Resources Committee

8 February 2017

Agenda Item	**10.b**
Report No	**RES/09/17**

Treasury Management Strategy Statement and Investment Statement – 2017/18

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 2017/18 is submitted to Committee for scrutiny. This Statement will then be submitted to the Council for approval in March 2017.

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 and 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 2017/18

The proposed strategy for 2017/18 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 2017/18 to 2019/20 (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

Sections 70 and 93 of the Local Government Finance Act 1992, establish the legal framework by which the Council is required to set 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 and 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 one 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 2017/18 to 2019/20

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.

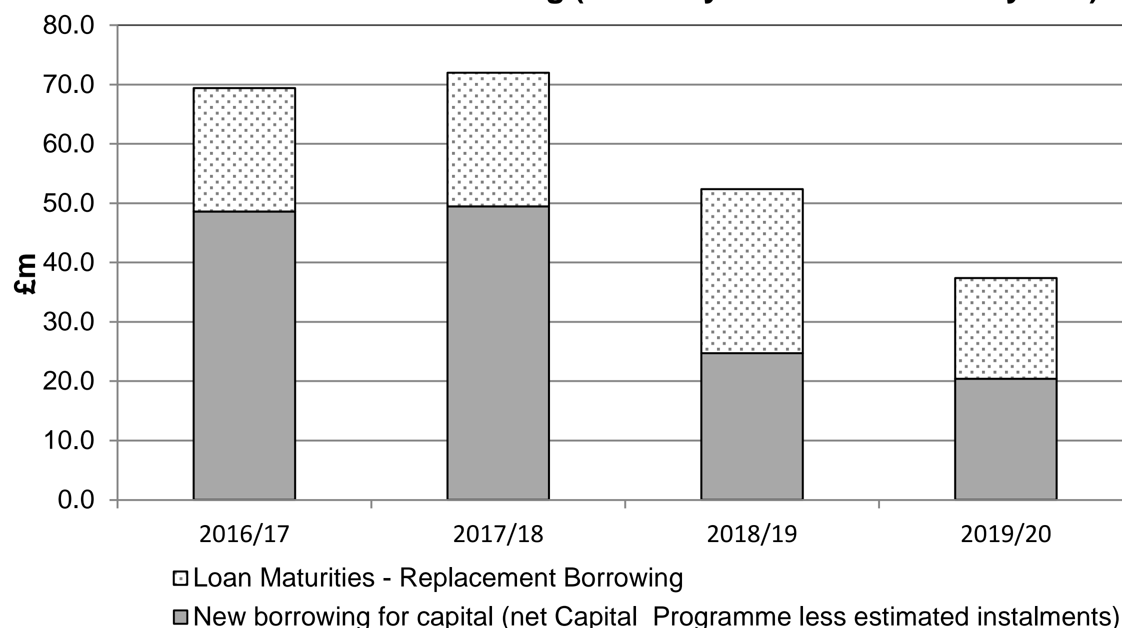
2.4 The Council's current General Fund capital programme was agreed in December 2015 with the Housing Revenue Account (HRA) capital programme was agreed in August 2015.

As advised at the December 2016 Council meeting, the Council's capital plan requires to be reviewed, as affordability is now a major challenge given pressures on the Revenue Budget. This Treasury Management Strategy Statement will play a key part of this review.

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 1 Estimates of borrowing (current year and next three years)



4. Statutory repayment of loans fund advances

4.1 The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 came into force on 1 April 2016. The main change introduced by the Regulations is to provide options for the prudent repayment of debt and requires the Council 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.

4.2 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, with all loans fund advances being repaid by the annuity method.

- For loans fund advances made between 1 April 2016 and 31 March 2021, the policy for the repayment of loans advances will also be the Statutory method, with all loans fund advances being repaid by the annuity method. The annuity rate applied to the loans fund repayments will continue to be based on the loans fund rate for the previous year which is calculated using interest paid as a proportion of the outstanding loans fund advances.

4.3 The annuity method links the repayment of the borrowing to the flow of benefits from an asset where the benefits are expected to increase in later years.

4.4 As required by the Local Government Finance Circular 7/2016, the commitments to repay loans fund advances for the General Fund and HRA are contained in Appendices 12 and 13.

