AGENDA ITEM No.5

EAST RENFREWSHIRE COUNCIL

AUDIT AND SCRUTINY COMMITTEE

19th February 2018

Report by Head of Accountancy (Chief Financial Officer)

Treasury Management Strategy Report for 2018/19

PURPOSE OF REPORT

1. To advise the Audit and Scrutiny Committee on the treasury management strategy for the financial year 2018/19.

RECOMMENDATIONS

2. It is recommended that Members:-

   (a) consider the content of the Treasury Management Strategy Report for 2018/19;

   (b) recommend to the Council that the Treasury Management Strategy for 2018/19 be approved, including the amendment of Treasury Management Practices in accordance with Annex F; and

   (c) recommend to the Council that they approve the policy on the repayment of loans fund advances, see section 6.4.

BACKGROUND

3. In line with the CIPFA Treasury Management Code of Practice 2011, 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 2018/19 is submitted in accordance with this requirement.

TREASURY MANAGEMENT STRATEGY FOR 2018/19 (TMS)

5. The TMS for 2018/19 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.

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Report Date: 12 February 2018

Key Words

Treasury Management, Interest Rates, Treasury Strategy, investment, debt rescheduling, Prudential Indicators

APPENDIX 1

EAST RENFREWSHIRE COUNCIL

TREASURY MANAGEMENT STRATEGY 2018/19

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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

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 2018/19** (this report).

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

- The capital plans of the Council (including prudential indicators);
- The Treasury Management Strategy (how the investments and borrowings are organised) including treasury indicators, and
- An investment strategy (investment options and limits applied).

b) **Mid-Year Treasury Management Report** – This will update members with the progress of the capital investment position, amending prudential indicators as necessary and whether any policies require revision.

c) **Annual Treasury Report** – This provides details of actual prudential and treasury indicators compared to the estimates within the strategy and performance of actual treasury operations.

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 Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:-

- A high-level 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 report is to ensure that all elected members fully understand the overall strategy, governance procedures and risk appetite entailed by the Strategy.

Most of this information is already provided to members via various other reports such as the Capital Investment Strategy, Capital Plan, Strategic Risk Register and regular treasury reports. In future, however, the new Capital Strategy will pull together all of the relevant information including capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

2.4 Treasury Management Strategy for 2018/19

The treasury management issues covered by this report are:

Capital Issues

- The capital plans and associated prudential indicators

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
- Performance Indicators

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 (the Code) and Scottish Government Investment Regulations.

2.5 Treasury Management Consultants

The Council uses Link Asset Services 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 external service providers.

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 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 2018/19 – 2020/21

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 planning 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 2018/19-2025/26 and housing capital plan 2018/19- 2022/23 which will be submitted to Council on 1 March 2018 together with the additional expenditure outlined above:

Capital Expenditure (PI-1) £'000	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
General Fund					
– Capital Programme	34,224	30,095	40,429	41,137	53,052
– Other Relevant Expenditure	-	22,307	-	-	-
General Fund Subtotal	**34,224**	**52,402**	**40,429**	**41,137**	**53,052**
Housing	**4,645**	**7,308**	**24,710**	**16,517**	**4,990**
Total	**38,869**	**59,710**	**65,139**	**57,654**	**58,042**

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 financial need.

General Fund £'000	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Capital Expenditure	34,224	30,095	40,429	41,137	53,052
Other Relevant Expenditure	-	22,307	-	-	-
Total	34,224	52,402	40,429	41,137	53,052
Financed by:					
Capital Receipts	172	2,390	1,750	1,350	600
Capital Reserve	13,600	13,966	6,000	0	0
Developer Contributions	760	787	1,759	1,462	2,344
Govt. General Capital Grant	5,954	7,459	6,866	8,105	6,866
Govt. Specific Capital Grants	1,995	1.998	4,028	3,900	1,800
Other Grants & Contributions	370	272	75	75	75
Repairs & Renewals Fund/CFCR	1,189	85	0	0	0
Net Borrowing Requirement for the year	**10,184**	**25,445**	**19,951**	**26,245**	**41,367**

As part of the long term capital planning process, the 2017/18 probable capital outturn has been reduced by £600,000 below the level reported to Cabinet on 30 November 2017. In addition the level and timing of capital receipts and borrowing during 2017/18 have been revised by £700,000 and £100,000 respectively. These revisions will be incorporated within the final 2017/18 monitoring report submitted to Cabinet during March 2018.

