314**	**4,114**
Total	**41,187**	**53,737**	**60,682**	**69,863**	**52,434**	**25,749**	**19,202**

3.2 Capital Financing Assumptions

The table below summarises the capital expenditure plans for the general fund and how these plans are being financed. Any shortfall of resources results in a funding borrowing need.

General Fund £'000	2018/19 Actual	2019/20 Probable	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Expenditure	32,559	44,186	43,093	50,243	44,567	19,435	15,088
Other Relevant Expenditure		-	-	-	-	-	-
Total	32,559	44,186	43,093	50,243	44,567	19,435	15,088
Financed by:							
Capital Receipts	1,903	101	4,450	850	-	-	-
Capital Reserve	8,466	1,200	-	-	-	-	-
Developer Contributions	693	594	1,366	854	906	724	734
Govt. General Capital Grant	6,866	7,957	5,346	6,634	6,634	6,634	6,634
Govt. Specific Capital Grants	7,363	7,317	6,250	675	1,515	675	1,115
Other Grants & Contributions	460	-	-	-	-	-	-
Repairs & Renewals Fund/CFCR	2,339	-	-	-	-	-	-
Net Borrowing Requirement for the year	**4,469**	**27,017**	**25,681**	**41,230**	**35,512**	**11,402**	**6,605**

As part of the long term capital planning process, the 2019/20 probable capital outturn has been reduced by £2,059,000 below the level reported to Cabinet on 28 November 2019. In addition the level and timing of capital income has reduced by £777,000, this therefore has impacted on the amount of borrowing required which has reduced by £1,282,000. These revisions will be incorporated within the 2019/20 monitoring report submitted to Cabinet during March 2020.

The table below summarises the capital expenditure plans for housing and how these plans are being financed. Any shortfall of resources results in a borrowing requirement.

Housing £'000	**2018/19 Actual**	**2019/20 Probable**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Capital Expenditure	8,628	9,551	17,589	19,620	7,867	6,314	4,114
Financed by:							
Capital Receipts – Right to Buy	204	-	-	-	-	-	-
Capital Receipts – Land Disposal	-	-	-	500	500	500	500
Recharges to Owners	-	300	100	100	100	100	100
Govt. Specific Capital Grants	2,898	1019	4,804	5,757	1,500	165	165
Commuted Sums	121	220	-	1,025	325	-	-
CFCR	300	-	-	-	-	-	-
Net Borrowing Requirement for the year	**5,105**	**8,012**	**12,685**	**12,238**	**5,442**	**5,549**	**3,349**

The table below summarises the borrowing requirement resulting from both the general fund (including PFI and leasing type arrangements) and housing capital plans.

Borrowing Requirement £'000	**2018/19 Actual**	**2019/20 Probable**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
General Fund	4,469	27,017	25,681	41,230	35,512	11,402	6,605
Housing	5,105	8,012	12,685	12,238	5,442	5,549	3,349
Net Borrowing Requirement for the year	**9,574**	**35,029**	**38,366**	**53,468**	**40,954**	**16,951**	**9,954**

3.3 The Council's Borrowing Requirement (the Capital Financing Requirement – Prudential Indicator PI-2)

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

The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing. From 1 April 2016 authorities may choose whether to use scheduled debt amortisation (loans pool charges) or another suitable method of calculation in order to repay borrowing.

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

schemes. The Council has liabilities of £90.480m relating to such schemes as at 31 March 2019.
The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £'000	2018/19 Actual	2019/20 Probable	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund	160,097	175,112	191,235	223,072	248,820	249,432	244,419
Housing	28,682	34,127	43,837	53,009	55,065	57,073	56,549
Total CFR (PI-2)*	**188,779**	**209,239**	**235,072**	**276,081**	**303,885**	**306,505**	**300,968**

Net borrowing requirement for the year (above)		35,029	38,366	53,468	40,954	16,951	9,954
Less scheduled debt amortisation and other financing movements		(14,569)	(12,533)	(12,459)	(13,150)	(14,331)	(15,491)
Movement in CFR		**20,460**	**25,833**	**41,009**	**27,804**	**2,620**	**(5,537)**

**The CFR for this calculation includes capital expenditure to 31 March of each financial year.*

3.4 Statutory Repayment of Loans Fund Advances

The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

- For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the Statutory Method (in line with Schedule 3 of the Local Government (Scotland) Act 1975), with all loans fund advances being repaid by the annuity method in line with the repayment profile determined in previous years.

