



Treasury Management Strategy Statement And Annual Investment Strategy 2019/20

Corporate Services
Finance and Procurement
Treasury and Capital
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1.0 Introduction

1.1 Introduction

The Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the 'Prudential Code for Capital Finance in Local Authorities' published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and therefore 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. They also require the Council to have regard to the "Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes" published by CIPFA which require the Council to set out its treasury management strategy for borrowing and investment and how it will give priority to security and liquidity in managing its investments.

1.2 Background

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

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

CIPFA defines treasury management as:

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

1.3 Reporting Requirements

The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

Policy and Resources Committee have delegated authority to oversee the monitoring of the Treasury Management Strategy and will receive the Annual and Mid Year Treasury Management reports for scrutiny and review.

Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

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

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

1.4 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the loans fund repayment policy

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.5 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. Training was undertaken by members as part of the 2017 Member Induction Programme and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.6 Treasury Management Consultants

The Council uses Link Asset Services (previously part of Capita Asset Services) as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

2.0 Capital Prudential Indicators 2019/20 to 2021/22

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

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The Updated Capital Plan for the period 2017/18 to 2026/27 includes actual and projected capital expenditure for that period. The 2017/18 to 2020/21 position is detailed below:

	Actual	Projected	Estimate		
Capital Expenditure	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Priority Projects	49.265	22.946	4.702	11.800	27.893
Asset Classes	23.335	25.357	31.258	26.311	22.735
Other (including Spend to Save)	1.985	1.711	-	-	-
Total as per Capital Investment Strategy	74.585	50.014	35.960	38.111	50.628

There are some variations in the level of Capital spend between years both within the Priority Projects and Asset classes, this is due to the profile of current spending plans, particularly in relation to the flood prevention schemes.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

	Actual	Projected	Estimate		
	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Capital Expenditure	74.585	50.014	35.960	38.111	50.628
Financed by:					
Scottish Govt Capital Grant	23.061	23.230	27.520	22.809	32.127
Capital Receipt	0.384	0.500	0.500	0.500	0.500
Capital Fund	6.304	0.748	-	-	-
Revenue Funding (CFCR)	0.753	-	-	-	-
Total Funding	30.502	24.478	28.020	23.309	32.627
Net Financing Need for Year	44.083	25.536	7.940	14.802	18.001

The peak in Scottish Government Grant for 2019/20 is due to the return of funding that the Scottish Government previously reprofiled. In 2021/22 the funding is due to increase due to the ring fenced funding to support the flood schemes within the strategy.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

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

Prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing.

The CFR includes any other long term liabilities (OLTL) (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £114 Million of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

	Actual	Projected	Estimate		
	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Capital Financing Requirement					
CFR exc OLTL	303.403	314.125	307.155	307.429	310.807
OLTL	130.727	113.628	110.791	107.753	104.436
Total CFR	434.130	427.753	417.946	415.182	415.243
Movement in CFR		-6.377	-9.807	-2.764	0.061

	Actual	Projected	Estimate		
	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Net financing need for the year (2.1 above)		25.536	7.940	14.802	18.001
Less scheduled debt amortisation		- 14.814	- 14.910	- 14.528	- 14.623
Less payment to OLTL		- 17.099*	- 2.837	- 3.038	- 3.317
Movement in CFR		-6.377	-9.807	-2.764	0.061

*The OLTL payment within 2018/19 reflects the removal of the Waste PFI liability following the contract termination.

As at 1 April 2018 £303.403 Million of advances made to support capital spending still requires to be charged to the revenue account. The redemption profile for this is shown on Annex 1.