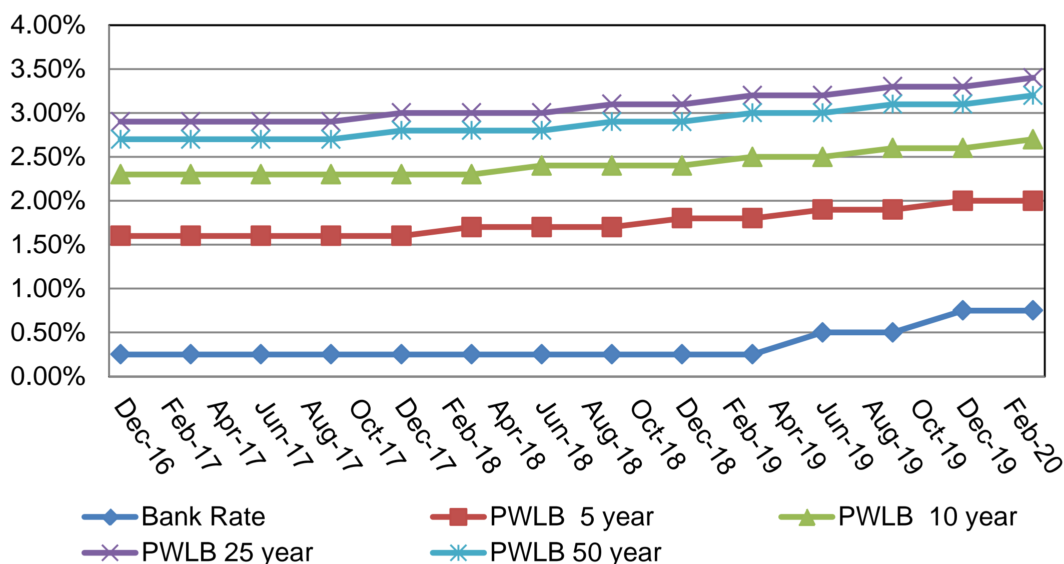
5. Prudential and Treasury Indicators

5.1 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.

5.2 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.

6. Economic Context and Prospects for Interest Rates

6.1 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 current Capita forecast for interest rates.



6.2 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 low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016; they fell sharply to historically low levels after the referendum and then even further after the MPC meeting of 4 August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. 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 future when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- Any new long-term borrowing will most likely cause a temporary increase in cash balances and corresponding cost of carry (a revenue cost – the difference between borrowing costs and investment returns).
- If long term borrowing rates do start to increase, long term borrowing may be undertaken to reduce refinancing risks and avoid incurring higher borrowing costs in the future.

7. Context

7.1 Since the consideration of the last Treasury and Investment Strategy Statement in early 2016, there are some matters relating to the Council's strategies and external environment that are highlighted below for context.

- Investment counter-parties – Increase to Limits

  At Resources Committee in November 2016, approval was given to

increase all individual counterparty limits from £15m to £20m with the exception of RBS and Clydesdale which remained at £25m and £10m respectively. This change was proposed in order to increase counterparty capacity and access better rates.

- Investment counter-parties – Money Market Fund

  Over the next few years, the EU will be working on developing proposals which may require these funds to move from Constant Net Asset value (CNAV) to Low Volatility Net Asset Value (LVNAV). These reforms are still to be agreed and are unlikely to be ready for implementation in 2017/18. Whenever these changes occur, Committee will be updated on the implications for the Council's investment strategy.

- Investment counter-parties MiFID II

  The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. The new MiFID II will become effective on 3 January 2018.

  Under the new regime, Local Authorities will automatically be deemed "Retail" clients by default. They will have the option to "opt-up" to "Professional" client status, or remain as "Retail". In order to opt-up, clients will need to meet qualitative and quantitative test criteria.

  Committee will be updated on any implications this may have on the Council's investment strategy.

- Economic and political context

  There are a range of factors that may impact on the current Treasury Management Strategy Statement.

  1. The financial impact of the UK's exit from the European Union (Brexit) has still to be clarified in both timing and negotiated settlement. This may have a negative impact on borrowing and investment returns, as well as reviewing the status and credit rating of counterparties.