- Loans fund advances relating to City Deal projects which will be supported in later years by Government funding will be repaid in accordance with the funding/income profile method. This links the repayments to the project income stream.

- For loans fund advances made after 1 April 2016, excluding the above, the Council will continue to calculate loan charge repayments in line with Schedule 3 of the Local Government (Scotland) Act 1975, using an annuity rate of 4%. The Council is permitted to use this option for new borrowing taken out over a transitional period of five years until 31 March 2021. Thereafter a new policy approach based on depreciation, asset life periods or funding/income profile must be adopted for any further new borrowing.

Additionally, the Scottish Government have reviewed legislation allowing Council's to vary loans fund repayments for advances based on prudent principles. Accountancy Services, in agreement with our External Auditors, have reviewed the Council's loans fund and incorporated planned changes to the repayment's schedule in the revenue estimates ensuring that each year's repayment amount is reasonably commensurate with the period and pattern of benefits.

The Non-HRA loans fund balances are expected to be, with year 1 being 2019/20:

£'000	Year 1	Years 2-5	Years 5-10	Years 10-15	Years 15-20	Years 20+
opening balance	69,617	89,365	177,989	166,852	137,169	115,451
advances	27,017	102,423	21,793	3,078	-	-
repayments	(7,269)	(13,799)	(32,930)	(32,761)	(21,718)	(115,451)
closing balance	89,365	177,989	166,852	137,169	115,451	-

The HRA loans fund balances are expected to be, with year 1 being 2019/20:

£'000	Year 1	Years 2-5	Years 5-10	Years 10-15	Years 15-20	Years 20+
opening balance	28,683	34,128	55,065	58,835	52,691	39,126
advances	8,012	30,365	19,312	6,331	-	-
repayments	(2,567)	(9,428)	(15,542)	(12,475)	(13,565)	(39,126)
closing balance	34,128	55,065	58,835	52,691	39,126	-

4 Borrowing

Section 3 provides a summary of the capital expenditure plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional Codes, so that sufficient cash is available to meet service activity and the Council's Capital Investment Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

The Council's actual and projected debt portfolio is summarised below. The table compares the actual and projected external debt against the Council's estimated borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

£'000 as at 31 March	2018/19 Actual	2019/20 Probable	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing	89,951	114,788	142,227	184,843	214,015	213,638	213,623
Other Long Term Liabilities	90,480	85,747	80,960	75,954	70,830	65,548	60,055
Total Gross Debt (Prudential Indicator PI-3)	**180,431**	**200,535**	**223,187**	**260,797**	**284,845**	**279,186**	**273,678**
CFR – the borrowing need	**188,779**	**209,239**	**235,072**	**276,081**	**303,885**	**306,505**	**300,968**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(8,348)**	**(8,704)**	**(11,885)**	**(15,284)**	**(19,040)**	**(27,319)**	**(27,290)**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-3) is that the Council needs to ensure that its gross debt figure (shown above) 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 2020/21 and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

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

4.2 Treasury Indicators: Limits to Borrowing Activity

a) The Operational Boundary (Prudential Indicator PI-4)

This indicator takes account of capital expenditure and financing requirements and projects the expected level of external debt for operational purposes. Temporary breaches of the operational boundary may occur as a result of unexpected cash movements. The Head of Accountancy (Chief Financial Officer) has delegated authority to manage the movement between borrowing and other long term liabilities such as finance leases in accordance with option appraisal and value for money considerations if it is considered appropriate. Any such movement will be reported to Council following the change.

Operational boundary for external debt (PI-4) £'000	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing **Other Long Term Liabilities**	**153,878** **85,747**	**199,726** **80,960**	**233,109** **75,954**	**240,571** **70,830**	**240,177** **65,548**
Total	**239,625**	**280,686**	**309,063**	**311,401**	**305,725**

b) The Authorised Limit for External Debt (Prudential indicator PI-5)

This is a key prudential indicator and represents a control on the maximum level of borrowing. It is similar to the operational boundary but includes further headroom to accommodate adverse cash flow movements and opportunities for advance borrowing. It represents a legal limit which external debt is prohibited to exceed and reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. In circumstances where a breach takes place the reasons shall be reported to the next meeting of the Council and the limit revised if appropriate.