3.0 Borrowing

The capital expenditure plans set out in Section 2 provide details of the investment priorities of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet these investment priorities and to support service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2018, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	Actual	Projected	Estimate		
Capital Financing Requirement	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
External Debt					
Debt at 1 April	205.723	245.747	256.469	249.499	49.773
Expected change in Debt	40.024	10.722	-6.970	0.274	3.378
OLTL at 1 April	107.940	130.727	113.628	110.791	107.753
Expected change in OLTL	22.787	- 17.099	- 2.837	- 3.038	- 3.317
Actual gross debt at 31 March	376.474	370.097	360.290	357.526	357.587
The Capital Financing Requirement	434.130	427.753	417.946	415.182	415.243
Under (over) borrowing	57.656	57.656	57.656	57.656	57.656

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt shown above does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council has complied with this prudential indicator in the current year and does not envisage any difficulties over the period of the current 10-year Capital Investment Strategy. This view takes into account current commitments, existing plans, and the proposals in the Financial Plans for 2019/20.

3.2 Treasury Indicators: Limits to Borrowing Activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt. The operational boundary from 2019/20 onwards reflects the estimated borrowing level for the year plus the borrowing required for the following two years based on the Capital Investment Strategy.

	Actual	Projected	Estimate		
Operational boundary	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Debt	270.269	278.527	282.301	284.015	286.894
Other long term liabilities	130.727	113.628	110.791	107.753	104.436
Total	400.996	392.155	393.092	391.768	391.330

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. From 2019/20 this is calculated as the operational boundary for debt plus 5%. Other Long Term Liabilities remain consistent.

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

	Actual	Projected	Estimate		
Authorised limit	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Debt	350.040	331.049	296.416	298.216	301.238
Other long term liabilities	130.727	113.628	110.791	107.753	104.436
Total	480.767	444.677	407.207	405.969	405.674

3.3 Prospects for Interest Rates (as provided by Link Asset Services, February 2019)

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and commentary gives their central view.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.80%	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.00%	1.10%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%

2018 was a year which started with weak growth of only 0.1% in quarter 1. However, quarter 2 rebounded to 0.4% in quarter 2 followed by quarter 3 being exceptionally strong at +0.6%. Quarter 4 though, was depressed by the cumulative weight of Brexit uncertainty and came in at only +0.2%. Growth is likely to continue being weak until the Brexit fog clears.

The above forecasts are based on a major assumption that Parliament and the EU agree an orderly Brexit, either by 29 March or soon after. At their 7 February meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they have given a figure for this of around 2.5% in ten years' time but have declined to give a medium term forecast. However, with so much uncertainty around Brexit, the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, devaluation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could provide fiscal stimulus to boost growth.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of

robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. Since then, US 10 year bond yields have fallen back on fears that the Fed could be too aggressive in raising interest rates and was going to cause a recession. However, the Fed dropped any specific reference to expecting further rate increases at their January 30 meeting. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

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.

Investment and borrowing rates

- *Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.*
- *Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have fallen significantly since then. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;*
- *There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.*

3.4 Borrowing Strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Finance & Procurement will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the Policy and Resources Committee at the next available opportunity.

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

3.6 Debt Rescheduling

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

The reasons for any rescheduling to take place will include:

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

Consideration will also be given to identify if there is any residual 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 Policy and Resources Committee at the earliest meeting following its action

4.0 Annual Investment Strategy

4.1 Investment Policy

The Council's investment policy has regard to the Scottish Government's Investments Investment (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010), and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017, ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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

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

Investment instruments identified for use in the financial year are listed in appendices 5.4 and 5.5. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness Policy

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (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 used by the Council to

determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years *
- Dark pink 5 years for Ultra short dated bond funds with a credit score of 1.25
- Light pink 5 years for Ultra short dated bond funds 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

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored on a real time basis. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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 sovereign support for banks and the credit ratings of that supporting government.

UK banks – ring fencing

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

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-

ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

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

4.3 Country and Sector Considerations

- a) All investments will be with UK institutions.
- b) These institutions must either be UK Local Authorities or UK Incorporated Institutions, UK Banks and Building Societies incorporated in the European Economic Area entitled to accept deposits through a branch in the UK.
- c) Although not currently used, the Council may consider the use in the future of the UK Government including in the form of gilts and the Debt Management Account Deposit Facility (DMADF), as well as Money Market Funds. Members' approval will be sought before investments are placed with these institutions.