  2. The financial challenges facing Highland Council and specific pressures on the revenue budget will require a review of the affordability of current capital plans. This will impact on the borrowing requirement of the current plan.

  3. The Scottish Government has indicated that capital grant may increase and this may provide some flexibility around long term borrowing.

  4. Combined funding for investment projects though the Scottish Futures Trust model may impact on future capital investment plans.

  5. The Scottish Government's borrowing powers, under devolved powers, may impact on future controls around local government borrowing.

8. Borrowing Strategy

8.1 Over the past few years the Council has benefitted from lower borrowing costs due to low interest rates, in particular utilisation of short term temporary borrowing and internal borrowing (use of existing cash). During financial year 2016/17, in order to achieve savings the Council made the best use of the low rates available on temporary borrowing and the only long term borrowing (for periods greater than 5 years) undertaken was £25m in June 2016 to replace PWLB debt that matured in March 2016.

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 with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.

Going forward into 2017/18 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.

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

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. Short dated borrowing from non PWLB sources through the Sterling Money Market.
3. Long term fixed rate market loans from the Sterling Money Market 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.
4. 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.

8.2 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.

8.3 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 3 – Comparison of gross and net debt positions at year end

	2015/16 Actual	**2016/17 Est-imate**	**2017/18 Est-imate**	**2018/19 Est-imate**	**2019/20 Est-imate**
External Debt (gross)	£818.5m	£867.1m	£916.5m	£941.3m	£961.7m
Temporary Investments	£50.9m	£50.0m	£50.0m	£50.0m	£50.0m
External Debt (net)	**£767.6m**	**£817.1m**	**£866.5m**	**£891.3m**	**£911.7m**

The Table above 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 2017/18, 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.

The current policy of short term borrowing means an increased workload for staff as short term borrowing needs to be replaced continually and cashflows monitored closely.

8.4 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.

9. Debt Rescheduling

9.1 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.

9.2 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).

9.3 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.

10. Annual Investment Strategy

10.1 Investment Policy

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, and 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 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 10**.

10.2 Creditworthiness policy

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

This Council uses the creditworthiness service provided by Capita Asset 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 and 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.

10.3 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, HM Treasury Debt Management Office.

The Council continues to use non-UK counterparties of high credit worthiness. The Capita Asset Services rating model is used in the same way as for UK

institutions. In addition to UK counterparties, only institutions registered in countries with an AAA or AA+ credit rating will be considered. The list of countries where the Council will consider investing is 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 counterparties.

10.4 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).

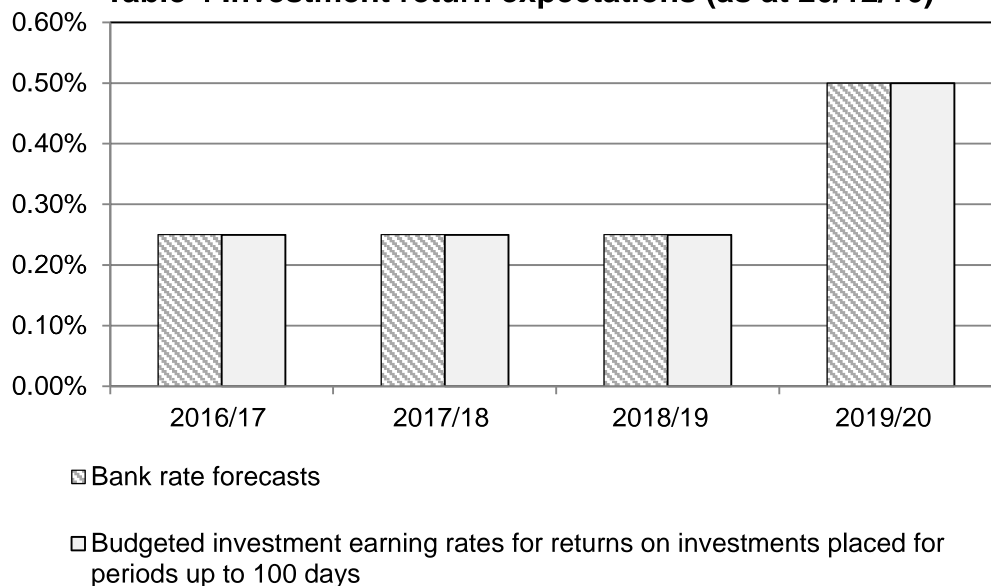
10.5 Investment return expectations

As detailed in section 6, Table 2 Capita view of interest rates, Bank Rate is forecast to remain unchanged at 0.25% before starting to rise from quarter 1 of 2019. 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 and are identical to the bank rate forecasts.