The authorised limits for external debt for the current year and two subsequent years are the legislation limits determined under Regulation 6(1) of the Local Authority (Capital Finance and Accountancy) (Scotland) Regulation 2016.

The proposed Authorised Limit for the Council is as follows:

Authorised limit for external debt (PI-5) £'000	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing **Other Long Term Liabilities**	**176,960** **85,747**	**229,685** **80,960**	**268,076** **75,954**	**276,657** **70,830**	**276,204** **65,548**
Total	**262,707**	**310,645**	**344,030**	**347,487**	**341,752**

c) Leasing – International Financial Reporting Standard (IFRS) 16

From 1 April 2020, leases which were previously off balance sheet will now be included. As leases form part of the other long term liability figures which make up the Prudential Indicators above, it is possible that the Indicators currently suggested will be exceeded. Once the detailed data gathering has been substantially completed, later in the 2020/21 financial year, an updated report may be required to inform the members of the detailed impact of IFRS 16 with amended Prudential Indicators for approval.

4.3 Prospects for Interest Rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. **Annex B** draws together a number of current city forecasts for short term (Base Rate) and longer fixed interest rates and the following table and commentary below gives the central view of Link Asset Services as at 23/12/19.

Link Asset Services Interest Rate										
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish (supporting discussion) due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates. There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by **H.M. Treasury** to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.

- While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Annex C contains a more comprehensive Economic Background narrative from Link Asset Services.

4.4 Borrowing Strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Head of Accountancy (Chief Financial Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *If it was felt that there was a significant risk of a sharp **FALL** in long and short term rates*, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.

- *If it was felt that there was a significant risk of a much sharper **RISE** in long and short term rates than that currently forecast*, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to Members at the next available opportunity.

4.5 Treasury Management Limits on Activity

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

(i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)

This covers a maximum limit for borrowing exposure to fixed interest rates, based on the debt position and is set at 100%.

(ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)

This identified a maximum limit for borrowing exposure to variable interest rates based upon the debt position and is set at 30%.

(iii) Maturity structure of borrowing (Treasury Indicator TI-3)

Gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing. The Council has set the limit of debt maturing in any one year to 15% at the time of borrowing.

4.6 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

The Head of Accountancy (Chief Financial Officer) has the authority to borrow in advance of need 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. The Head of Accountancy (Chief Financial Officer) will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:

- The benefits of borrowing in advance,
- The risks created by additional levels of borrowing and investment, and
- How far in advance it is reasonable to borrow considering the risks identified

Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

4.7 Debt Rescheduling

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings

- Helping to fulfil the treasury strategy
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

However rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

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

4.8 New financial institutions as a source of borrowing

Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks),
- Municipal Bonds Agency (no issuance at present but there is potential)

The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

5 Investment Strategy

5.1 Investment Objectives and Policy

The Council's investment policy implements the requirements of the Local Government Investments (Scotland) Regulations 2010 (and accompanying Finance Circular 5/2010) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code").

The above regulations and guidance place a high priority on the management of risk. The Council's investment priorities will be security first, liquidity second and then return. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

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

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

4. This authority has defined the list of **types of investment instruments** that are permitted investments authorised for use in Annex D. Annex E expands on the risks involved in each type of investment and the mitigating controls.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the information gathered (see points 1-3 above)

6. This authority has engaged **external consultants**, (see paragraph 2.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 5.6c).

8. The Council has determined that it will only use approved counterparties from within the United Kingdom.

9. As a result of the change in accounting standards for 2019/20 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 5.7). Regular monitoring of investment performance will be carried out during the year.

5.2 Creditworthiness Policy

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

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

The Head of Accountancy (Chief Financial Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary (see **Annex F**). These criteria provide an overall pool of classes of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list, with the exception of the Council's own banker. Any rating changes, rating watches (notification of a likely change), rating Outlooks (notification of a longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applied to a counterparty that is already at the minimum Council criteria will be suspended from use, with all other counterparties being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties are:

- Banks 1 - good credit quality **–** the Council will only use UK banks which have, as a minimum, the following Fitch (or equivalent) ratings (where rated):
    i. Short Term – *F1*
    ii. Long Term – *A-*
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland ring-fenced operations*. This bank can be included if it continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies - The Council will use societies which meet the ratings for banks outlined above;
- Money Market Funds
- Ultra-Short Dated Bond Funds
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, including Police & Fire

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

Hub Schemes. The Council also invests in hub projects, which are based on robust business cases and a cashflow from public sector organisations (i.e low risk). As additional assurance we restrict such investments to hub schemes where the Council is a significant participant.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as stated in **Annex F**.

