The Highland Council

12 May 2016

Agenda Item	12
Report No	HC/20/16

Treasury Management Strategy Statement and Investment Statement – 2016/17

Report by Director of Finance

Summary

The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities. A requirement of the Code is for an annual Treasury Management Strategy Statement and Investment Statement to be approved by Council for the forthcoming financial year.

In compliance with the Code, the attached Treasury Management Strategy Statement and Investment Statement for 2016/17 was submitted to Resources Committee for scrutiny on 24 February and is now submitted to the Council for approval.

1. Introduction

1.1 Background

Treasury management is defined as:

"*The management of the local authority's 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*."

1.2 Statutory Requirements

The Local Government in Scotland Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in Section 10 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 CIPFA Requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 4th March 2010. The Code was further updated in November 2011.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated Committee is the Resources Committee.

1.4 Treasury Management Strategy for 2016/17

The proposed strategy for 2016/17 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita.

The strategy covers:

- treasury limits for 2016/17 to 2018/19 (which will limit the treasury risk and activities of the Council);
- the current treasury position;
- the borrowing requirement, based upon the Council's current capital programmes;
- Prudential and Treasury Indicators;
- prospects for interest rates;
- the borrowing strategy (including policy on borrowing in advance of need);
- debt rescheduling;
- annual investment strategy.

1.5 Balanced Budget Requirement

It is a statutory requirement under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions.

Therefore, increases in capital expenditure must be limited to a level whereby the corresponding increases in revenue charges are affordable and within the projected future income of the Council. Increases in revenue charges would include the following:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure; and
- any increases in running costs from new capital projects.

1.6 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny (the Resources Committee).

The training needs of treasury management officers are periodically reviewed, with training provided throughout the year using a number of mediums; in-house training, meetings with and training provided by Treasury advisers, external training courses, attendance at treasury forum meetings with other Councils.

1.7 Treasury management advisors

The Council uses Capita as its external treasury management advisors. Capita were appointed to this role effective from 1 July 2014 for a three year period with an option to extend for 1 year.

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

The Council also recognises their responsibility for treasury management decisions and will ensure that undue reliance is not placed upon our external service providers.

2. Treasury Limits for 2016/17 to 2018/19

2.1 It is a statutory duty under part 7 of the Local Government in Scotland Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to allocate to capital expenditure.

2.2 The Council must have regard to the Prudential Code when setting the Affordable Capital Expenditure Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council house rent levels is ‘acceptable’.

2.3 Whilst termed an “Affordable Capital Expenditure Limit”, the capital plans to be considered for inclusion may incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The affordable capital expenditure limit is to be set, on a rolling basis, for the forthcoming and two successive financial years.

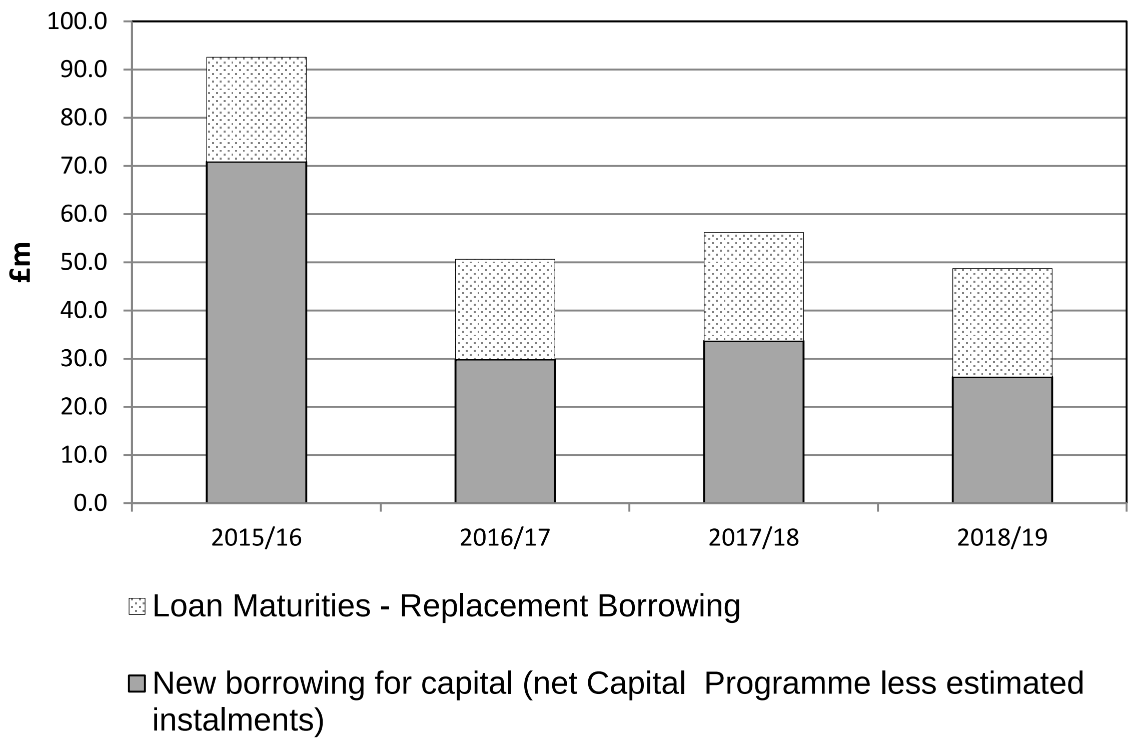
2.4 The Council's current General Fund capital programme was agreed in December 2015.with the Housing Revenue Account (HRA) capital programme agreed in August 2015.

