Agenda Item No. 7

South Ayrshire Council

Report by Head of Finance and ICT
to South Ayrshire Council
of 28 February 2019

Subject: Treasury Management and Investment Strategy 2019/20

---

1. Purpose

1.1 The purpose of this report is to request that Members consider the proposed Treasury Management and Investment Strategy for financial year 2019/20.

2. Recommendation

2.1 It is recommended that the Council approves the Treasury Management and Investment Strategy for 2019/20 (attached as Appendix 1).

3. Background

3.1 The Treasury Management service undertakes two main roles wiithin the Council:

3.1.1 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 investment appetite, whilst providing adequate liquidity initially before considering investment return.

3.1.2 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. Cash flow management will include long term and short tem borrowing, and the use of cash backed surpluses.

3.2 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects.

3.3 The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

3.4 Whilst any loans to third parties, commercial investment initiatives or other non-financial investments will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure),and are separate from the day to day treasury management activities.

3.5 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.'

4. Proposals

4.1 The purpose of the Treasury Management and Investment Strategy is to detail the planned activities for the treasury service in the forthcoming financial year. The draft proposed Strategy for 2019/20 is attached at Appendix 1.

4.2 The Strategy sets out the basis for decision making in relation to managing the Council's cash flow position to ensure appropriate investment returns are achieved and ensuring that appropriate funding for budgeted capital investment plans during 2019/20 are in place and to ensure the relevant borrowings are in line with debt charge budgets.

4.3 The overall objectives for the Council's Treasury Management and Investment Strategy are:

4.3.1 ***For Borrowings the objective is:***

- to minimise the revenue cost of borrowings;
- to manage the Council's cash flow;
- to manage the borrowing repayment profile;
- to assess interest rate movements, and borrow/invest accordingly;
- to monitor and review the level of variable rate loans held in order to take advantage of interest rate movements; and
- to identify and evaluate opportunities for debt rescheduling.

4.3.2 ***For Temporary Investments the objective is:***

- to protect capital security of the invested funds; and
- to obtain the best market return available commensurate with protection of security and liquidity.

Temporary investments will continue to be managed using the following priorities in order of importance:

- security of capital;
- liquidity; and
- yield.

4.4 *Reporting Requirements*

4.4.1 Treasury Management activity reports are required to be adequately scrutinised before being recommended to the Council for approval. The scrutiny role is undertaken by the Audit and Governance Panel.

4.4.2 The reporting of Treasury Management to Members in 2019/20 is therefore proposed to be as follows:

(i) **A Treasury Management and Investment Strategy Report (this report)** - This first, and most important, report covers:

- the capital plans (including prudential indicators);
- the Treasury Management Strategy (how the investments and borrowings are to be managed) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

This report is presented to full Council for approval.

(ii) **A Mid-Year Treasury Management Report** – This will update Members on the progress of the strategy, including loan charges, prudential indicators, and any proposed change to the strategy or whether any policies require revision.

This report is presented to the Audit and Governance Panel for scrutiny, then to the Leadership Panel for approval, followed by referral to Council as a ‘C’ paragraph.

(iii) **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.

This report is presented to the Audit and Governance Panel for scrutiny, then to the Leadership Panel for approval, followed by referral to Council as a ‘C’ paragraph.

4.5 *Capital Strategy*

4.5.1 In December 2017, CIPFA issued revised Prudential and Treasury Management Codes of Practice.

4.5.2 As from 2019/20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:

- A high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed; and
- The implications for future sustainability.

4.5.3 The aim of the report is to ensure that all Elected Members are able to understand the overall strategy, governance procedures and risk apetite of the Strategy.

4.5.4 The Capital Strategy includes capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

4.5.5 The Capital Investrment Strategy is included within the Council's overall Financial Strategy which is presented to Leadership Panel on an annual basis.

5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

6. Financial Implications

6.1 There are no resources implications arising from this report other than those resulting from the delivery of the proposed Strategy as contained in Appendix 1.

7. Human Resources Implications

7.1 Not applicable.

8. Risk

8.1 ***Risk Implications of Adopting the Recommendations***

8.1.1 There are no risks associated with adopting the recommendations.

8.2 ***Risk Implications of Rejecting the Recommendations***

8.2.1 The Council would not be compliant with the requirements of the CIPFA Treasury Management Code of Practice.

9. Equalities

9.1 The proposals in this report have been assessed through the Equality Impact Assessment Scoping process. There are no significant potential positive or negative equality impacts of agreeing the recommendations and therefore an Equalities Impact Assessment is not required. A copy of the Equalities Scoping Assessment is attached as Appendix 2.

10. Sustainable Development Implications

10.1 ***Considering Strategic Environmental Assessment (SEA)*** - This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy or strategy.