UK banks – *ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

5.3 Country and Council's Banker

a) Country Limits

The Council has determined that it will only use approved counterparties from within the United Kingdom. This policy may be reviewed if the sovereign rating for the UK is downgraded to below AA – as a result of a "no deal" Brexit.

b) Council's Own Banker

The Council's own banker (The Clydesdale bank) will be maintained on the Council's counterparty list in situations where rating changes mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities overnight and short-term investment facilities.

5.4 The Monitoring of Investment Counterparties

All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service of Link Asset Services.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- Additional market information (for example Credit Swaps and negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

If the Council has funds invested in an institution which is downgraded to below the acceptable rating criteria, the Council will enter discussions with the counterparty to establish if the funds can be returned early. This however will be subject to an appropriate cost versus risk assessment of the specific situation.

The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Under exceptional market conditions, the Head of Accountancy (Chief Financial Officer) may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out in this Strategy. These restrictions will remain in place until the Head of Accountancy (Chief Financial Officer) is of an opinion that the banking system has returned to ‘normal’. Similarly a restriction may be placed on the duration of investments.

5.5 Types of Investments

For institutions on the approved counterparty list, investments will be restricted to safer instruments (as listed in **Annex E**). Currently this involves the use of money market funds, the Debt Management Agency Deposit Facility (DMADF) and institutions with higher credit ratings than the minimum permissible rating outlines in the investment strategy, as well as the Council’s own bank.

Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:

- Sterling International Brokers Limited
- Tradition (UK) Limited
- Martins Brokers
- King and Shaxson Capital Limited
- Tullet Prebon Brokers
- Imperial Treasury Services

5.6 Investment Strategy and bank rate projections

a) In-house funds

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

b) Bank Rate

On the assumption that the UK and EU agree a Brexit deal, including the terms of trade by the end of 2020 or soon after, then the Bank Rate is forecast to increase slowly over the next few years. Bank Rate forecasts for financial year-ends (March) as at December 2019 are:

Quarter 1 2021	0.75%
Quarter 1 2022	1.00%
Quarter 1 2023	1.00%

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

	Now
2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later Years	2.25%

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similar to the downside.

- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

c) Investment Treasury Indicator And Limit (Treasury Indicator TI-4)
Total Principal Funds Invested for Greater Than 365 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 treasury indicator and limit proposed is:

Maximum principal sums invested > 365 days (TI-4)			
	2019/20	2020/21	2021/22
Principal sums invested > 365 days	5%	5%	5%

For its cash flow generated balances, the Council will seek to utilise its notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

5.7 Risk Benchmarking

These benchmarks are simple guides to minimise risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmarks is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or annual report.

a) Security

The Council's **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

0.06% historic risk of default when compared to the whole portfolio for 1 year.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £100,000 East Renfrewshire Council
  £25,000 East Renfrewshire Culture & Leisure Trust

c) Yield

Local Measures of yield benchmarks are:

Investments – Internal returns above the 7 day LIBID rate

5.8 End of year investment report

At the end of the financial year, the Head of Accountancy (Chief Financial Officer) will report on its investment activity as part of the annual treasury report.

6 Performance Indicators

6.1 The CIPFA Code 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.

6.2

6.3 Debt Performance Indicators

(i) Average "Pool Rate" charged by the Loans Fund compared to Scottish Local Authority average Pool Rate:
Target is to be at or below the Scottish Average for 2019/20

(ii) Average borrowing rate movement year on year:
Target is to maintain or reduce the average borrowing rate for the Council versus 2019/20.