4.4 Institutional Limits

The Councils General institutional investment limits are as follows

- Bank of Scotland £25M*
- Other UK Banks £10M
- UK Local Authorities £5M
- UK Building Societies £5M

*the Bank of Scotland limit is higher than other institutions as they are the Council's main banking provider and all main accounts are held with them.

Limits applied to individual counterparties will be detailed within the Council's Treasury Management Practices – Schedules

4.5 Investment Strategy

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

Investment returns expectations.

On the assumption that the UK and EU agree a Brexit deal in spring 2019 or soon after, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 - 0.75%
- 2019/20 - 1.00%
- 2020/21 - 1.50%
- 2021/22 - 2.00%

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

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.25%
2021/22	1.75%
2022/23	2.00%
2023/24	2.25%
Later years	2.50%

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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

4.6 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.

5.0 Appendices

5.1 The Capital Prudential and Treasury Indicators 2019/20 – 2021/22

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

5.1.1 Capital Expenditure

Capital expenditure plans for the period 2019/20 to 2021/22 included in the Capital Investment Strategy agreed by Full Council on 28 February 2019 are as follows:

	Actual	Projected	Estimate		
	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Capital Expenditure					
Priority Projects	49.265	22.946	4.702	11.800	27.893
Asset classes	23.335	25.357	31.258	26.311	22.735
Total as per Capital Investment Strategy	72.600	48.303	35.960	38.111	50.628

5.1.2 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicator:

Ratio of financing costs to net revenue stream

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

%	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Excluding OLTL	6.6%	6.6%	6.8%	6.8%	6.8%
Including OLTL	7.5%	11.5%*	7.6%	7.7%	7.7%

*the increase in 2018/19 is due to the settlement of the Waste PFI contract.

5.1.3 Maturity structure of borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

Maturity Structure of Long Term Debt 2019/20			
	Lower	Upper	Current Actual
Under 12 months	0%	20%	3.97%
12 months to 2 years	0%	20%	0.60%
2 years to 5 years	0%	25%	13.26%
5 years to 10 years	0%	25%	8.45%

10 years and above	50%	100%	73.72%
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Limit on Temporary Debt (Under 12 months) 2019/20 (as percentage of total external debt)			
	Lower	Upper	Current Actual
Under 12 months	0%	25%	22.15%

Current external debt totals £254.319m. The maturity profile of this debt is as follows, and is shown in Annex 2.

Maturity Profile of Long Term Debt 2019/20		
	2017/18 Actual £m	Current Actual £m
Under 1 Year	7.977	7.854
1 to 2 Years	6.250	1.198
2 to 5 Years	2.055	26.248
5 to 10 Years	31.961	16.726
10 to 15 Years	0.720	0.709
15 to 20 Years	0.681	0.681
20 to 25 Years	0.703	1.758
25 to 30 Years	6.643	8.084
30 to 35 Years	18.462	28.104
35 to 40 Years	40.209	37.633
40 to 45 Years	20.563	16.002
45 to 50 Years	25.000	39.000
Over 50 Years	7.000	14.000
Total Long-Term Debt	168.224	197.997
Temporary Debt	37.559	56.322
Total External Debt	205.783	254.319

The average duration to maturity on this debt is 32.2 years.

5.1.4. Control of interest rate exposure

Limits on interest rate exposure 2019/20			
	Lower	Upper	Current Actual
Fixed Rate Exposure	70%	100%	99.28%
Variable Rate Exposure	0%	30%	0.72%

5.2 Interest Rate Forecasts 2018 – 2021

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

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.80%	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.00%	1.10%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Bank Rate													
Link Asset Services	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%	1.75%	1.75%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	1.80%	1.90%	2.00%	2.20%	2.50%	2.50%	2.60%	2.60%	0.00%	0.00%	0.00%	0.00%	0.00%
10yr PWLB Rate													
Link Asset Services	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
Capital Economics	2.20%	2.30%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.70%	2.80%	3.00%	3.10%	3.30%	3.20%	3.20%	3.10%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.60%	2.70%	2.80%	2.90%	3.20%	3.20%	3.20%	3.10%	-	-	-	-	-

As supplied by Link Asset Services February 2019.