11. Options Appraisal

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

12. Link to Council Plan

12.1 The matters referred to in this report contribute to the Council strategic objective of ‘Effective leadership that promotes fairness’ and within that to the outcome ‘Ensure the Council is structured to make the best use of resources’.

13. Results of Consultation

13.1 There has been no public consultation on the contents of this report.

13.2 Consultation has taken place with Councillor Peter Henderson, Portfolio Holder for Resources and Performance, and the contents of this report reflect any feedback provided.

14. Next Steps for Decision Tracking Purposes

14.1 If the recommendations above are approved by Members, the Head of Finance and ICT will ensure that all necessary steps are taken to ensure full implementation of the decision within the following timescales, with the completion status reported to the Leadership Panel in the ‘Council and Leadership Panel Decision Log’ at each of its meetings until such time as the decision is fully implemented:

Implementation	***Due date***	***Managed by***
The approved strategy will be incorporated in the 2019/20 treasury and investment planning and management process	1 April 2019	Head of Finance and ICT

Background Papers **CIPFA Code of Practice for Treasury Management in the Public Services**

CIPFA The Prudential Code for Capital Finance in Local Authorities

The Local Government Investments (Scotland) Regulations 2010

The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016

Person to Contact **Tim Baulk, Head of Finance and ICT**
County Buildings, Wellington Square, Ayr, KA7 1DR
Phone 01292 612620
E-mail tim.baulk@south-ayrshire.gov.uk

Date: 21 February 2019

Appendix 1

south
AYRSHIRE
COUNCIL

Treasury Management and Investment Strategy 2019/20

February 2019

Index

Introduction

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. ‘

The background for the requirements strategy is set out in the in the undernoted legislation:

All treasury management reports written during the financial year of 2018/19 will need to take into account the under-noted:

- CIPFA Code of Practice on Treasury Management 2017;
- CIPFA Prudential Code 2017;
- CIPFA Treasury Management in the Public Services Guidance Notes 2018;
- CIPFA statement 17.10.18 on borrowing in advance of need and investments in commercial properties;
- CIPFA Bulletin 02 Treasury and Capital Management Update October 2018;
- Statutory investment regulations; and
- Statutory guidance for annual loan repayments

South Ayrshire Council’s Treasury Management and Investment Strategy for 2019/20 is set out in the following Sections 1 to 4 plus Annex A and B.

Treasury Management and Investment Strategy 2019/20

Section 1 - Capital Plans and Prudential Indicators 2018/19 to 2021/22

The Council's capital expenditure plans and delivery are the key drivers of treasury management activity. The capital expenditure plans are reflected in prudential indicators, which are designed to assist in providing Members with an overview of the Council's capital plans.

1.1 ***Capital Expenditure*** - This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of the budget cycle.

Members are asked to approve the capital expenditure forecasts:

Capital Expenditure	***2017/18 Actual £'000***	***2018/19 Projected £'000***	***2019/20 Estimate £'000***	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***
General Services	25,289	33,075	72,037	53,977	59,524
HRA	14,885	19,851	32,636	18,326	12,116
Total	**40,174**	**52,926**	**104,673**	**72,303**	**71,640**
Financed by:					
Government Grant/Other	(13,571)	(18,571)	(24,550)	(14,000)	(10,000)
Capital Receipts/Other	(14,583)	(17,232)	(8,973)	(9,237)	(7,909)
Net financing need for the year – (Borrowing)	**12,020**	**17,123**	**71,150**	**49,066**	**53,731**

The table above takes in to account the latest 2018/19 and 2019/20 budget projections for spend and any programme decisions that impact on future years. The table also summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources.

Any shortfall of resources results in a funding requirement (borrowing).

***Other Long Term Liabilities* (OLTL)** - The above summarised capital plan excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

1.2 ***Borrowing and 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, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets that are financed by borrowing.

The CFR includes any other long term liabilities (e.g. PFI schemes and finance leases). Whilst these schemes increase the CFR and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council does not require borrowing separately for these schemes.

The Council has £83.6m of such schemes within the CFR as at 31 Mar 18.

The table below shows the projected and estimated movement in the CFR based on current capital expenditure plans.

Capital Financing Requirement	***2017/18 Actual £'000***	***2018/19 Projected £'000***	***2019/20 Estimate £'000***	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***
General Services	238,356	245,582	311,421	342,731	382,488
HRA	57,155	56,992	77,386	85,382	88,445
CFR	**295,511**	**302,574**	**388,807**	**428,113**	**470,933**
Other Long Term Liabilities	(83,605)	(80,512)	(102,219)	(99,567)	(95,777)
Underlying Borrowing Need	**211,906**	**222,062**	**286,588**	**328,546**	**375,156**
Movement in CFR	**4,782**	**7,063**	**86,233**	**39,306**	**42,820**
Movement in CFR represented by					
Net financing need for the year	12,020	17,123	71,150	49,066	53,731
Less scheduled debt amortisation	(7,238)	(10,060)	15,083	(9,760)	(10,911)
Movement in CFR	**4,782**	**7,063**	**86,233**	**39,306**	**42,820**

A key aspect of the regulatory and professional guidance is that Elected Members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 1.1 and the details above demonstrate the scope of this activity and, by approving these figures; consider the scale proportionate to the Authority's remaining activity.