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.



10.6 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**.

10.7 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 Asset Services as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the Authority 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.

10.8 Treasury Management Scheme of Delegation

Please see **Appendix 11**.

10.9 The Treasury Management Role of Section 95 Officer

Please see **Appendix 11**.

11. Implications

11.1 The resource and risk implications are covered in the attached tables. In addition there are particular economic and political risks that have been included in section 7. There are no specific legal, equality, climate change/Carbon Clever, Gaelic or rural implications relating to this report.

Recommendation

1. Members are invited to scrutinise for their interests the Treasury Management Strategy Statement and Investment Statement for 2017/18 and the Prudential Indicators as detailed in **Appendix 2** of the report.

2. Members are asked to note that, 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 2017/18 will subsequently be submitted to the Council for approval in March 2017.

Designation: Director of Finance

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Date: 30 January 2017

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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 31/12/2016
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 2017 to 2020 (as at 16 December 2016)

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

Bank Rate	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capita Asset Services	**0.25%**	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
Capital Economics	**0.25%**	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%

5yr PWLB Rate	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capita Asset Services	**1.52%**	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Capital Economics	**1.52%**	1.40%	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%

10yr PWLB Rate	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capita Asset Services	**2.33%**	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	**2.33%**	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%

25yr PWLB Rate	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capita Asset Services	**2.95%**	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	**2.95%**	2.85%	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%

50yr PWLB Rate	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capita Asset Services	**2.69%**	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	**2.69%**	2.70%	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%

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.

	2015/16 Actual	**2016/17 Original Estimate**	**2016/17 Revised Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
General Fund	£117.4m	£86.0m	£115.5m	£106.0m	£85.8m	£83.3m
Housing Revenue Account	£55.8m	£26.4m	£35.1m	£30.7m	£26.6m	£27.2m
Total	**£173.2m**	**£112.4m**	**£150.6m**	**£136.7m**	**£112.4m**	**£110.5m**

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

General Fund	£77.3m	£47.5m	£68.2m	£65.3m	£50.0m	£50.0m
Housing Revenue Account	£36.4m	£15.6m	£17.6m	£23.9m	£17.1m	£17.7m
Total	**£113.7m**	**£63.1m**	**£85.8m**	**£89.2m**	**£67.1m**	**£67.7m**

Loan charge instalments is the repayment of principal.

General Fund	(£28.2m)	(£24.0m)	(£28.6m)	(£31.3m)	(£33.7m)	(£35.9m)
Housing Revenue Account	(£7.4m)	(£9.4m)	(£8.6m)	(£8.4m)	(£8.6m)	(£11.4m)
Total	**(£35.6m)**	**(£33.4m)**	**(£37.2m)**	**(£39.7m)**	**(£42.3m)**	**(£47.3m)**

Net borrowing for new capital expenditure.

General Fund	£49.1m	£23.5m	£39.6m	£34.0m	£16.3m	£14.1m
Housing Revenue Account	£29.0m	£6.2m	£9.0m	£15.5m	£8.5m	£6.3m
Total	**£78.1m**	**£29.7m**	**£48.6m**	**£49.5m**	**£24.8m**	**£20.4m**

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.