The affordability of the General Fund capital plan was considered as part of the process undertaken to agree a 10 year plan. An additional £2.5m will be required to be added to the Loan Charges budget for the first 9 years of the plan to ensure that the projects contained therein are fully funded. The implications on HRA rent levels of the agreed capital programme were considered as part of the process undertaken to set an HRA programme.

3. Borrowing Requirement

3.1 The following table sets out the borrowing requirement, showing current year, as well as estimates for future years. The borrowing requirement takes account of borrowing to support the agreed capital programmes, less the projected instalments as capital repayments are charged to revenue accounts through loan charges. This figure is then adjusted to take account of any further borrowing required to go towards the capital financing requirement, or to replace existing loans maturing in these years.

Table 2 Estimates of borrowing requirement (current year and next three years)



4. Prudential and Treasury Indicators

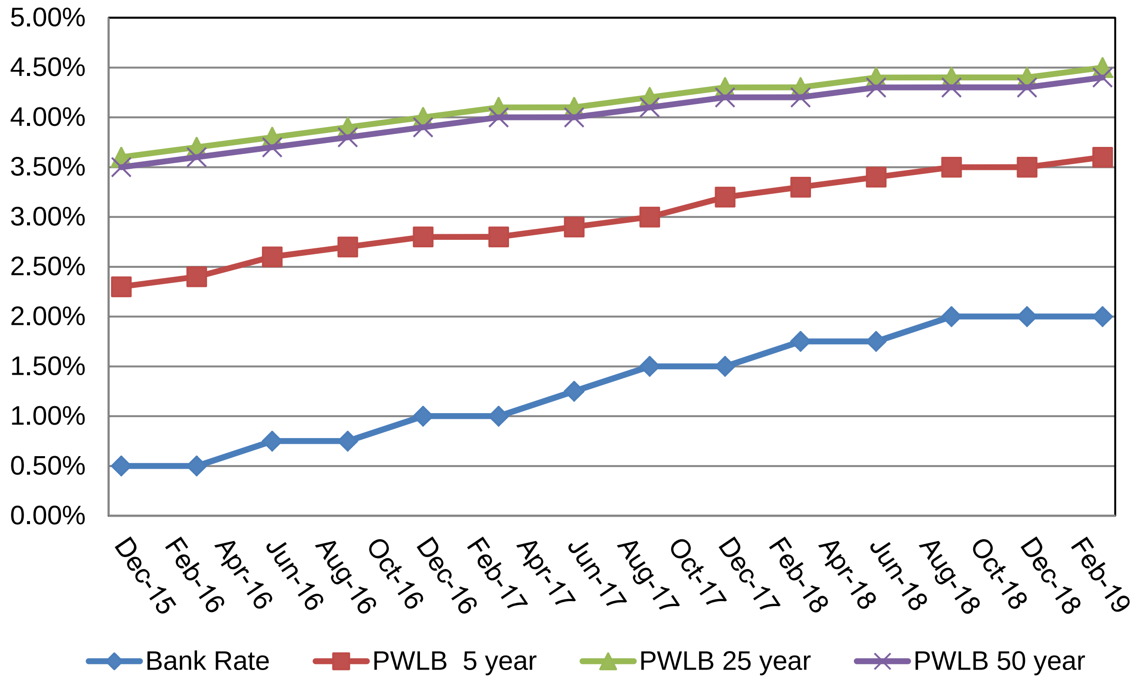
4.1 The prudential and treasury Indicators which are relevant for setting an integrated treasury management strategy are in **Appendix 2**. These Indicators are based on the Council's current capital programmes.

4.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted in February 2002 and the revised 2009 Code was adopted on by the Council on 4 March 2010. The Code was further updated in November 2011, and the Council continues to adhere to the Code.

5. Economic Context and Prospects for Interest Rates

5.1 As part of the service Capita provide, economic forecasts are regularly provided to inform the Council's view on interest rates and longer fixed interest rates. The following graph is the Capita forecast for interest rates.

Capita view of interest rates (as at 21/12/15)



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

continuing low short term investment returns.

6. Context

6.1 Since the consideration of the last Treasury and Investment Strategy Statement in early 2015, there are some matters relating to the Council's strategies and external environment that are highlighted below for context.

- Investment counter-parties – Money Market Funds

  The Council continues to use Money Market Funds (MMF) as part of its Investment counter-party strategy which are a permitted counter-party in accordance with the current strategy.

  However, there is a European Directive (MiFID II – Markets in Financial Instruments Directive) due to come into force in January 2017 which would automatically classify Local Authorities as retail customers. As a result, local authorities may not have access to certain financial products unless they can satisfy the criteria to be classified as a professional investor. The requirements of this directive are still to being finalised and the Council will assess the implications of any change and use alternative counter-parties if necessary.

- Investment counter-parties – Government Backed Banks

  The UK Government has already commenced disposal of some of its holding in Lloyds, and long-term clearly the expectation is both Lloyds and RBS are returned fully to the private sector. Following the reduction in Government holdings in Lloyds, the credit rating was reduced from blue (1 year) to red (6 months).

- Investment counter-parties – Non UK Banks

  The Council is using Svenska Handelsbanken (Swedish bank with a strong credit rating) as a counterparty.

- Investment counter-parties – Certificates of Deposit

  From August 2015 onwards, the Council placed certificates of deposits with Standard Chartered and Royal Bank of Scotland which are both UK registered banks. Certificates of deposit are a permitted investment and are similar to fixed term deposits but can be traded before the maturity date. The use of certificates of deposit enables the Council to access counterparties which would not deal directly as the Council is restricted to investing £15m with any single counterparty.