1.3 *Capital Affordability Indicators*

The previous section covers the overall capital and 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.

1.3.1 Actual and Estimates of the 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 of the Council.

	2017/18 Actual %	***2018/19 Projected %***	***2019/20 Estimate %***	***2020/21 Estimate %***	***2021/22 Estimate %***
General Services	6.05	5.99	6.11	6.63	6.98
HRA	10.96	10.82	11.11	13.23	13.37
Average Rate	6.74	6.64	6.79	7.48	7.82

1.3.2 HRA Debt Ratios

£'000	***2017/18 Actual £'000***	***2018/19 Projected £'000***	***2019/20 Estimate £'000***	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***
HRA debt	56,834	56,670	77,064	85,060	88,123
HRA revenues	29,991	30,511	31,085	31,706	32,340
Ratio of debt to revenues	1.89	1.85	2.48	2.68	2.72

£'000	***2017/18 Actual £'000***	***2018/19 Projected £'000***	***2019/20 Estimate £'000***	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***
HRA debt	56,834	56,670	77,064	85,060	88,123
Number of dwellings	8,082	8,142	8,162	8,182	8,202
Debt per dwelling	£7,032	£6,960	£9.442	£10,396	£10,744

All of the above indicators at 1.3 are designed to indicate the financing costs of the Council's investment plans against its revenues and that of the HRA. The Code does not provide target figures and also states that these indicators are not comparable between authorities given the wide ranging variations in Council's historic debt and borrowing and investment plans.

Section 2 - Treasury Management

The capital expenditure plans set out in Section 1 provide details of the service activity 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 this service activity. This will involve both the management of the cash flow and, where capital plans require, the arrangement of approporiate borrowing facilities.

The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

2.1 ***Current Portfolio Position***

2.1.1 The Council's treasury portfolio position as 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.

External Debt	***2017/18 Actual £'000***	***2018/19 Projected £'000***	***2019/20 Estimate £'000***	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***
Opening Debt at 1 April	190,709	206,293	213,652	263,163	307,159
Long Term Debt Maturities	(4,416)	(2,641)	(12,489)	(1,004)	(5,725)
New External Debt	20,000	10,000	62,000	45,000	53,000
External Debt	**206,293**	**213,652**	**263,163**	**307,159**	**354,434**
Other long-term liabilities (PPP + Finance Leases)	59,869	80,512	102,219	99,567	95,777
Actual/Est Debt at 31 March	**289,898**	**294,164**	**365,382**	**406,726**	**450,211**
The Capital Financing Requirement	**295,511**	**302,574**	**388,807**	**428,113**	**470,933**
Under / (Over) Borrowing	**5,613**	**8,410**	**23,425**	**21,387**	**20,722**
Cash Investments	(57,100)	(55,000)	(50,000)	(50,000)	(50,000)
Net External Debt	**149,193**	**158,652**	**213,163**	**257,159**	**304,434**

2.1.2 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 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.

2.1.3 The Head of Finance and ICT reports that the Council complied with this prudential indicator in the current year. This view takes into account current commitments, existing plans, and the proposals in the budget report.

2.2 *Treasury Indicators: Limits to Borrowing Activity*

2.2.1 **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 and the Council's under/over borrowed position.

Operational Boundary	***2018/19 £'000***	***2019/20 £'000***	***2020/21 £'000***	***2021/22 £'000***
Debt	224,000	272,000	315,000	365,000
Other long term liabilities	81,000	103,000	100,000	95,000
Total	**305,000**	**375,000**	**415,000**	**460,000**

2.2.2 **The Authorised Limit for External Borrowing** - a further key prudential indicator represents a control on the maximum level of external debt. 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.

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.