	2015/16 Actual	**2016/17 Original Estimate**	**2016/17 Revised Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
General Fund excluding PPP	£608.8m	£623.4m	£655.5m	£689.5m	£705.8m	£719.9m
PPP	£122.0m	£118.2m	£118.2m	£114.5m	£110.3m	£105.7m
Total	**£730.8m**	**£741.6m**	**£773.7m**	**£804.0m**	**£816.1m**	**£825.6m**
Housing Revenue Account	£234.1m	£240.1m	£244.0m	£259.5m	£267.9m	£274.2m
Total	**£964.9m**	**£981.7m**	**£1,017.7m**	**£1,063.5m**	**£1,084.0m**	**£1,099.8m**
Joint Boards	£22.2m	£21.1m	£21.1m	£20.0m	£19.0m	£17.9m
Total CFR (incl Police/Fire) (1)	**£987.1m**	**£1,002.8m**	**£1,038.8m**	**£1,083.5m**	**£1,103.0m**	**£1,117.7m**

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

Gross Borrowing	£818.4m	£872.4m	£867.1m	£916.6m	£941.3m	£961.7m
Other Long Term Liabilities	£122.0m	£118.2m	£118.2m	£114.5m	£110.3m	£105.7m
Total Gross Debt (2)	**£940.4m**	**£990.6m**	**£985.3m**	**£1,031.1m**	**£1,051.6m**	**£1,067.4m**
Investments	£50.9m	£50.0m	£50.0m	£50.0m	£50.0m	£50.0m
Net Borrowing	**£889.5m**	**£940.6m**	**£935.3m**	**£981.1m**	**£1,001.6m**	**£1,017.4m**

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.

	2015/16 Actual	**2016/17 Original Estimate**	**2016/17 Revised Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Difference between CFR (1) and Total Gross Debt (2)	£46.7m	£12.2m	£53.5m	£52.4m	£51.4m	£50.3m

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	**2015/16 Actual**	**2016/17 Original Estimate**	**2016/17 Revised Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Borrowing	£924.3m	£963.6m	£963.6m	£1,055.7m	£1,074.2m	£1,086.7m
Other Long Term Liabilities	£122.0m	£118.2m	£118.2m	£114.5m	£110.3m	£105.7m

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	2015/16 Actual	2016/17 Original Estimate	2016/17 Revised Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Borrowing	£818.5m	£947.6m	£947.6m	£937.4m	£962.1m	£982.5m
Other Long Term Liabilities	£122.0m	£118.2m	£118.2m	£114.5m	£110.3m	£105.7m

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.

	2015/16 Actual	2016/17 Original Estimate	2016/17 Revised Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund including PPP	11.9%	13.0%	12.4%	13.0%	13.8%	14.6%
Housing Revenue Account	33.9%	33.8%	37.8%	36.6%	36.9%	41.7%

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.

	2015/16 Actual	2016/17 Original Estimate	2016/17 Revised Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Estimates of the Incremental impact of capital investment decisions on the Band D Council tax	£16.87	-£42.51	£14.89	£68.39	£116.13	£155.49
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)	£58.57 (£1.22)	£163.29 (£3.40)	£27.19 (£0.57)	£135.04 (£2.81)	£257.29 (£5.36)	£353.29 (£7.36)

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	2015/16 Actual	2016/17 Original Estimate	2016/17 Revised Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Upper Limit (Fixed)	£708.4m (indicator £865.1m)	£884.7m	£920.6m	£969.0m	£992.7m	£1,012.0m
Upper Limit (Variable)	£59.0m (indicator £302.8m)	£309.6m	£322.2m	£339.1m	£347.4m	£354.2m

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 20/12/16)

The UK economy

GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which was interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC), meeting of 4th August** was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The **MPC meeting of 3 November** left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, **consumers** have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it

is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and

core inflation was 1.4%, confirming the likely future upwards path.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. **House prices** have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

USA

The American economy had a patchy 2015 with sharp swings in the quarterly **growth rate** leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth. The Fed embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the **presidential election** in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the **bond market and bond yields** rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even

rein back on some of those policies himself.

In the first week since the US election, there was a major shift in **investor sentiment** away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

Eurozone (EZ)

In the Eurozone, **the ECB** commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.
- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their

vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- **4 December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- **French presidential election;** first round 13 April; second round 7 May 2017.
- **French National Assembly election June 2017.**
- **German Federal election August – 22 October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of **free movement of people** within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

China and Japan

Economic growth in **China** has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both needs to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in **Japan** is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries
There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

Capita's forward view
The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

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 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 start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been 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, has called into question whether,

or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. 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 strong economic growth becomes more firmly established. The expected substantial rise in the Fed rate over the next few years may 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 would be likely to exert some upward pressure on bond yields in other developed countries but 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 in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 04.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates,

especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing 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.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

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. 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, and 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 10**.