6.4 Loan Charges

Loan Charges for 2020/21 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in February 2020, which are estimated as follows:

£m	2020/21 Estimate	2021/22 Estimate
Capital Repayments	4.771	4.387
Interest on Borrowing	3.924	4.742
Expenses	0.170	0.174
Total Loan Charges*	**8.865**	**9.303**

**The Loan Charges exclude the capital element of PPP repayments*

7 Monitoring and Reporting

In line with the CIPFA Code the following formal reporting arrangements will be adopted:

Requirement	Purpose	Responsible Body	Frequency
Scrutiny of Treasury Management Strategy	Detailed scrutiny prior to annual approval by Council	Audit & Scrutiny Committee	Annually
Treasury Management Strategy	Reporting on Annual Strategy	Council	Annually prior to start of new financial year
Scrutiny of Treasury Management Mid-Year Report	Detailed scrutiny prior to approval by Council	Audit & Scrutiny Committee	Annually in October/November of the current year
Treasury Management Mid-Year Report	Mid-Year Performance Report	Council	Annually after reported to the Audit & Scrutiny Committee
Scrutiny of Treasury Management Annual Report	Detailed scrutiny prior to approval by Council	Audit & Scrutiny Committee	Annually in September/ October of the financial year
Treasury Management Annual Report	Annual Performance report for previous financial year	Council	Annually after reported to the Audit & Scrutiny Committee
Treasury Management Practices		Council	As appropriate
Treasury Management Policy Statement	Reviews and Revisions	Council	As required

8 Member and Officer Training

The CIPFA Code requires the Head of Accountancy (Chief Financial Officer) to ensure that both members and officers with responsibility for treasury management receive adequate training in this area. This Council will address this important issue by:

a) Elected Members

- Working with members to identify their training needs
- Working with Link Asset Services to identify appropriate training provision for elected members

b) Officers dealing with treasury management matters will have the option of various levels of training including:

- Treasury courses run by the Council's advisers
- Attendance at CIPFA treasury management training events
- Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
- Training identified as part of the Council's Performance Review & Development system in line with the approved Treasury Management Practices (TMPs).

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Reference	Indicator	Page Ref.	2020/21	2021/22	2022/23	2023/24	2024/25
PRUDENTIAL INDICATORS							
Capital Expenditure Indicator							
PI-1	Capital Expenditure Limits General Fund Housing Total		£'000 43,093 17,589 **60,682**	£'000 50,243 19,620 **69,863**	£'000 44,567 7,867 **52,434**	£'000 19,435 6,314 **25,749**	£'000 15,088 4,114 **19,202**
PI-2	Capital Financing Requirement General Fund Housing Total		£'000 191,235 43,837 **235,072**	£'000 223,072 53,009 **276,081**	£'000 248,820 55,065 **303,885**	£'000 249,432 57,073 **306,505**	£'000 244,419 56,549 **300,968**
Affordability Indicator							
External Debt Indicators							
PI-3	Gross Debt Borrowing Other Long Term Liabilities Total		£'000 142,227 80,960 **223,187**	£'000 184,843 75,954 **260,797**	£'000 214,015 70,830 **284,845**	£'000 213,638 65,548 **279,186**	£'000 213,623 60,055 **273,678**
PI-4	Operational Boundary for External Debt Borrowing Other Long Term Liabilities Total		£'000 153,878 85,747 **239,625**	£'000 199,726 80,960 **280,686**	£'000 233,109 75,954 **309,063**	£'000 240,571 70,830 **311,401**	£'000 240,177 65,548 **305,725**
PI-5	Authorised Limit for External Debt Borrowing Other Long Term Liabilities Total		£'000 176,960 85,747 **262,707**	£'000 229,685 80,960 **310,645**	£'000 268,076 75,954 **344,030**	£'000 276,657 70,830 **347,487**	£'000 276,204 65,548 **341,752**
Indicators of Prudence							
PI-6	(Under)/Over Gross Borrowing against the CFR		£'000 **(11,885)**	£'000 **(15,284)**	£'000 **(19,040)**	£'000 **(27,319)**	£'000 **(27,290)**
TREASURY INDICATORS							
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt		**100% of debt position**				
TI-2	Upper Limit to Variable Interest Rates based on Net Debt		**30% of debt position**				
TI-3	Maturity Structure of Fixed Interest Rate Borrowing		**15% maturing in any one year**				
TI-4	Maximum Principal Sum invested greater than 365 days		**5%**	**5%**	**5%**	**5%**	**5%**

ANNEX B: INTEREST RATE FORECASTS 2020 – 2023

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1 November 2012.