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	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Capital Expenditure	4,645	7,308	24,710	16,517	4,990
Financed by:					
Capital Receipts – Right to Buy	1,108	1,700	0	0	0
Capital Receipts – Land Disposal	51	0	0	500	500
Recharges to Owners	452	724	683	449	462
Govt. Specific Capital Grants	870	797	8,469	5,025	0
Commuted Sums	401	352	1,135	552	0
CFCR	450	0	0	0	0
Net Borrowing Requirement for the year	**1,313**	**3,735**	**14,423**	**9,991**	**4,028**

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	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
General Fund	10,184	25,445	19,951	26,245	41,367
Housing	1,313	3,735	14,423	9,991	4,028
Net Borrowing Requirement for the year	**11,497**	**29,180**	**34,374**	**36,236**	**45,395**

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 underlying borrowing requirement. 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 scheduled debt amortisation (loans fund principal repayments) reduce the borrowing need.

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 and so the Council is not required to separately borrow for these schemes. The Council has liabilities of £75.951m relating to such schemes as at 31 March 2017.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £'000	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
General Fund	**152,428**	**167,683**	**176,930**	**192,071**	**222,562**
Housing	**26,755**	**27,577**	**38,960**	**45,543**	**45,911**
Total CFR (PI-2)*	**179,183**	**195,260**	**215,890**	**237,614**	**268,473**
Movement in CFR represented by:					
Net borrowing requirement for the year (above)		29,180	34,374	36,236	45,395
Less scheduled debt amortisation and other financing movements		(13,103)	(13,744)	(14,512)	(14,536)
Movement in CFR		**16,077**	**20,630**	**21,724**	**30,859**

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

3.4 Affordability Prudential Indicators

Further prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The updated indicators are as follows:

a) Ratio of financing costs to net revenue stream (Prudential Indicator PI-3)

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs, net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream (PI-3)	**2016/17 Actual**	**2017/18 Probable**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
General Fund	**8.35%**	**8.77%**	**9.32%**	**9.36%**	**9.35%**
Housing	**37.06%**	**35.95%**	**38.80%**	**41.40%**	**40.57%**

The estimates of financing costs include current commitments and the proposals in the capital plans for 2017/18 to 2020/21. The levels of government grant support for 2019/20 and 2020/21 have not been issued and the general fund indicator for these years is based on estimates.

The increasing ratio for Housing reflects the increased investment levels in the Housing stock, including the provision of 240 new units.

4 Treasury Management Strategy

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 its liabilities as they fall due. 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	2016/17 Actual	2017/18 Probable	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Borrowing	63,509	76,754	124,146	146,993	146,442
Other Long Term Liabilities	75,951	94,791	90,482	85,749	80,962
Total Gross Debt (Prudential Indicator PI-4)	**139,460**	**171,545**	**214,628**	**232,742**	**227,404**
CFR – the borrowing need	**179,183**	**195,260**	**215,890**	**237,614**	**268,473**
(Under) / Over Borrowing (Prudential Indicator PI-7)	**(39,723)**	**(23,715)**	**(1,262)**	**(4,872)**	**(41,069)**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-6) 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 the current and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing in advance of need is not undertaken for revenue 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-5)

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-5) £'000	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Borrowing **Other Long Term Liabilities**	**126,754** **94,791**	**149,146** **90,482**	**146,993** **85,749**
Total	**221,545**	**239,628**	**232,742**

b) The Authorised Limit for External Debt (Prudential indicator PI-6)

This indicator is similar to the operational boundary but includes further headroom to accommodate adverse cash flow movements and opportunities for advance borrowing. It represents a limit which external debt is not expected 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 same delegated powers are in place as for the operational boundary.