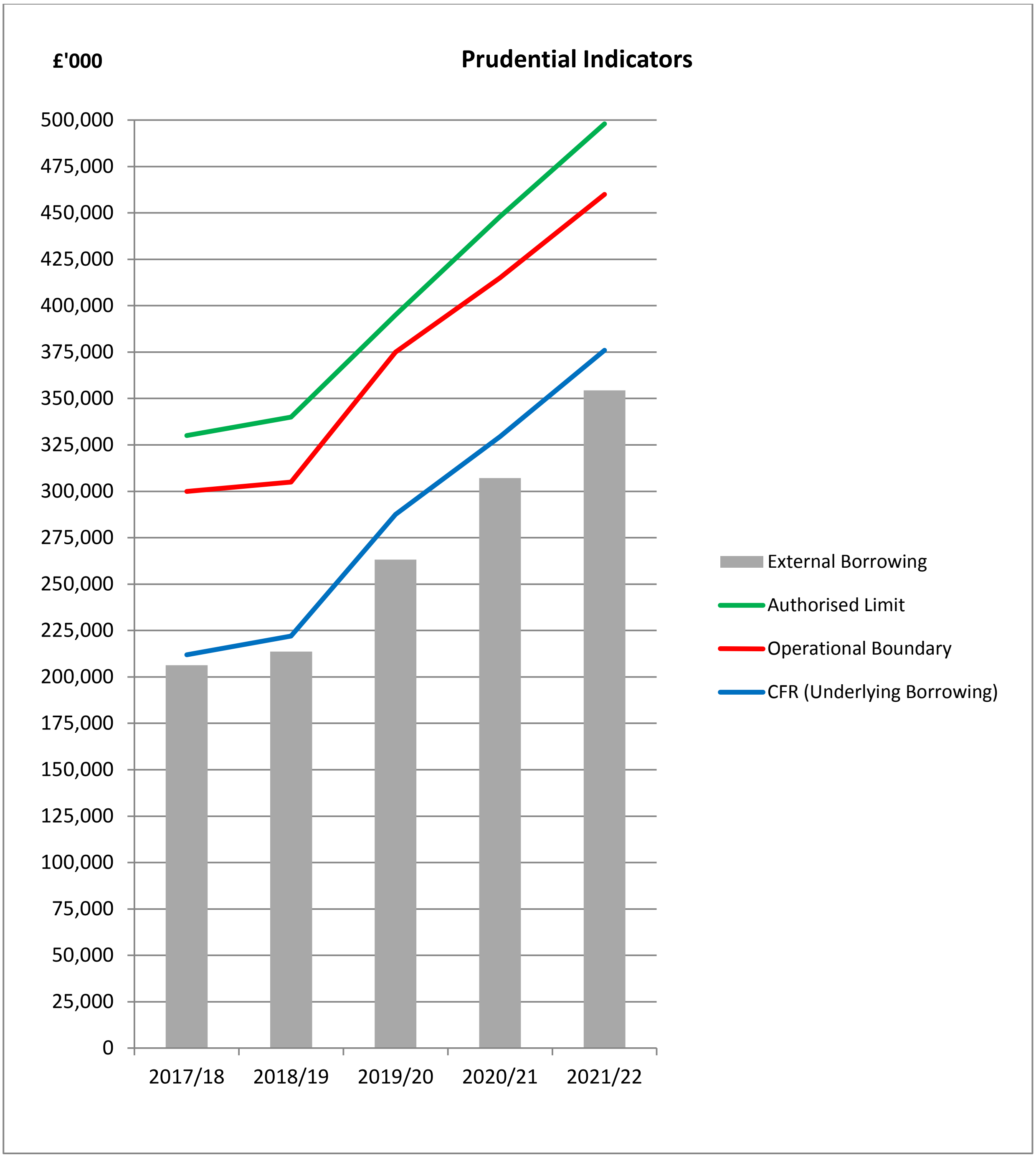
Authorised limit	***2018/19 £'000***	***2019/20 £'000***	***2020/21 £'000***	***2021/22 £'000***
Debt	256,000	317,000	350,000	400,000
Other long term liabilities	84,000	103,000	100,000	100,000
Total	**340,000**	**420,000**	**450,000**	**500,000**

2.2.3 The under-noted graph shows the relationship between the 4 main components of capital financing:

- Authorised Limit (Debt);
- Operational Boundary (Debt);
- Capital Financing Requirement; and
- Actual External Debt

2.2.4 The graph below shows the increasing trend in the substantial capital investment plans of the Council in the medium term, and therefore increasing debt and capital financing requirements going forward.

Both the authorised debt and operational boundary indicators include a margin for the balance of other financing arrangements such as PPP schemes.



2.3 ***Economic Commentary***

2.3.1 **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.

2.3.2 **Inflation** has been weak during 2018 but, unemployment falling to remarkably low levels in the US and UK has led to an acceleration of wage inflation. The US Federal Reserve has therefore increased rates nine times and the Bank of

England twice. However, the Eurpoean Central Bank (ECB) is now probably unlikely to make a start on raising rates in 2019.

2.3.3 **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.

2.3.4 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.

2.3.5 **UK.** 2018 was a year which started with weak growth of only 0.1% in Qtr1. However, Qtr2 rebounded to 0.4% followed by Qtr3 being exceptionally strong at +0.6%. Qtr4 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 uncertainty 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.

2.3.6 **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.

2.3.7 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.

2.3.8 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.

2.3.9 **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 Qtr1 to 4.2% in Qtr2 and 3.5%, (3.0% y/y), in Qtr3, 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.