- PWLB Certainty Rate

  The PWLB certainty rate which was introduced in 2012 continues to apply. There is a 0.20% discount on existing PWLB borrowing rates available for Councils willing to provide HM Treasury with future forecasts of their borrowing requirements. The Council submitted the necessary forecasts and can now benefit from the discount. Entry into the certainty rate arrangement does not commit, nor limit the Council, to a notified level of borrowing.

7. Borrowing Strategy

7.1 Over the past few years the Council has benefitted from lower borrowing costs due to low interest rates, in particular utilisation ofshort term temporary borrowing and internal borrowing (use of existing cash). During financial year 2015/16, in order to achieve savings the Council made the best use of the low rates available on temporary borrowing and to date has not undertaken any long-term borrowing.

Going forward into 2016/17 the Council will continue to use short term borrowing to fund the capital programme. Council officials will also give consideration to a strategy of de-risking by taking slightly longer term borrowing (up to 5 years) with the aim of mitigating the risk of increased borrowing costs as interest rates start to rise.

The Council will however ensure its strategy remains flexible, and will give consideration to new borrowing from the following sources based on prevailing market conditions:

1. Appropriately dated PWLB borrowing.
2. Temporary borrowing from the money markets or other local authorities.
3. Short dated borrowing from non PWLB below sources.
4. Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
5. Consideration of any government supported or promoted lending initiatives, which may offer attractive sources of finance e.g. low cost borrowing for specific energy efficiency projects.

7.2 Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were 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 medium/ long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it were 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 a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that longer term fixed rate funding will be taken whilst interest rates were still relatively cheap.

7.3 External v. Internal Borrowing

As reflected in the table below, the Council's objective is to maintain a level of temporary investments which will ensure a level of liquid cash available to the Council. The level shown takes account of the level of Council reserves and balances, and potential for these to be utilised through planned use or unforeseen events. Through this approach, the Council seeks to mitigate re-financing risk, particularly were the Council's reserves to be eroded due to unforeseen events.

Table 4 – Comparison of gross and net debt positions at year end

	2014/15 Actual	**2015/16 Est-imate**	**2016/17 Est-imate**	**2017/18 Est-imate**	**2018/19 Est-imate**
External Debt (gross)	£761.1m	£831.2m	£872.4m	£899.2m	£926.9m
Temporary Investments	£65.3m	£50.0m	£40.0m	£40.0m	£40.0m
External Debt (net)	**£695.8m**	**£781.5m**	**£832.4m**	**£859.2m**	**£886.9m**

Table excludes long-term liabilities e.g. PPP schemes

- Another factor in considering the level of investments held is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments and mitigating of re-financing risk.
- The expectation is for continuing low bank rates for deposits in 2016/17, therefore the Council will keep its range of available counter-parties under regular review, to maximise value for money considerations. However, as clearly stated within this strategy, the priorities for the Council's investments are security and liquidity first, and only then looking at investment yield..

The Treasury Team will monitor the interest rate market, take advice from professional advisors, and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Resources Committee at the next available opportunity.

7.4 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. In accordance with the revised Code, any decision to borrow in advance will be within the 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.

In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- consider the merits and demerits of alternative forms of funding.
- consider the prevailing and projected interest rates based on best available information.
- Consider appropriate maturity profiles of new borrowing.
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

The maximum extent to which borrowing in advance would be undertaken will be based upon the existing and projected capital financial requirement, and existing level of debt.

8. Debt Rescheduling

8.1 At this time, and due to the early repayment penalties imposed by PWLB, there are limited opportunities for debt rescheduling. However, this position will be kept under regular review.

8.2 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 strategy outlined in section 8 above, and
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.3 Consideration will also be given to the 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 Resources Committee, at the earliest meeting following its action.

9. Annual Investment Strategy

9.1 <u>Investment Policy</u>

The Council's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). **The Council's investment priorities will be security first, liquidity second, then return.**

The Council will also aim to achieve the optimum return on its investments commensurate 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.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

The Council's policy in relation to Investment instruments and counter-parties identified for use in the financial year are listed in **Appendices 5, 6, 7, 8 and 9** and explanatory notes on investment types and risks are detailed in **Appendix 10**.

9.2 Creditworthiness policy

The Council recognises the vital importance of credit-worthiness checks on the counter-parties it uses for investments.

This Council uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with further credit overlays to provide a colour coded system based on recommended durational band for use of the counter-party.

This Council does not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Capita creditworthiness service uses a wider array of information than just primary ratings, from all three agencies, but by using a risk weighted scoring system, does not give undue consideration to just one agency's ratings.

The Capital creditworthiness service is used on an advisory basis, with the decision on creditworthiness ultimately resting with the Treasury Team

9.3 Foreign Exposures/Country limits

In relation to Money Market Funds, only AAA rated Sterling denominated funds will be used.

At present the Council uses mainly UK based institutions for investment.

Examples of the institutions that the Council will invest in include UK banks and building societies, UK Local Authorities, non UK banks and building societies of high credit worthiness, HMT Treasury Debt Management Office.

The Council continues to use non-UK counterparties of high credit worthiness. The Capita Treasury Services rating model is used in the same way as for UK institutions. In addition only institutions registered in countries with an AAA or AA+ will be considered. The list of countries where the Council will consider investing are at **Appendix 8**.

Appendices 5, 6, 7, 8 and 9 set out further details on the Council's permitted investments and approach to use of counter-parties.