This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35(1) of the Local Government in Scotland Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The proposed Authorised Limit for the Council is as follows:

Authorised limit for external debt (PI-6) £'000	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Borrowing **Other Long Term Liabilities**	**145,767** **94,791**	**171,518** **90,482**	**169,042** **85,749**
Total	**240,558**	**262,000**	**254,791**

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.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Dec 2017	0.50	1.5	2.1	2.8	2.5
Mar 2018	0.50	1.6	2.2	2.9	2.6
Jun 2018	0.50	1.6	2.3	3.0	2.7
Sep 2018	0.50	1.7	2.4	3.0	2.8
Dec 2018	0.75	1.8	2.4	3.1	2.9
Mar 2019	0.75	1.8	2.5	3.1	2.9
Jun 2019	0.75	1.9	2.6	3.2	3.0
Sep 2019	0.75	1.9	2.6	3.2	3.0
Dec 2019	1.00	2.0	2.7	3.3	3.1
Mar 2020	1.00	2.1	2.7	3.4	3.2
Jun 2020	1.00	2.1	2.8	3.5	3.3
Sep 2020	1.25	2.2	2.9	3.5	3.3
Dec 2020	1.25	2.3	2.9	3.6	3.4
Mar 2021	1.25	2.3	3.0	3.6	3.4

As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after an historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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 and emerging market developments. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. 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.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

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

- The Bank of England takes action too quickly 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.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation 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 returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

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

Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

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 both prudent and cost effective as investment returns are low and counterparty risk is still as issue to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 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 long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *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 start date and 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

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings
- Helping to fulfil the treasury strategy
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

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

5 Investment Strategy

5.1 Investment Objectives and Policy

The Council's investment policy has regard to The Scottish Government's Investments (Scotland) Regulations (and accompanying Finance Circular) and the latest CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the Code").

The Council's primary investment objectives are:

i) The safeguarding or **security** of the re-payment of principal and interest of investments on a timely basis; and
ii) The **liquidity** of its investments

The council will also aim to achieve the optimum return on its investments corresponding with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

In accordance with the above guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, the Council has below (see 5.3 below) clearly stipulated the minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The intention of the approach is to provide security of investment and minimisation of risk.

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 on the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

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

The borrowing of monies purely to invest or on-lend, without relevant Scottish Government consent, is unlawful and this Council will not engage in such activity.

The Council will ensure its investments have sufficient liquidity. For this purpose it will set out procedures for determining the maximum periods over which funds may prudently be committed.

5.2 Council Permitted Investments

The Local Government Investments (Scotland) Regulations 2010 require the Council to give approval for all the types of investments to be used and set appropriate limits for the amount that can be held in each investment type. These types of investments are termed **Permitted Investments** and any investments used which have not been approved as a permitted investment will be considered ultra vires.

The permitted investment instruments which may be used by the Council (and its subsidiary organisations) in the forthcoming year are detailed in **Annex E** and their objectives explained in **Annex D**, the following are included:

Cash type instruments

- Deposits with the Debt Management Account Deposit Facility (DMADF) (UK Government)
- Deposits with other local authorities or public bodies
- Money Market Funds
- Ultra-Short Dated Bond Funds
- Call account deposit accounts with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- Term deposits with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- UK Government Gilts and Treasury Bills
- Certificates of Deposit with financial institutions (banks and building societies)
- Corporate Bonds
- Floating Rate Note

Other investments

- Investment properties
- Loans to third parties, including soft loans
- Loans to local authority companies/partnerships/ charity
- Shares in Hub schemes

Details of the risks, mitigating controls and limits associated with each of these permitted categories are also shown in **Annex E**.

5.3 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 consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list, with the exception of the Council's own banker. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- Banks 1 - good credit quality **–** the Council will only use banks which are UK banks and 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. 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 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 rely 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**.

5.4 Country and Council's Banker

a) Country Limits

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

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.

5.5 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.