5.3 Economic Background (as provided by Link Asset Services, February 2019)

GLOBAL OUTLOOK. *World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.*

Inflation *has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to an acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is now probably unlikely to make a start on raising rates in 2019.*

KEY RISKS - central bank monetary policy measures

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

*The key issue now is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), also reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a significant risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we did, indeed, see a sharp fall in equity values in the last quarter of 2018 and into early 2019. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** It is particularly notable that, at its 30 January 2019 meeting, the Fed dropped its previous words around expecting further increases in interest rates; it merely said it would be "patient".*

*The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to*

reducing its holdings of debt, (currently about \$50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. 2018 was a year which started with weak growth of only 0.1% in quarter 1. However, quarter 2 rebounded to 0.4% in quarter 2 followed by quarter 3 being exceptionally strong at +0.6%. Quarter 4 though, was depressed by the cumulative weight of Brexit uncertainty and came in at only +0.2%. Growth is likely to continue being weak until the Brexit fog clears.

The MPC has stated that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they have given a figure for this of around 2.5% in ten years' time but have declined to give a medium term forecast. However, with so much uncertainty around Brexit, the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, the MPC could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, devaluation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could provide fiscal stimulus to boost growth.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. In the February Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead given a scenario of minimal increases in Bank Rate.

The **labour market** figures in November were particularly strong with an emphatic increase in total employment of 141,000 over the previous three months, unemployment at 4.0%, a 43 year low on the Independent Labour Organisation measure, and job vacancies hitting an all-time high, indicating that employers are having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation continued at its high point of 3.3%, (3 month average regular pay, excluding bonuses). This means that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.2%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15 January. Prime Minister May is currently, (mid-February), seeking some form of modification or clarification from the EU of the Irish border backstop issue. However, our central position is that the Government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and an unemployment rate of 4.0%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in December. However, CPI inflation overall fell to 1.9% in December and looks to be on a falling trend to continue below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, which was the fifth increase in 2018 and the ninth in this cycle. However, they dropped any specific reference to expecting further increases at their January 30 meeting. The last increase in December compounded investor fears that the Fed could overdo the speed and level of increases in rates in 2019 and so cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow. Since the more reassuring words of the Fed in January, equity values have recovered somewhat.

The tariff war between the US and China generated a lot of heat during 2018; it could significantly damage world growth if an agreement is not reached during the current three month truce declared by President Trump to hold off from further tariff increases.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. Current forward indicators for economic growth and inflation have now been on a downward trend for a significant period which will make it difficult for the ECB to make any start on increasing rates until 2020 at the earliest. Indeed, the issue now is rather whether the ECB will have to resort to new measures to boost liquidity in the economy in order to support growth. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. In its January meeting, it made a point of underlining that it will be fully reinvesting all maturing debt for an extended period of time past the date at which it starts raising the key ECB interest rates.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

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

monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in subsequent years which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there was a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March 2018 of a government which has made a lot of anti-austerity noise. The EU rejected the original proposed Italian budget and demanded cuts in government spending. The Italian government nominally complied with this rebuttal – but only by delaying into a later year the planned increases in expenditure. This particular can has therefore only been kicked down the road. The rating agencies have downgraded Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold Italian debt. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- **Weak capitalisation of some European banks.** Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority EU governments.** Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.

- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. Elections to the EU parliament are due in May/June 2019.
- The increases in interest rates in the US during 2018, combined with a potential trade war between the USA and China, sparked major volatility in equity markets during the final quarter of 2018 and into 2019. Some **emerging market countries** which have borrowed heavily in dollar denominated debt, could be particularly exposed to investor flight from equities to safe havens, typically US treasuries, German bunds and UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

5.4 Treasury Management Practice (TMP1): Permitted Investments And Associated Risk

Permitted Investments

This Council approves the following forms of investment instrument for use as permitted investments.