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.
- Short dated borrowing from non PWLB sources through the Sterling Money Market.
- Long term fixed rate market loans from the Sterling Money Market 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

<table>
<tr><th></th><th>Minimum Credit Criteria</th><th>Liquidity risk</th><th>Market risk</th><th>Max % of total investmt</th><th>Max. maturity period</th></tr>
<tr><td>Cash deposits – local authorities, banks, building societies and cash funds</td><td rowspan="5">Relevant parameters as per specific investment mandates and/or specific trust deeds</td><td>term</td><td>yes</td><td rowspan="5" colspan="2">Relevant parameters as per specific investment mandates and/or specific trust deeds</td></tr>
<tr><td>Equities – UK and Overseas</td><td>term</td><td>yes</td></tr>
<tr><td>Fixed Income, Index Linked Bonds, Unit Trusts</td><td>term</td><td>yes</td></tr>
<tr><td>War Stock</td><td>term</td><td>no</td></tr>
<tr><td>Alternative Investments - Property</td><td>term</td><td>yes</td></tr>
</table>

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.

Stage 1 - Permitted Investments

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	UK sovereign rating	term	no	**100**	**6 mths**
Term deposits – local authorities	N/A	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**
Enhanced cash funds with a credit score of 1.25	AAA	trade plus 2 to 5 days	See Note 2	**100**	**1 yr**
Enhanced cash funds with a credit score of 1.5	AAA	trade plus 2 to 5 days	See Note 2	**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 – Enhanced Cash 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.

Note 3 - 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 Asset 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:

Yellow	5 years *
Dark pink	5 years for Enhanced cash funds (EMMFs) with a credit score of 1.25
Light pink	5 years for Enhanced cash funds (EMMFs) with a credit score of 1.5
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

*Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.

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.

Stage 3 – Counter-party Limits

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 £20m 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 suitable counterparties, with a £10m limit applying to each.

Appendix 8

Approved countries for investment (as at 20/12/16)

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

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.

Appendix 9

Current counter party list as at 31/12/2016

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 14/12/16	**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	£20m	Not used
Term deposits (*restricted to £20m invested >364 days*)				
Term deposits – local authorities	Yellow (5 years)	2 years	£20m	Not used
Term deposits – banks and building societies (UK only)	Varies	2 years	£20m	Not used
Commonwealth Bank of Australia	Orange (1 year)	2 years	£20m	Not used
Coventry Building Society	Red (6 months)	2 years	£20m	Not used
DZ Bank	Orange (1 year)	2 years	£20m	Not used
Goldman Sachs	Red (6 months)	2 years	£20m	Not used
Nationwide	Red (6 months)	2 years	£20m	Not used
Certificates of deposit				
Standard Chartered	Red (6 months)	1 Year	£20m	Not used
Royal Bank of Scotland	Blue (1 year)	2 years	£20m	Not used

Call accounts				
Clydesdale Bank (Council's Banker)	No colour	1 year	£10m	£10m
Barclays	Red (6 months)	1 year	£20m	Not used
Santander	Red (6 months)	1 year	£20m	Not used
Svenska Handelsbanken	Orange (1 year)	1 year	£20m	£10m
Money Market Funds				
Standard Life Asset Management	AAA	1 Year	£20m	Not used
Insight Asset Management	AAA	1 Year	£20m	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. Enhanced cash 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 the ECFs have an “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.
e. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. 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.
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.

Type of Permitted Investment	Treasury Risks	Mitigating Controls
g. 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.
h. 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.
i. 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.
j. 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.
k. 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.

Type of Investment	Treasury Risks	Mitigating Controls
l. 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.
m. 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.
n. 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.
o. 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.