5.6 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

5.7 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).

b) Bank Rate

Bank Rate is forecast to stay flat at 0.50% until quarter 4 of 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year-ends (March) as at December 2017 are:

2017/2018	0.50%
2018/2019	0.75%
2019/2020	1.00%
2020/2021	1.25%

The overall balance of risk to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

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 > 364 & 365days (TI-4)			
	2015/16	2016/17	2017/18
Principal sums invested > 364 & 365 days	5%	5%	5%

For positive cash balances and in order to maintain liquidity, the Council will seek to use overnight investment accounts, short term (< 1 month) notice accounts, money market funds and short-dated deposits (overnight to six months).

5.8 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

c) Yield

Local Measures of yield benchmarks are:

Investments – Internal returns above the 7 day LIBID rate

d) Activity

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 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 2017/18

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2017/18.

6.3 Loan Charges

Loan Charges for 2018/19 are expected to be at or below the Revenue Budget estimate contained in the Council’s Financial Plans to be approved in February 2018, which are estimated as follows:

£m	2018/19 Estimate	2019/20 Estimate
Capital Repayments	6.395	6.371
Interest on Borrowing	3.728	4.057
Expenses	0.140	0.138
Total Loan Charges*	**10.263**	**10.566**

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

6.4 Statutory Repayment of Loans Fund Advances

Under the Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016, 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%. This rate is in keeping with the estimated loans fund rate for 2017/18 to 2021/22. 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.

The Non-HRA loans fund balances are expected to be, with year 1 being 2017/18:

£'000	**Year 1**	**Years 2-5**	**Years 5-10**	**Years 10-15**	**Years 15-20**	**etc**
opening balance	76,477	73,178	142,050	114,062	74,030	43,498
advances	3,424	87,727	12,423	-	-	-
repayments	6,723	18,855	40,411	40,032	30,532	43,498
closing balance	73,178	142,050	114,062	74,030	43,498	-

The HRA loans fund balances are expected to be, with year 1 being 2017/18:

£'000	**Year 1**	**Years 2-5**	**Years 5-10**	**Years 10-15**	**Years 15-20**	**etc**
opening balance	26,755	27,632	45,966	36,321	25,238	15,810
advances	3,790	28,442	7,686	-	-	-
repayments	2,913	10,108	17,331	11,083	9,428	15,810
closing balance	27,632	45,966	36,321	25,238	15,810	-

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 Treasury Management Consultants and Advisers

The Council uses Link Asset Services as its external treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital financing issues and the drafting of Member reports
- Economic and interest rate analysis
- Debt services which includes advice on the timing of borrowing
- Debt rescheduling advice surrounding the existing portfolio
- Generic investment advice on interest rates, timing and investment instruments
- Credit ratings/market information service

As part of the service provided, Link Asset Services meet with Council officers periodically to review the current Treasury Management and Investment Strategies and also review the service provided to the Council.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that it does not only rely upon information and advice from our external service providers.

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.

9 Member and Officer Training

The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. 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).

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ANNEXES

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ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Reference	Indicator	Page Ref.	2018/19	2019/20	2020/21
PRUDENTIAL INDICATORS					
Capital Expenditure Indicator					
PI-1	Capital Expenditure Limits General Fund Housing Total	7	£'000 40,429 24,710 65,139	£'000 41,137 16,517 57,654	£'000 53,052 4,990 58,042
PI-2	Capital Financing Requirement General Fund Housing Total	9	£'000 176,930 38,960 215,890	£'000 192,071 45,543 237,614	£'000 222,562 45,911 268,473
Affordability Indicator					
PI-3	Ratio of Financing Costs to Net Revenue Stream: General Fund Housing	9	 9.32% 38.80%	 9.36% 41.40%	 9.35% 40.57%
External Debt Indicators					
PI-4	Gross Debt Borrowing Other Long Term Liabilities Total	10	£'000 124,146 90,482 214,628	£'000 146,993 85,749 232,742	£'000 146,442 80,962 227,404
PI-5	Operational Boundary for External Debt Borrowing Other Long Term Liabilities Total	11	£'000 126,754 94,791 221,545	£'000 149,146 90,482 239,628	£'000 146,993 85,749 232,742
PI-6	Authorised Limit for External Debt Borrowing Other Long Term Liabilities Total	11	£'000 145,767 94,791 240,558	£'000 171,518 90,482 262,000	£'000 169,042 85,749 254,791
Indicators of Prudence					
PI-7	(Under)/Over Gross Borrowing against the CFR	10	£'000 (1,262)	£'000 (4,872)	£'000 (41,069)
TREASURY INDICATORS					
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt	15	100% of debt position		
TI-2	Upper Limit to Variable Interest Rates based on Net Debt	15	30% of debt position		
TI-3	Maturity Structure of Fixed Interest Rate Borrowing	15	15% maturing in any one year		
TI-4	Maximum Principal Sum invested greater than 364 days	21	5%	5%	5%