2.3.10 **Eurozone.** Growth was 0.4% in Qtrs1and 2 but fell back to 0.2% in Qtr3, 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 if 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.

2.3.11 **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.

2.3.12 **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.

2.3.13 **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.

2.4 **Prospects for Interest Rates -** The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

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%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	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	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

2.4.1 The interest rate forecasts provided by Link Asset Services above 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.

2.4.2 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.

2.4.3 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.

2.4.4 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.

2.4.5 The balance of risks to the UK

(i) The overall balance of risks to economic growth in the UK is probably neutral.

(ii) 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.

(iii) 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.

(iv) 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.

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

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

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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.

(vi) Other minority EU governments. Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.

(vii) 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.

(viii) 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.

(ix) 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.

(x) Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

(i) Brexit – if both sides were to agree a compromise that removed all threats of economic and political disruption.

(ii) The Federal Reserve 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.

(iii) 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.

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

2.4.8 Brexit timetable – In March 2017 the UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.

2.5 ***Borrowing Strategy***

At the time of writing this report, the Council is estimated to have an under-borrowed position at the end of 2018/19 of £8.410m, (around 3.8% of the total underlying borrowing requirement).This would mean that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external loan debt and means that an element of internal resources, cash and revenue surpluses have been used to finance capital expenditure. This is a prudent strategy in the current economic interest rate environment with borrowing rates significantly higher than investment rates. Given the under-borrowed position is only 3.8% of the borrowing requirement it removes an element of interest rate risk.

During **2019/20** it is estimated that the Council and HRA will have additional borrowing requirements of £**71.150m**

The strategy is to fund the majority of this requirement from long term external borrowing of **£62m** whilst increasing the under-borrowed position to around 8.4% of the borrowing requirement. Although an increase from the current year position this remains prudent strategy in the current interest rate environment and also allows flexibility in taking a pragmatic approach in terms of the pace of the major capital spend in 2019/20

The treasury team are monitoring longer term interest rate forecasts on a regular basis in order to assess timing of longer term borrowing whilst still minimising the cost of carrying any new borrowing prior to the loans actually being required.

Whilst the under-borrowed position remains a minimal risk the significant borrowing requirements in 2019/20 and the level of temporary borrowing will require close monitoring in terms of potential rate increases particularly in light of the Brexit implications. The estimates of borrowing required are set out in the under-noted table:

New Borrowing (Year)	***General Services £'000***	***HRA £'000***	***Total £'000***
2019/20	49,688	21,462	71,150
2020/21	39,727	9,339	49,066
2021/22	49,274	4,457	53,731
2022/23	36,127	509	36,636
2023/24	7,465	2,318	9,783
Total 5 Yr Borrowing	**182,281**	**38,085**	**220,366**

It is emphasised that a pragmatic approach will be taken when considering the timing of this borrowing externally in the light of prevailing interest rates,the overall treasury strategy, cost of carry, and in particular the out-turn of capital expenditure as the projects are delivered in 2018/19 and 2019/20.

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, for example, 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; and

- 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 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 fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Any decisions on new borrowing will be reported to Members within the mid-year Treasury Report or the end of year out-turn report.

2.5.1 Treasury Management Limits on Activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing.

	2018/19	***2019/20***	***2020/21***	***2021/22***
Interest Rate Exposures				
	Upper	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%	25%

Maturity Structure of Fixed Interest Rate Borrowing		
	Lower	**Upper**
Under 12 months	0.00%	25%
1 – 2 years	0.00%	25%
2 – 5 years	0.00%	50%
5 – 10 years	0.00%	75%
10 years and above	0.00%	90%

2.6 ***Statutory Repayment of Loans Fund Advances***

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

A variety of options are provided to Councils and method c below will be the prudent repayment option adopted by the Council.

a. **Statutory method**

b. **Depreciation method** – annual repayment of loans fund advances will follow standard depreciation accounting procedures ;

c. **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method;

d. **Funding / Income profile method** – loans fund advances will be repaid by reference to an associated income stream.

2.6.1 Finance Circular 7/2016 suggests Councils set out additional disclosures on loans fund account information, so the proposed disclosure note below has been provided to assist. Paragraph 89 of the Finance Circular also states, ‘a local authority should set out their policy on the interest rate selected for the annuity calculation’.

The annuity rate applied to the loans fund repayments was based on historic interest rates and is currently 5%. However, under regulation 14 (2) of SSI 2016 No 123, the Council has reviewed and re-assessed the historic annuity rate to ensure that it is a prudent application.

The result of this review suggests that an annuity rate of 5% would remain a prudent approach and provides for principal repayments closely associated with the use of the assets.