9.4 Investment Strategy

In-house funds are mainly cash-flow derived and investments will be made in accordance with cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

9.5 Investment return expectations

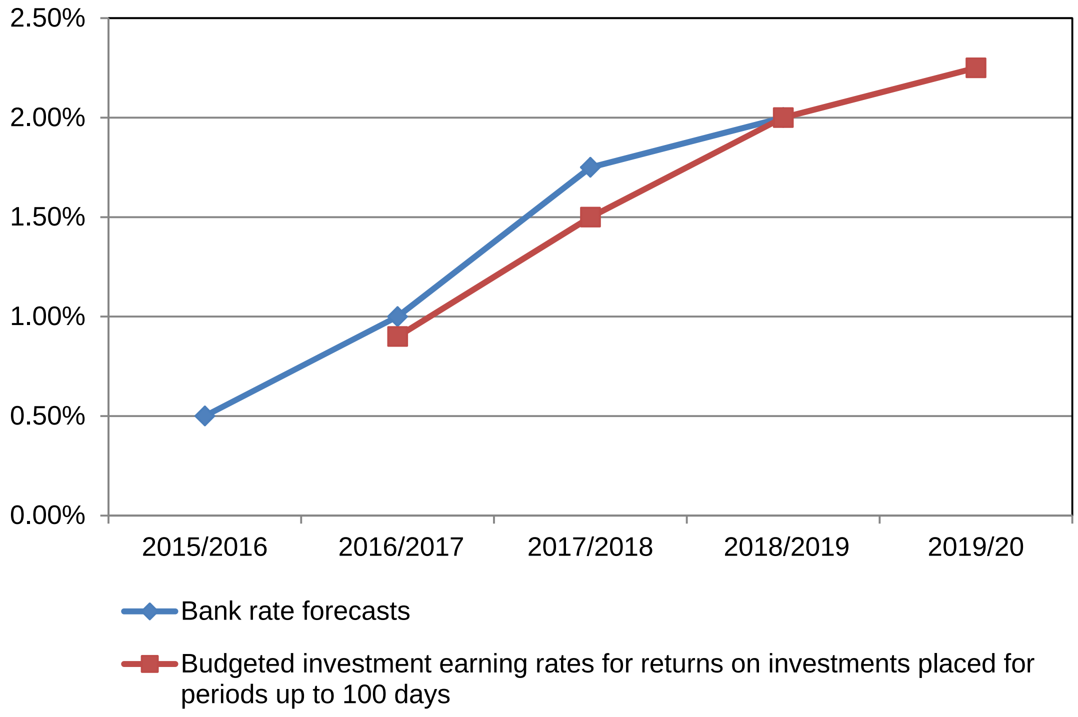
As detailed in section 6, Table 3 Capita view of interest rates, Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 3 of 2016. Bank Rate forecasts for financial year ends (March) are in the graph below.

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are also in the graph below

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

Investment return expectations (as at 21/12/15)



9.6 For its cashflow generated balances, the Council will seek to utilise its business reserve accounts, notice accounts, short-dated deposits and money market funds in order to benefit from the compounding of interest.

9.7 End of Year Investment Report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report. Forecasts of investment balances for the next three years are provided in **Appendix 2**.

9.8 Policy on the Use of External Service Providers

The Council's tendered Treasury Management advisor contract is subject to regular review. The Council currently uses Capita Treasury Services as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

9.9 Treasury Management Scheme of Delegation

Please see **Appendix 11**.

9.10 The Treasury Management Role of Section 95 Officer

Please see **Appendix 11**.

10. Implications

10.1 The resource and risk implications are covered in the attached tables. There are no specific legal, equality or climate change/Carbon Clever implications relating to this report.

Recommendation

In compliance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities, the attached Treasury Management Strategy Statement and Investment Statement for 2016/17 is submitted to Council for approval.

Designation: Director of Finance

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Date: 23 March 2016

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Appendices

1. Interest Rate Forecasts
2. Prudential and Treasury Indicators
3. Economic Background
4. Treasury Management Policy
5. Permitted Investments – Common Good, Charitable, Educational and Other Trust Funds
6. Permitted Investments – Non Treasury Investments
7. Permitted Investments – Treasury Investments
8. Approved countries for investment
9. Current counter party list as at 14/01/2015
10. Treasury Management Practice 1 (TMP1) Credit and Counterparty Risk Management
11. Treasury Management Scheme of Delegation and Role of the Section 95 Officer

Appendix 1

Interest Rate Forecasts 2016 to 2019 (as at 1 November 2015)

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

Capita Asset Services Interest Rate View														
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
3 Month LIBID	0.60%	0.70%	0.80%	0.90%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%
6 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.10%	2.20%	2.20%	2.30%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.40%	2.50%	2.50%	2.70%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB Rate	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB Rate	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.40%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Capital Economics	3.40%	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

Appendix 2

Prudential and Treasury Indicators

The borrowing set out within the Prudential Indicators is based upon the General Fund capital programme agreed by the Council in December 2015. In relation to the HRA, borrowing is required to fund the programme agreed in August 2015 The Estimates of Capital Expenditure below in indicator 3 and 4 include expenditure in relation to the National Housing Trust which is self-financing.

A. Indicators for Affordability, Prudence and Capital Expenditure

Indicator 1 - Capital Expenditure

Gross Capital Expenditure in absolute terms rather than as a ratio, these show the overall levels of estimated capital investment irrespective of how they are being funded.

	2014/15 Actual	**2015/16 Original Estimate**	**2015/16 Revised Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund	£107.9m	£113.3m	£139.2m	£86.0m	£95.7m	£85.8m
Housing Revenue Account	£43.3m	£39.7m	£61.1m	£26.4m	£27.0m	£27.6m
Total	**£151.2m**	**£153.0m**	**£200.3m**	**£112.4m**	**£122.7m**	**£113.4m**

Net Capital Expenditure is the borrowing or funding requirement for new capital investment in each year.