Bank Rate														
	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**0.75%**	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	**0.75%**	0.75%	0.75%	0.75%	0.75%	-	-	-	1.00%	-	-	-	-	-
5yr PWLB Rate														
	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.34%**	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	**2.34%**	2.40%	2.50%	2.50%	2.60%	-	-	-	2.80%	-	-	-	-	-
10yr PWLB Rate														
	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.55%**	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	**2.55%**	2.60%	2.70%	2.80%	2.80%	-	-	-	3.10%	-	-	-	-	-
25yr PWLB Rate														
	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**3.07%**	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	**3.07%**	3.00%	3.10%	3.20%	3.20%	-	-	-	3.40%	-	-	-	-	-
50yr PWLB Rate														
	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.90%**	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	**2.90%**	3.00%	3.10%	3.20%	3.20%	-	-	-	3.50%	-	-	-	-	-

BLANK PAGE

ANNEX C

LINK Asset Services Economic Background

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report,** (now renamed the Monetary Policy Report), on 7 November, it is questionable as to how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. **Growth** has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of Targeted Longer-Term Refinancing Operations (TLTROs)**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by ‘growth friendly’ fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the

CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates**.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 4.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the**

EU. On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.

- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.

- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.

- Weak capitalisation of some **European banks**, particularly Italian banks.

- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.

- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.

- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.

- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.

- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

ANNEX D

Objectives of each type of Permitted Investment instrument

1. DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.

b) **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The authority will ensure diversification of its portfolio of deposits ensuring that an approved maximum can be placed with any one institution or group. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

c) **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either partial or full direct ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

a) Term deposits with high credit worthiness banks which are fully or semi nationalised. As for 1b. but Government full, (or substantial partial), ownership, implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers that this indicates a low and acceptable level of residual risk.

3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

a) **Government liquidity funds.** These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due to the higher quality of underlying investments, they offer a lower rate of return than MMFs. However, their net return is typically on a par with the DMADF, but with instant access.

b) **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or capabilities to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.

c) **Ultra-short dated bond funds.** These funds are similar to MMFs, can still be AAA rated but have variable net asset values (VNAV) as opposed to a traditional MMF which has a Constant Net Asset Value (CNAV). They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have WAM's and Weighted Average Life (WAL's) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills.

a) **Treasury bills.** These are short term bills (up to 18 months, but usually 9 months or less) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

b) **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the

DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

5. SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

a) **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly financial institutions). They are negotiable instruments, so can be sold ahead of maturity and also purchased after they have been issued. However, that liquidity can come at a price, where the yield could be marginally less than placing a deposit with the same bank as the issuing bank.

b) **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a financial institution, company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.

c) **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

6. OTHER

a) **Properties fund.** This is a collective investment fund specialising in property. Rather than owning a single property with all the risk exposure that means to one property in one location rising or falling in value, maintenance costs, tenants actually paying their rent / lease etc., a collective fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the potential for the property sector to rise in value. However, timing is critical to entering or leaving this sector at the optimum times of the property cycle of rising and falling values. Typically, the minimum investment time horizon for considering such funds is at least 3-5 years.

b) **Loans to 3rd parties.** These are loans provided to third parties at either market rates of interest or below market rates. Each application is supported by the service rationale behind the loan and requires member approval. These loans are highly illiquid and may exhibit credit risk.

c) **Loans to a Local Authority Company/ Partnership or Charity**. These loans have to be supported by the service rationale /business case and requires member approval. In general these loans will involve some form of security or clear cash flow that is available to service the debt. These loans are highly illiquid and may exhibit credit risk.

d) **Shares in Hub schemes**. These are shares in projects that have both Council and the Scottish Government as participants. As such the Council are well placed to influence and ensure the successful completion of the projects, which are based on robust business cases with a cash flow from the public sector organisations. These investments are highly illiquid with a low credit risk.

ANNEX E

Credit and Counterparty Risk Management

Permitted Investments, Associated Controls and Limits for East Renfrewshire Council and East Renfrewshire Culture & Leisure Trust