1. Treasury Investments

1.1 Deposits

	Minimum Credit Criteria	Liquidity risk	Market risk	Maximum investment	Max. maturity period
Debt Management Agency Deposit Facility	n/a	term	no		3 months
Term deposits – local authorities	n/a	term	no	£5,000,000	3 months
Term accounts – banks and building societies	Link colour rating green	term	no	£10,000,000	3 months
Call deposits – banks and building societies	Link colour rating green	instant	no	£15,000,000	3 months

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

- a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk.
- b) **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a higher rate of return than the DMADF (dependent on term) and now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

c) **Call accounts with high credit worthiness banks and building societies.**

The objectives are as for 1.1 b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

1.2 Deposits with counterparties currently in receipt of government support / ownership

	Minimum Credit Criteria	Liquidity risk	Market risk	Maximum investment	Max. maturity period
Term accounts - UK nationalised banks	Link colour rating blue	term	no	£20,000,000	3 months
Call deposits - UK nationalised banks	Link colour rating blue	instant	no	£20,000,000	3 months

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

a) **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1.1 b. but Government ownership partial or full implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers this indicates a low and acceptable level of residual risk.

b) **Call accounts with high credit worthiness banks which are fully or semi nationalised.** As for 1.1 c. but Government ownership partial or full implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers this indicates a low and acceptable level of residual risk.

2. Treasury Risks

All the investment instruments in the above tables are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. The column in the tables above headed as 'liquidity risk' will show each investment instrument as being instant access, or term i.e. money is locked in until an agreed maturity date.
3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.
4. **Interest rate risk:** this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.
5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

3. Controls on Treasury Risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of high creditworthiness to enable investments to be made safely.
2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.
3. **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value
4. **Interest rate risk:** this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.
5. **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

4 Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
a. Deposits with the Debt Management Account Facility (UK Government) (Very low risk)	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 3 months.
b. Deposits with other local authorities or public bodies (Very low risk)	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. 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.	£5m and maximum 3 months.
c. 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) and (b) 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, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	£25m. (Individual counterparty limits per Treasury Management Practices – Schedules)
d. 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) and (b) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	£25m and maximum 3 months. (Individual counterparty limits per Treasury Management Practices – Schedules)

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):

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

6. Non Treasury Investments

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 share holding, 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.

6.1 Investments

	Minimum Credit Criteria	Liquidity risk	Market risk	Maximum investment	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 below).		instant	no		
Local Authority Investment Properties.		term	no		
Other Investment Deposits		term	no		

- a) **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
- b) **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.
- c) **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.

Current Approvals

Subordinated Debt – At the Policy and Resources Committee on 17 February 2015, Members agreed that the Council's investment strategy be amended to permit subordinated debt investments in Sub HubCo projects. The maximum duration of investments was extended to 30 years at the Policy and Resources Committee on 14 January 2016. Current investments total £225,010 out of a maximum of £800,000.

Equity Investment – At the Policy and Resources Committee on 14 January 2016, Members agreed that the Council's investment strategy be amended to permit a 10 percent equity stake in the Design, Build, Maintain and Finance (DBFM) Holding Company set up for the Dalbeattie Learning Campus Project with a cost/exposure of 10p (10 pence).

5.5 Scheme Of Delegation

5.5.1 The Council shall;

- receive and review reports on treasury management policies, practices and activities,
- approve the annual strategy.

5.5.2 The Council's Policy and Resources Committee shall;

- approve / amend the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- consider and approve budget;
- approve the division of responsibilities;
- receive and review regular monitoring reports and act on recommendations;
- approve the selection of external service providers and agree terms of appointment.

5.5.3 The Section 95 Officer shall;

- review the treasury management policy and procedures and make recommendations to the responsible body.

5.6 The Treasury Management Role of the Section 95 Officer

The S95 (responsible) officer is required to:

- recommend clauses, treasury management policy/practices for approval, review the same regularly, and monitor compliance;
- submit regular treasury management policy reports;
- submit budgets and budget variations;
- receive and review management information reports;
- review the performance of the treasury management function;
- ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensure the adequacy of internal audit, and liaising with external audit;
- recommend the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensure that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensure that the authority has adequate expertise, either in house or externally provided, to carry out the above

Loans Fund Advances - Redemption Profile As At 1 April 2018

Annex 1