Appendix 12 Commitment to pay to repay loans fund advances (General Fund)

	Financial year	HISTORIC DEBT Opening Balance	Instalment	NEW DEBT Opening Balance	Instalment	New Borrowing
		£	£	£	£	£
1	2016-17	**608,810,941**	28,620,203	-	-	68,202,000
2	2017-18	580,190,738	28,624,834	68,202,000	2,661,772	65,306,000
3	2018-19	551,565,904	28,641,771	130,846,228	5,429,070	50,000,000
4	2019-20	522,924,133	28,709,771	175,417,159	7,738,003	50,000,000
5	2020-21	494,214,362	28,508,517	217,679,156	10,104,095	50,000,000
6	2021-22	465,705,845	27,991,744	257,575,061	12,285,978	50,000,000
7	2022-23	437,714,101	26,506,995	295,289,083	11,510,709	51,000,000
8	2023-24	411,207,106	25,814,163	334,778,374	14,866,437	51,500,000
9	2024-25	385,392,943	24,736,904	371,411,937	16,500,713	-
10	2025-26	360,656,039	23,495,393	354,911,224	15,932,076	-
11-15	2026-27	337,160,646	104,565,178	338,979,149	70,947,866	-
16-20	2031-32	232,595,468	76,815,833	268,031,282	72,857,860	-
21-25	2036-37	155,779,635	37,924,968	195,173,422	67,034,988	-
26-30	2041-42	117,854,667	27,071,561	128,138,434	38,094,154	-
31-35	2046-47	90,783,105	19,250,897	90,044,280	25,896,625	-
36-40	2051-52	71,532,209	17,506,011	64,147,655	11,496,960	-
41-45	2056-57	54,026,198	15,974,684	52,650,696	8,235,108	-
46-50	2061-62	38,051,514	15,315,095	44,415,588	8,689,275	-
51-55	2066-67	22,736,418	14,827,199	35,726,313	10,307,601	-
56-60	2071-72	7,909,219	7,909,219	25,418,712	12,661,821	-
61-65	2076-77	-	-	12,756,891	10,523,564	-
66-70				2,233,327	2,233,327	
Totals			**608,810,941**		**436,008,000**	**436,008,000**

Appendix 13 Commitment to pay to repay loans fund advances (HRA)

	Financial year	HISTORIC DEBT Opening Balance	Instalment	NEW DEBT Opening Balance	Instalment	New Borrowing
		£	£	£	£	£
1	2016-17	**234,149,968**	8,630,194	-	-	17,631,000
2	2017-18	225,519,775	7,859,447	17,631,000	688,099	23,897,000
3	2018-19	217,660,327	7,410,341	40,839,901	1,682,891	17,102,000
4	2019-20	210,249,986	9,524,295	56,259,011	2,463,548	17,732,000
5	2020-21	200,725,692	9,420,023	71,527,463	3,290,655	18,394,000
6	2021-22	191,305,668	10,550,917	86,630,807	4,213,002	-
7	2022-23	180,754,752	9,647,343	82,417,806	3,884,562	-
8	2023-24	171,107,408	10,211,242	78,533,244	3,559,044	-
9	2024-25	160,896,166	9,482,845	74,974,199	3,357,196	-
10	2025-26	151,413,322	9,582,070	71,617,004	3,089,569	-
11-15	2026-27	141,831,252	48,942,338	68,527,435	14,486,473	-
16-20	2031-32	92,888,914	40,812,949	54,040,961	16,249,433	-
21-25	2036-37	52,075,965	13,873,200	37,791,529	13,495,716	-
26-30	2041-42	38,202,765	11,529,597	24,295,813	6,573,473	-
31-35	2046-47	26,673,168	8,299,928	17,722,340	5,097,535	-
36-40	2051-52	18,373,240	3,670,332	12,624,805	1,655,670	-
41-45	2056-57	14,702,908	1,745,970	10,969,134	1,824,350	-
46-50	2061-62	12,956,938	3,123,271	9,144,784	1,917,040	-
51-55	2066-67	9,833,667	5,960,445	7,227,744	2,354,886	-
56-60	2071-72	3,873,223	3,873,223	4,872,858	2,892,733	-
61-65	2076-77	-	-	1,980,125	1,980,125	-
Totals			**234,149,968**		**94,756,000**	**94,756,000**