ANNEX B: INTEREST RATE FORECASTS 2017 – 2021

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate														
Link Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	-	-	-	-	-
5yr PWLB Rate														
Link Asset Services	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.70%	1.90%	2.30%	2.60%	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-
10yr PWLB Rate														
Link Asset Services	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.30%	2.60%	2.80%	3.10%	3.30%	3.30%	3.30%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate														
Link Asset Services	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.95%	3.15%	3.45%	3.65%	3.90%	3.90%	3.90%	3.90%	3.90%	-	-	-	-	-
50yr PWLB Rate														
Link Asset Services	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.80%	3.10%	3.30%	3.60%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

ANNEX C

Link Asset Services Economic Background

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution.**

KEY RISKS - central bank monetary policy measures

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income,** which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a **lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply ‘look through’ tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a **shift *UP* in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that might prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.0% y/y), 0.7% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

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 credit systems.

JAPAN. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling 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.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

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 12 months, although none have ever been issued for this maturity) 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. **Investment 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 £5,000,000	£5m, maximum 6 months.
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) (**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/£35m overall
d. Ultra-Short Dated Bond Funds (ECFs) **(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)	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. The selection defaults to the lowest available colour band / credit rating to provide	As shown in the counterparty listing (Annex F)

(**Low risk depending on credit rating**)		additional risk control measures. Day to day investment dealing with the criteria will be further strengthened by use 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. The selection defaults to the lowest available credit rating to provide additional risk control measures. 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. Fixed bonds will be restricted to those meeting the base criteria. 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
j. Floating Rate Note **(Medium to high risk depending on period and credit rating)**	This is a money market instrument with a floating /variable rate of interest, which re-fixes over a reference rate , for example LIBOR.	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. . The Floating Rate Note will be restricted to those meeting the base criteria. 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
k. Investment properties (**Medium Risk)**	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.	No limit
l. Loans to third parties, including soft loans (**Low to Medium Risk depending on Credit Risk**)	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

m. Loans to a local authority company/ partnership or charity (**Low Risk)**	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/LLP 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. In general these loans will involve some form of security or clear cash flow that is available to service the debt.	£1m
n. Shares in Hub Schemes (**Very Low Risk**)	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).

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Annex F **EAST RENFREWSHIRE COUNCIL**

ORGANISATIONS APPROVED FOR THE INVESTMENT OF SURPLUS FUNDS

		Limits	
Banking Group	**Individual Counterparty**	**Deposit**	**Transaction**
Bank of England	Debt Management Office	£5m	£5m
	UK Treasury Bills	£5m	£5m
Barclays Banking Group	Barclays Bank	£5m	£5m
Goldman Sachs International Bank		£5m	£5m
Lloyds Banking Group:	Bank of Scotland	£10m	£10m
Royal Bank of Scotland Group:	Royal Bank of Scotland	£5m	£5m
Santander Group	Santander UK PLC	£5m	£5m
Standard Chartered Bank		£5m	£5m
Clydesdale Bank		£0	£0
Building Societies			
Nationwide		£5m	£5m
Local Authorities			
All Local Authorities including Police & Fire		£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		£35m	£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 364 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.