General Fund	£51.5m	£70.4m	£70.4m	£47.5m	£55.0m	£50.0m
Housing Revenue Account	£24.8m	£19.2m	£36.0m	£15.6m	£17.5m	£18.1m
Total	**£76.3m**	**£89.6m**	**£106.4m**	**£63.1m**	**£72.5m**	**£68.1m**

Indicator 2 – Capital Financing Requirement (CFR)

These indicators represent the level of the Council's underlying need to borrow or finance by other long-term liabilities for a capital purpose. This includes past and future borrowing or funding.

	2014/15 Actual	**2015/16 Original Estimate**	**2015/16 Revised Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund excluding PPP	£557.6m	£611.0m	£599.9m	£623.4m	£650.4m	£670.0m
PPP	£125.9m	£122.0m	£122.0m	£118.2m	£114.5m	£110.3m
Total	**£683.5m**	**£733.0m**	**£721.9m**	**£741.6m**	**£764.9m**	**£780.3m**
Housing Revenue Account	£205.2m	£222.6m	£233.8m	£240.1m	£246.8m	£253.4m
Total	**£888.7m**	**£955.6m**	**£955.7m**	**£981.7m**	**£1,011.7m**	**£1,033.7m**
Joint Boards	£23.2m	£22.2m	£22.2m	£21.1m	£20.1m	£19.0m
Total CFR (incl Police/Fire) (1)	**£911.9m**	**£977.8m**	**£977.9m**	**£1,002.9m**	**£1,031.8m**	**£1,052.7m**

Treasury Position This indicator shows the expected borrowing position, net of investments.

Gross Borrowing	£761.1m	£821.1m	£831.2m	£872.4m	£899.2m	£926.9m
Other Long Term Liabilities	£125.9m	£121.9m	£121.9m	£118.2m	£114.5m	£110.3m
Total Gross Debt (2)	**£887.0m**	**£943.1m**	**£953.1m**	**£990.6m**	**£1,013.7m**	**£1,037.2m**
Investments	£65.3m	£50.0m	£50.0m	£50.0m	£50.0m	£50.0m
Net Borrowing	**£821.7m**	**£893.1m**	**£903.1m**	**£940.6m**	**£963.7m**	**£987.2m**

Difference between CFR (1) and Total Gross Debt (2)

This indicator shows the difference between the Capital Financing Requirement, and the Estimated Gross Debt. The difference represents an 'under-borrowed' position, with capital financed from internal cash flows.

	2014/15 Actual	2015/16 Original Estimate	2015/16 Revised Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Difference between CFR (1) and Total Gross Debt (2)	£24.9m	£34.7m	£24.8m	£12.3m	£18.1m	£15.5m

Indicator 3 – Authorised Limit for Borrowing

The Authorised Limit is the maximum level of external borrowing which should not be exceeded. The limit is linked to the estimated level of capital financing requirement, with some capacity for variations from that sum e.g. if capital expenditures are exceeded.

Authorised Limit	2014/15 Actual	2015/16 Original Estimate	2015/16 Revised Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	£916.5m	£924.3m	£924.3m	£963.6m	£996.8m	£1,028.8m
Other Long Term Liabilities	£125.9m	£121.9m	£121.9m	£118.2m	£114.5m	£110.3m

Indicator 4 - Operational Boundary for Borrowing

An Operational Boundary is also required which represents the Director of Finance’s estimate of the day to day limit for the Treasury Management activity based on the most likely i.e. prudent but not worst case scenario.

Operational Boundary	2014/15 Actual	2015/16 Original Estimate	2015/16 Revised Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	£854.5m	£907.1m	£907.1m	£947.6m	£974.4m	£1,002.1m
Other Long Term Liabilities	£125.9m	£121.9m	£121.9m	£118.2m	£114.5m	£110.3m

Indicator 5 – Ratio of financing costs to net revenue stream

These indicators show the capital financing costs (interest charges, the provision for the repayment of debt and the financing of PPP outstanding capital investment liability) as a percentage of government grant (revenue), Council Tax, Rents and other income. This allows the authority to track how much of its annual income is needed to pay for its capital investment plans and outstanding funding liabilities compared to its day to day running costs.

	2014/15 Actual	**2015/16 Original Estimate**	**2015/16 Revised Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund including PPP	12.4%	13.0%	12.4%	11.5%	12.5%	13.1%
Housing Revenue Account	34.5%	33.8%	36.3%	39.9%	43.4%	44.4%

Indicator 6 – Estimates of the Incremental impact of capital investment decisions on the Band D Council tax and housing rents levels

These indicators demonstrate the **notional** impact of varying new capital investment expressed as a cost on the Band D Council Tax and Rents. These are notional rather than actual increases in Council Tax and rent, as the Council has or will utilise savings and other measures to fund its capital plans, to minimise the impact on tax and rent levels.

	2014/15 Actual	**2015/16 Original Estimate**	**2015/16 Revised Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Estimates of the Incremental impact of capital investment decisions on the Band D Council tax	£12.41	£56.32	£12.07	-£42.51	£65.43	£34.52
Estimates of the Incremental impact of capital investment decisions on the housing rent levels (weekly figures based on a 48 week year are shown in brackets)	£48.94 (£1.02)	£114.03 (£2.38)	£93.46 (£1.95)	£163.29 (£3.40)	£158.76 (£3.31)	£69.91 (£1.46)

Indicator 7- Interest rate exposures of debt net of investments

Interest rate exposures of debt net of investments are required to be set in compliance with the Code. This limits the Council's exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for Treasury Management activities. It promotes a prudent strategy aimed to avoid the adverse effects of fluctuating interest rates. The limits are based on the Capital Financing Requirement with variable exposures limited to 35% of fixed.