Loans Fund Advances to General Fund

Loans Fund	Actual 2017/18 £'000	Est 2018/19 £'000	Est 2019/20 £'000	Est 2020/21 £'000	Est 2021/22 £'000
Opening Balance	147,011	152,684	163,003	207,135	241,097
Add advances	11,718	16,189	49,688	39,727	49,274
Less repayments	(6,045)	(5,870)	(5,556)	(5,765)	(5,727)
Closing Balance	**152,684**	**163,003**	**207,135**	**241,097**	**284,644**

Loans Fund Advances to HRA

Loans Fund	Actual 2017/18 £'000	Est 2018/19 £'000	Est 2019/20 £'000	Est 2020/21 £'000	Est 2021/22 £'000
Opening Balance	57,725	56,834	56,671	77,065	85,061
Add advances	302	935	21,462	9,339	4,457
Less repayments	(1,193)	(1,098)	(1,068)	(1,343)	(1,394)
Closing Balance	**56,834**	**56,671**	**77,065**	**85,061**	**88,124**

2.7 ***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.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 20% of the expected increase in borrowing need (CFR) over the three year planning period; and

- Would not look to borrow more than 12 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting arrangements.

2.8 ***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; and
- 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 Members in the mid-year or year-end treasury reports.

Section 3 – Annual Investment Strategy

3.1 *Investment Policy*

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

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

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

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

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

4. The Council has defined the list of **types of investment instruments** that are permitted investments authorised for use in Annex A. Annex B expands on the risks involved in each type of investment and the mitigating controls.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 3.2.

6. **Transaction limits** are set for each type of investment in appendix 3.2.

7. The Council will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 3.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 3.3).

9. The Council has engaged **external consultants**, (see paragraph 4.3), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in **sterling**.

As a result of the change in accounting standards for 2018/19 under **IFRS 9,** the council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (This area is currently under review by LASAAC and the Scottish Government. Members will be updated when there is further news)

The Council will pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, Regular monitoring of investment performance will be carried out during the year.

3.2 ***Credit Worthiness Policy***

3.2.1 The Council applies the credit worthiness service provided by Link Asset Services (LAS). This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit 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; and
- 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 Credit Default Swap (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 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 (UK part nationalised banks)
- Orange - 1 year
- Red - 6 months
- Green - 100 days
- No Colour - not used

3.2.2 The under-noted table sets out the monetary limits that will be applied to each counterparty within each colour on the creditworthiness matrix.

Applying the criteria in the under-noted table has been derived from the Council's current investment activities in terms of funds available for investment, and cash flow requirements. This policy also provides a clear defined policy on investment activity limits.

	Colour Code *(Based on credit information)*	***Limit per Counterparty***	***Maximum Maturity Period***
Banks/ Building Societies	Yellow	£25m	5 Years
Banks – (UK Part Nationalised)	Blue	£25m	1 Year
Banks/ Building Societies	Purple	£20m	2 Years
Banks/ Building Societies	Orange	£15m	1 Years
Banks/ Building Societies	Red	£10m	6 months
Banks/ Building Societies	Green	£5m	100 days
Banks/ Building Societies	No Colour	£0	0 days
Council's Corporate Bankers	Orange	£50m	1 Year
Debt Management Account – UK Treasury	AA+	unlimited	6 months
Local / Public Authorities	N/A	£10m	2 Years
Money Market Funds CNAV	AAA	£20m	Liquid
Money Market Funds LVNAV	AAA	£20m	Liquid
Money Market Funds VNAV	AAA	£20m	Liquid
Ultra short dated bond funds with a credit score of 1.25	Dark Pink/ AAA	£20m	Liquid
Ultra short dated bond funds with a credit score of 1.25	Light Pink/ AAA	£20m	Liquid

The Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, 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 weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link 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 weekly basis.

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 this external service. In addition the Council will also use market data, market information, information on sovereign support for banks and credit rating of that supporting government.

3.3 ***Country Limits – Credit Worthiness***

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Rating Agency. The list of countries that qualify using this credit criteria as at the date of this report are shown below.

This list will be adjusted should ratings change in accordance with this policy.

Rating			***Country***		
AAA	Australia	Canada	Denmark	Germany	Luxembourg
	Netherlands	Norway	Singapore	Sweden	Switzerland
AA+	Finland	Honk Kong	USA		
AA	Abu Dhabi (UAE)	France	UK		
AA-	Belgium	Qatar			

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

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Bank Rate and 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 Qtr1 2022.

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.

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.

Bank Rate forecasts for financial year ends (March) are and these rates will form the basis of budgeted returns on the Councils investments in the medium term.

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

- 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.

Invesment Treasury Indicator and Limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Maximum principal sums invested > 365 days			
	2018/19 £m	***2019/20 £m***	***2020/21 £m***
Principal sums invested > 364 days	£0.233m	£0.233m	£0.233m

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

3.5 *Investment – Cash Liquidity*

A key responsibility of the Treasury function is to ensure the Council maintains adequate liquidity of cash to ensure its payment obligations can be fully met at all times. This liquidity of cash is required on a daily basis to meet the cash flow requirements of payments to employees, suppliers, agencies, re-payment of loan interest and benefits etc.