Type of Investment	Treasury Risks	Mitigating Controls	Limits
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk**)	This is a deposit with the UK Government and, as such, counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months	Little mitigating controls required. As this is a UK Government investment, the monetary limit is unlimited	unlimited
b. Deposits with other local authorities or public bodies (**Very low risk**)	These are considered quasi UK Government debt and, as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment.	£5m (per body), maximum 6 months
c. Money Market Funds (MMFs) Low Volatility Net Asset Value (LVNAV) **(Low to very low risk**)	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	£5m per fund/£40m overall
d. Ultra-Short Dated Bond Funds **(Low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where they have a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	£10m overall, part of category c.
e. Call account deposit accounts with financial institutions (banks and building societies) (**Low risk depending on credit rating**)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. These type of investments have no risk to value, liquidity is high and investment can be returned at short notice	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s. Day to day investment dealing with this criteria will be further strengthened by use	As shown in the counterparty listing (Annex F)

		of additional market intelligence.	
f. Term deposits with financial institutions (banks and building societies) (**Low to medium risk depending on period & credit rating**)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty listing (Annex F)
g. UK Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and, as such, counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£5m, maximum 6 months
h. Certificates of Deposit with Financial Institutions (Banks & Building Societies) **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	Dependent on institution as listed in counterparty listing in annex F
i. Corporate Bonds **(Medium to high risk depending on period and credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Corporate bonds will be restricted to those	Dependent on institution as listed in counterparty listing in annex F

		meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	
j. Investment properties	These are non-service properties which are being held pending disposal or for a longer-term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids)	In larger investment portfolios, some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.	No limit
k. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rationale behind the loan and the likelihood of partial or full default.	£0.5m
l. Loans to a local authority company/ partnership or charity	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid	Each loan to a local authority company requires Member approval and each application is supported by the service rationale/business case behind the loan and the likelihood of partial or full default.	£1m
m. Shares in Hub Schemes	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term. These projects are based on robust business cases with a cash flow from public sector organisations (i.e. low credit risk)	Investment limited to HUB schemes where the Council is a major participant

The Monitoring of Investment Counterparties

The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Asset Services, including when ratings change, and counterparties are checked promptly. On occasion rating may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately (with the exception of the Council's Bank) and if required new counterparties which meet the criteria will be added to the list with written permission of the Head of Accountancy (Chief Financial Officer).

Annex F **EAST RENFREWSHIRE COUNCIL**

ORGANISATIONS APPROVED FOR THE INVESTMENT OF SURPLUS FUNDS

Banking Group	Individual Counterparty	Limits Deposit	Transaction
Bank of England	Debt Management Office	Unlimited	Unlimited
	UK Treasury Bills	£5m	£5m
Barclays Banking Group	Barclays Bank	£5m	£5m
Goldman Sachs International Bank		£5m	£5m
HSBC		£5m	£5m
Lloyds Banking Group:	Bank of Scotland	£12.5m	£12.5m
Royal Bank of Scotland Group:	Royal Bank of Scotland National Westminster Bank	£5m	£5m
Santander Group	Santander UK PLC	£7.5m	£7.5m
Standard Chartered Bank		£5m	£5m
Clydesdale Bank		£0	£0
Building Societies			
Nationwide		£5m	£5m
Local Authorities			
All Local Authorities including Police & Fire (per fund)		£5m	£5m
Money Market Funds and Ultra-Short Dated Bond Funds			
Maximum limit of £5m per fund, exception being Federated with a maximum of £10m		£40m	£5m

Credit Ratings

	Fitch		Moodys		S&P	
	LT	ST	LT	ST	LT	ST
Minimum Criteria	A-	F1	A3	P-1/P-2	A	A-1/A-2

(Unless Government backed)
(please note credit ratings are not the sole method of selecting counterparty)

Limit

Investment of surplus funds is permitted in each of the above organisations, with the limits set on an individual basis by the Head of Accountancy (Chief Financial Officer).

The limit may only be exceeded or another organisation approved with the written permission of the Head of Accountancy (Chief Financial Officer).

Deposit Periods

The maximum period for any deposit is currently set at 6 months, based on the Link Assets Services suggested Duration Matrix, with the exception of the Bank of Scotland which is set at 365 days. These limits can only be exceeded with the written permission of the Head of Accountancy (Chief Financial Officer).

Hub scheme deposit periods are dependent on the lifetime of the associated scheme.

GLOSSARY OF TERMS

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
Gilts	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
LIBID	London Interbank Bid Rate The rate at which banks bid on Eurocurrency Deposits, being the rate at which a bank is willing to borrow from other banks.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
Treasury Indicators	These consist of a number of Treasury Management Indicators that local authorities are expected to ‘have regard’ to, to demonstrate compliance with the Treasury Management Code of Practice.