Interest rate exposures of debt net of investments	2014/15 Actual	2015/16 Original Estimate	2015/16 Revised Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Upper Limit (Fixed)	£638.1m (indicator £825.5m)	£865.1m	£855.9m	£884.7m	£917.3m	£942.5m
Upper Limit (Variable)	£61.8m (indicator £288.9m)	£302.8m	£299.6m	£309.6m	£321.0m	£329.8m

Maturity structure of fixed rate borrowing during 2015/16

This indicator identifies the amount of debt maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. The Council currently applies the prudent practice of ensuring that no more than 30% of its total gross fixed rate debt matures in any one financial year unless triggered through specific debt restructuring exercises.

	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	25%

Maximum principal invested for period longer than 364 days

The maximum total principal sum which may be invested with a maturity for a period longer than 364 days and within the permitted investment limits is £20m

Compliance with other prudential indicators

In addition to the above, the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice.
- Ensure that over the medium term borrowing will only be for a capital purposes (i.e. net external borrowing is less than the CFR)

The compliance with these indicators is highlighted in the body of the report.

The above indicators have been set to contain the Council's exposure to the possibility of loss that might arise as a result of having to seek early redemption of principal sums invested over the longer term.

The Council's current investment strategy is to maintain only temporary, shorter-term investments for portfolio management purpose. This affords operational flexibility and enables returns to be compounded more frequently.

Appendix 3

Economic Background Provided by Capita Treasury Services (as at 21/12/15)

The UK economy

UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.2%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, more recent, round of falls in fuel prices which will now delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until 2017, though the forecasts in the Report itself were for an even slower rate of increase.

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

Eurozone (EZ)

In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, this more recent lacklustre progress, combined with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and / or increasing its size in order to get inflation up from the current level of around zero towards its target of 2%. The ECB will also aim to help boost the rate of growth in the EZ.

Greece

During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing / communist coalition has taken power in Portugal which is heading towards unravelling previous pro austerity reforms. This outcome could be replicated in Spain. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

USA

GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.1% in Q3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong; this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

China and Japan

Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its ‘arrows’ of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

Emerging countries

There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

This change in investors’ strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

Capita’s forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

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

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Treasury management policy Appendix 4

1.1 Treasury management is defined as:

"*The management of the local authority's 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*."

1.2 The Council regards the successful identification, monitoring and control of risk to be key to the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

1.3 The Council acknowledges that effective treasury management will support the achievement of its business and service objectives. It is therefore committed to achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Investment policy

2.1 The Council's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). **The Council's investment priorities will be security first, liquidity second, then return.**

2.2 The Council will also aim to achieve the optimum return on its investments commensurate 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. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

2.3 The Council's Treasury Management Consultants provide a creditworthiness matrix to aid the assessment of the risk involved in lending to individual counterparties.

2.4 The Council's detailed policies in relation to Investment instruments and counter-parties identified for use in the financial year are listed in **Appendices 5, 6, 7, 8 and 9** and explanatory notes on investment types and risks are detailed in **Appendix 9**.

Borrowing policy

3.1 The Council will ensure its strategy remains flexible, and will give consideration to new borrowing from the following sources based on prevailing market conditions:

- Appropriately dated PWLB borrowing.
- Temporary borrowing from the money markets or other local authorities.
- Short dated borrowing from non PWLB below sources.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
- Consideration of any government supported or promoted lending initiatives, which may offer attractive sources of finance e.g. low cost borrowing for specific energy efficiency projects.

Appendix 5

Permitted Investments – Common Good, Charitable, Educational and Other Trust Funds

The Council approves the following forms of investment instruments for use as permitted investments for these Funds as set out in the Table below (these include internally and externally managed funds):

Investments

	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investmt	Max. maturity period
Cash deposits – local authorities, banks, building societies and cash funds	Relevant parameters as per specific investment mandates and/or specific trust deeds	term	yes	Relevant parameters as per specific investment mandates and/or specific trust deeds	
Equities – UK and Overseas		term	yes		
Fixed Income, Index Linked Bonds, Unit Trusts		term	yes		
War Stock		term	no		
Alternative Investments - Property		term	yes		

Permitted Investments – Non Treasury Investments **Appendix 6**

Definition of non-treasury investments

Regulation 9 of the Local Government Investment (Scotland) Regulations 2010 adds to the normal definition of investments the following categories: -

a) All shareholding, unit holding and bond holding, including those in a local authority owned company, is an investment;
b) Loans to a local authority company or other entity formed by a local authority to deliver services, is an investment;
c) Loans made to third parties are investments;
d) Investment property is an investment.

However, the following loans are excluded from the definition of investments: -

- Loans made by a local authority to another authority or harbour authority using powers contained in Schedule 3, paragraph 10 or 11 of the Local Government (Scotland) Act 1975.

Permitted Investments – Non-Treasury Investments

The Council approves the following forms of investment instruments for use as permitted investments for Non-Treasury Investments as set out in the Table below:

Investments

	Minimum Credit Criteria	**Liquidity risk**	**Market risk**	**Max % of total investments**	**Max. maturity period**
Loans to Companies, including Local Authority owned.	See Regulation Notes below	term	no	See Regulation requirements and current approvals below.	
Shares and Bonds in Companies, including Local Authority owned.		term	no		
Loans to Third Parties including investments in sub-ordinated debt (see note 1 and 2).		instant	no		
Local Authority Investment Properties.		term	no		
Other Investment Deposits (see note 3)		term	no		

Regulation 24. A local authority shall state the limits for the amounts which, at any time during the financial year, may be invested in each type of permitted investment, such limit being applied when the investment is made. The limits may be defined by reference to a sum of money or a percentage of the local authority's overall investments, or both. A local authority may state that a permitted investment is unlimited. Where a limit is not placed on any type of permitted investment the risk assessment must support that categorisation and an explanation provided as to why an unlimited categorisation is recommended.