The Council does not currently utilise an overdraft facility from its bankers, Bank of Scotland as liquidity cash is available using investment accounts. Additionally the Council has access to short term loan funding from the money markets when required.

Liquidity - in respect of this area the Council seeks to maintain:

- Bank overdraft - £0.00m; and
- Liquidity cash available of £10m.

3.6 *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. This report will be submitted to the Council's Audit and Governance Panel and South Ayrshire Council prior to 30 September following the end of each financial year (or as soon as practicable depending on Council meeting dates)

Section 4 – Governance Arrangements

4.1 *Financial Regulations*

The Financial Regulations set out the responsibilities of the Council and the Audit and Governance Panel in respect of treasury matters as follows:

4.1.1 **Full Council**

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

4.1.2 **Leadership Panel**

- receiving and reviewing reports on treasury management policies, practices and activities; and
- approval of a mid year review and annual report, followed by referral to Council as a 'C' paragraph.

4.1.3 **Audit and Governance Panel**

- Responsibility for ensuring effective scrutiny of treasury management strategy, policy and operations.

4.2 *Role of the Section 95 Officer – Head of Finance and ICT*

The S95 (responsible) officer has authority through the Scheme of Delegation and the Financial Regulations for the day to day execution and administration of treasury management decisions in line with the Council's Strategy and Treasury Management Practices. This includes:

- recommending clauses, treasury management policy 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; and
- recommending 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 longer term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money

- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing

- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees ensuring that members are adequately informed and understand the risk exposures taken on by an authority

- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above

- creation of Treasury Management Practices which specifically deal with how non- treasury investments will be carried out and managed, to include the following:

    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

    - *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

    - *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

4.3 ***Policy on the Use of External Service Providers***

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

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

4.4 ***Training***

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training. This especially applies to Members responsible for scrutiny of the treasury function.

Training sessions for both the Council's Corporate Management Team and Members have been held in recent years and the treasury team will continue to consider other training options in due course.

Permitted Investments

The Council approves the following forms of investment instrument for use as permitted investments as set out in **Table 1 to 6** on pages 34 to 36.

a) Treasury risks

The Council is required to set out each investment risk and the control on those risks.

All the investment instruments in Tables 1 to 6 are subject to the following risks:

a. **Credit and counter-party risk:** this is the risk of failure by 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 the highest, relative, level of creditworthiness.

b. **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. However, it has to be pointed out that while some forms of investment e.g. Gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: a. Cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in tables 1 / 2 headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get cash, or term – i.e. money is locked in until an agreed maturity date.

c. **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. However, some cash rich local authorities may positively want exposure to market risk – for example, those investing in investment instruments with a view to obtaining a long term increase in value.

d. **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. All types of investment instrument have interest rate risk except for the following forms of instrument which are at variable rate of interest (and the linkage for variations is also shown):

e. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation powers or regulatory requirements, and that the organisation suffers losses accordingly.

b) Controls on treasury risks

a. **Credit and counter-party risk**: this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 3.2 and 3.3.

b. **Liquidity risk:** the Council has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

c. **Market risk:** this Council does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.

d. **Interest rate risk:** the Council 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 maximize investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.

e. **Legal and regulatory risk:** the Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

c) Unlimited investments

The Council is required to set out which investment instruments may be unlimited in terms of the percentage of total portfolio that may be invested into that type of investment.

The Council has given the following types of investment an unlimited category:

a. **Debt Management Agency Deposit Facility.** This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury – i.e. the UK Government's sovereign rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.

b. **High credit worthiness banks and building societies.** See Section 3.2 relating to creditworthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the Council will ensure diversification of its portfolio ensuring that no more than 50% of the total portfolio can be placed with any one institution or group at any one time.

d) Objectives of each type of investment instrument – (Section 1 -6 below)

The Council is required to set out an explanation of the objectives of each type of investment instrument which an authority approves as being 'permitted' and also requires authorities to explain any special circumstances that have led them to a particular approach.

1. Deposits

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

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

b. **Term deposits with high credit worthiness banks and building societies -** See paragraph 3.2 for an explanation of this authority's definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The Council will ensure diversification of its portfolio of deposits ensuring that no more than 50% of the total portfolio can be placed with any one institution or group. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

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

Fixed term deposits with variable rate and variable maturities (structured deposits). This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide Councils with greater flexibility to adopt new instruments as and when they are brought to the market.

d. **Collateralised deposits.** These are deposits placed with a bank which offers collateral backing based on specific assets. Examples seen in the past have included local authority LOBOs, where such deposits are effectively lending to a local authority as that is the ultimate security.