Regulation 25. The local authority should identify for each type of permitted investment the objectives of that type of investment. Further, the local authority should identify the treasury risks associated with each type of investment, together with the controls put into place to limit those risks. Treasury risks include credit or security risk of default, liquidity risk – the risks associated with committing funds to longer term investments and market risk – the effect of market prices on investment value.

Regulation 32. The Strategy shall include details of the maximum value and maximum periods for which funds may prudently be invested. The Strategy shall set out the local authority objectives for holding longer term investments. The Strategy shall also refer to the procedures for reviewing the holding of longer term investments particularly those investments held in properties, shareholdings in companies or joint ventures.

The policy above, and requirements of regulations 24, 25 and 32, will be considered, and reported to members, as part of any report pertaining to new investment proposals.

In Part 1, section 12 of the Regulations, Consent includes as an investment any loan issued to a third party. Such loans are neither capital nor revenue transactions, but are often made for Service reasons and for which specific statutory provision exists. For Service reasons these loans may be offered at an interest rate below the market rate. All loans to third parties are classified as investments for the purposes of the Consent. Where the loan is advanced at less than a market interest rate there is an associated loss of investment return which would otherwise have been earned on these monies. The Council's Annual Accounts will recognise and present all loans to third parties as investments.

This Council will refrain from issuing loans to third parties at less than market rate. If, in exceptional circumstances, the Council agrees to issue a loan/s to third parties at less than market rate the associated loss of investment return will be chargeable to the budget of the sponsoring Service. In circumstances where investment risk is a predominant factor the rate chargeable will reflect the equivalent market rate where this is greater than the Council's Loans Fund's most recent actual average interest rate. In all other cases the interest rate chargeable will be the Council's Loans Fund's most recent actual average interest rate.

Current Approvals

Note 1 – Subordinated Debt – the Highland Council, on 25 October 2012, agreed to permit an investment, at a maximum level of £1m for all current and future investments, for a maximum maturity period of 25 years, in 'Hub Co' projects.

Note 2 – Land banking Fund and Loan Advances to Registered Social Landlords (RSLs) – the Council has for many years operated a 'land bank fund'. The fund is used to provide loans and grants to partner organisations (including RSLs), enabling strategic sites to be secured or prepared for development of housing. The Land bank Fund is a revolving facility with loans repaid as land and property is resold or developed.

Note 3 – From May 2005 The Council has held £1.175m of unsecured loan stock in Inverness Airport Business Park Ltd (IABP). Under the Loan Stock Instrument IABP can exercise a right to defer the repayment due to be made to the Council in May 2010 and in May 2015. IABP have exercised this right on both repayment dates so the full amount of Loan Stock due to the council remains outstanding.

Permitted Investments – Treasury Management **Appendix 7**

The Council's policy in relation to permitted investments is a three-stage process as summarised below.

1. Only use of permitted investments per the investment strategy is allowed. See Appendix 10 for definition of the different types of investment.
2. Credit-worthiness of counter-parties will be assessed having taken advice from the Council's treasury management advisers, Capita. Maximum maturity periods for individual counter-parties will be based upon advice from the Adviser, with limits on treasury investments > 364 days as per the prudential indicators, and shown below.
3. Counter-party limits, as set out within the investment strategy will be applied.

The following sections explain each aspect of the 3-stage process in further detail.

<u>Stage 1 - Permitted Investments</u>

The Council approves the following forms of investment instruments for use as permitted treasury management investments as set out in the Tables below. While there is a maximum permitted maturity period set out in the Tables, the actual maturity period will be based on an assessment of risk as part of the credit-worthiness assessment (see stage 2).

In relation to Money Market Funds, only AAA rated Sterling denominated funds will be used.

In relation to all other counter-parties, the Council will mainly use UK based institutions but where there are non-UK counterparties of high credit worthiness these may be used. In determining whether a counterparty is UK or non UK, entities are classified under where their primary regulator is based. The list of countries where the Council can invest are at **Appendix 7**. For example UK banks and building societies, UK Local Authorities, non UK banks and building societies of high credit worthiness, HMT Treasury Debt Management Office.

a. Deposits (UK institutions only)

	Minimum Credit Criteria	**Liquidity risk**	**Market risk**	**Max % of total investments** (Stage 2 Below)	**Max. maturity period**
Debt Management Agency Deposit Facility	--	term	no	**100**	**6 mths**
Term deposits – local authorities	--	term	no	**100**	**2 yrs**
Term deposits – banks and building societies	See Stage 2 below	term	yes	**100**	**2 yrs**
Call accounts – banks and building societies	See Stage 2 below	instant	yes	**100**	**1 yr**

b. Deposits with counterparties currently in receipt of government support/ownership (UK institutions only)

	Minimum Credit Criteria	**Liquidity risk**	**Market risk**	**Max % of total investments** (Stage 2 Below)	**Max. maturity period**
UK nationalised banks	See Stage 2 Below	term	limited	**100**	**2 yrs**
Term deposits – banks and building societies	See Stage 2 below	term	limited	**100**	**2 yrs**

UK Government support to the banking sector (implicit guarantee)	See Stage 2 below	term	limited	**100**	**2 yrs**

c. Collective investment schemes structured as Open Ended Investment Companies (OEICs). Sterling Deposits Only.

	Minimum Credit Criteria	**Liquidity risk**	**Market risk**	**Max % of total investments**	**Max. maturity period**
Money Market Funds	Short Term F1+ Long-term AAA__ Volatility rating MR1+	instant	See Note 1	**100**	**1 yr**

Note 1 – Money Market Funds: These funds invest in short term instruments such as Government/Treasury issues, short-term corporate paper and Certificates of Deposits. By keeping a short time-frame, these funds attempt to reduce risk. The objective of these Funds is to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero – see Appendix 7 Paragraph 3 (a) for more details. Each Money Market Fund is treated as a single counter-party in relation to counter-party limits.

Note 2 - If forward deposits are to be made, the forward period plus the deal period will not exceed one year in aggregate.

Stage 2 – Credit worthiness policy and assessment

This Council uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

- All credit ratings are monitored from a weekly list which can be updated daily by Capita. The Council is alerted to changes to ratings of all three agencies as these occur through its use of the Capita creditworthiness service.
- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, immediate consideration will be given to whether funds should be withdrawn from this counterparty and the timescale for doing this.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a daily basis via its Passport website. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Based on the Capita approach, the Council will therefore use counterparties within the following durational bands:

Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No Colour	Not to be used

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

In relation to Money Market Funds, the Council will use Capita's weekly investment monitor, and other regular updates, to ensure its MMF counter-parties meet the minimum credit criteria described in the table above.

As set out within the Prudential Indicators, a limit is set on the value of Treasury Investments which can be invested for more than 364 days. The limit is £20m, which represents the maximum sum invested for longer than 364 days. Though the period of investment must be decided using Capita credit ratings and maximum limits in permitted investments.

<u>Stage 3 – Counter-party Limits</u>

The limits described below apply to the Council's treasury management operations. Separate limits apply for the Pension Fund, with Highland Council limits relating to all operations excluding the Pension Fund. If for unavoidable short term operational reasons, limits are breached this will be communicated to management immediately.

Due to market volatility in treasury management investments and varying levels of investment it is possible that at any time in the year one category of investment could represent 100% of the portfolio although it is likely that investments will carry greater diversification than this.

No more than £15m can be invested with any single counterparty, with the exception of the nationalised or semi nationalised UK banks (see section B above) where no more than £25m can be invested in each bank.

The Council will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers is currently £10m for the Highland Council bank accounts.

The Highland Council Pension Fund will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers is currently £10m. The Pension Fund may also use other counterparties, with a £10m limit applying to each.

Appendix 8

Approved countries for investment

If a country rating is downgraded, this will be removed from our approved countries for investment.

AAA

- Australia
- Canada
- Denmark
- Germany
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Netherlands
- U.K.
- U.S.A.

Appendix 9

Current counter party list as at 14/01/2016

The following table is for use by the in house treasury management team and is a list of current counterparties used. However, the use of counterparties depends on credit ratings and the Council may stop using certain counterparty's and/or decide to use alternative counterparties within its permitted investments. If for unavoidable short term operational reasons, limits are breached this will be communicated to management immediately.

	At time of investment use Capita rating Current rating 14/01/16	Maximum Duration per TMSS	Investment limits	
			Highland Council	Highland Council Pension Fund (note 1)
Government Backed Deposits				
Debt Management Agency Deposit Facility	Yellow (5 years)	6 months	Unlimited	Not used
Deposits with Counterparties currently in receipt of Government Support/Ownership				
RBS	Blue (1 year)	2 years	£25m	£10m
Bank of Scotland	Red (6 months)	2 years	£25m	Not used
Term deposits (*restricted to £20m invested >364 days*)				
Term deposits – local authorities	Yellow (5 years)	2 years	£15m	Not used
Term deposits – banks and building societies (UK only)	Varies	2 years	£15m	Not used
Nationwide	Red (6 months)	2 years	£15m	Not used
Goldman Sachs				
Certificates of deposit				
Standard Chartered	Red (6 months)	1 Year	£15m	Not used
Royal Bank of Scotland	Blue (1 year)	2 years	£15m	Not used
Call accounts				
Clydesdale Bank (Council's Banker)	No colour	1 year	£10m	£10m
Barclays	Red (6 months)	1 year	£15m	Not used
Santander	Red (6 months)	1 year	£15m	Not used
Svenska Handelsbanken	Blue (1 year)	1 year	£15m	£10m

Money Market Funds				
Standard Life Asset Management	AAA	1 Year	£15m	Not used
Insight Asset Management	AAA	1 Year	£15m	Not used

Note 1 – the Pension Fund currently uses a limited number of counter-parties as shown above. In line with the limits detailed on appendix 6, additional counter-parties could be considered up to the limits stipulated.

Appendix 10 Treasury Management Practice 1 (TMP1) Credit and Counterparty Risk Management

Type of Permitted Investment	**Treasury Risks**	**Mitigating Controls**
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.
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. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non-local authority deposits will follow the approved credit rating criteria.
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 are Constant Net Asset Value (CNAV), and the fund has a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.
d. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties.
e. 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.

Type of Permitted Investment	Treasury Risks	Mitigating Controls
f. 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.
g. Certificates of deposits with financial institutions **(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. 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. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence
h. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period & credit rating)**	These tend to be medium to 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 very low and investments can only be broken with the agreement of the counterparty (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 Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.
i. Corporate bonds **(Medium to high risk depending on period & 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. The selection defaults to the lowest available credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.

Type of Investment	Treasury Risks	Mitigating Controls
j. Investment properties	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.
k. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.
l. Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.
m. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.
n. Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Capita Asset Services, including when ratings change, and counterparties are checked promptly. On occasion ratings 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 by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

Appendix 11

Treasury Management Scheme of Delegation

(i) The Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

(ii) The Council's Resources Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- receiving and reviewing regular monitoring reports and acting on recommendations; including scrutiny/review of annual strategy, annual report and mid-year report;

(iii) Director of Finance

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- approval of the division of responsibilities;
- approving the selection of external service providers and agreeing terms of appointment.

The Treasury Management Role of the Section 95 Officer

The S95 (responsible) Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit

  recommending the appointment of external service providers.