See Table 1 below for details on the credit criteria for deposits.

2. **Deposits with Counterparties currently in receipt of Government Support/ Ownership**

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

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

b. **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide Councils with greater flexibility to adopt new instruments as and when they are brought to the market.

See Table 2 below for details on the credit criteria for deposits with counterparties.

3. **Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)**

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

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

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

d. **Gilt funds.** These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in highly rated government securities. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.

e. **Bond funds.** These can invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in non-government bonds.

See Table 3 below for details on the credit criteria for OIECs

4. Securities Issued or Guaranteed by Governments

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

a. **Treasury bills.** These are short term bills (up to 12 months, although none have ever been issued for this maturity) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** e.g. National Rail. This is similar to gilt due to the explicit Government guarantee.

d. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. Use limited to issues of nations with at least the same sovereign rating as for the UK.

e. **Bonds issued by Multi-Lateral Development Banks (MLDBs).** These are similar to c. and e. above but are issued by MLDBs which are typically guaranteed by a group of sovereign states e.g. European Bank for Reconstruction and Development.

See Table 4 below for details on the credit criteria for Securities Issued or Guaranteed by Governments

5 Securities issued by Corporate Organisations

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

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

b. **Commercial paper.** This is similar to CDs but is issued by commercial organisations or other entities. Maturity periods are up to 365 days but commonly 90 days.

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

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

See Table 5 below for details on the credit criteria for Securities Issued by Corporate Organisations

6 Other

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

See Table 6 below for details on the credit criteria for Property funds

Table 1 - Deposits

	Liquidity risk	***Market risk***	***Max % of total investment***	***Max. maturity***
Debt Management Agency Deposit Facility	Term	no	100%	6 months
Term deposits – local / public authorities	Term	no	100%	2 years
Call accounts – banks and building societies	Instant	no	100%	N/A
Term deposits – banks and building societies	Term	no	100%	See Credit Policy (colour code)
Fixed term deposits with variable rate and variable maturities: Structured deposits.	Term	no	10%	See Credit Policy (colour code)

Table 2 - Deposits with Counterparties Currently in Receipt of Government Support/ Ownership

	Liquidity risk	***Market risk***	***Max % of total investment***	***Max. maturity period***
UK Part Nationalised Banks	Term	no	100%	See Credit Policy (colour code)
Banks nationalised by high credit rated (sovereign rating) countries – non UK	Term	no	100%	See Credit Policy (colour code)
Fixed term deposits with variable rate and variable maturities: Structured deposits	Term	Yes	10%	See Credit Policy (colour code)

Table 3 - Collective Investment schemes structured as Open Ended Investment Companies (OEIC's)

	Liquidity risk	Market risk	Max % of total investment	Max. maturity period
Government Liquidity Funds	Instant	See Section 3	20%	See credit policy
Money Market Funds (CNAV)	Instant	See Section 3	100%	See credit policy
Money Market Funds LVNAV	Instant	See Section 3	50%	See credit policy
Money Market Funds VNAV	Instant	See Section 3	50%	See credit policy
Ultra short dated bond funds with a credit score of 1.25	T+1 – T+5	See Section 3	50%	See credit policy
Ultra short dated bond funds with a credit score of 1.50	T+1 – T+5	See Section 3	50%	See credit policy
Bond Funds	Min T+2	See Section 3	50%	See credit policy
Gilt Funds	Min T+2	See Section 3	50%	See credit policy

Table 4 - Securities issued or guaranteed by governments

	Minimum Credit Criteria	***Liquidity risk***	***Market Risk***
Treasury Bills	UK sovereign	Sale T+1	Yes
UK Government Gilts	UK Sovereign	Sale T+1	Yes
Bond issuance issued by a financial institution which is guaranteed by UK Government e.g. National Rail	UK Sovereign	Sale T+3	Yes
Sovereign Bond issues (other than UK Government)	AAA	Sale T+1	Yes
Bonds issued by multi-lateral development banks	AAA	Sale T+1	Yes

Table 5 - Securities issued by corporate organisations

	Liquidity risk	***Market risk***	***Max % of total investment***
Certificates of deposit issued by banks and building societies	Sale T+1	yes	20%
Commercial Paper	Sale T+1	yes	20%
Floating Rate Notes	Sale T+0	yes	20%
Corporate bonds	T +3	Yes	20%

Table 6 - Other

	Liquidity risk	***Market risk***	***Max % of total investment***	***Max. maturity period***
Property Funds	Variable	Yes	20%	3-5 Yrs
Local Authority Mortgage Scheme	Variable	Yes	20%	25Yrs

Treasury Management Practice – Credit and Counterparty Risk Management

South Ayrshire Council and Common Good Funds Permitted Investments, Associated Controls

Type of Investment	*Treasury Risks*	*Mitigating Controls*	*Council Limits*	*Common Good Limits*
Cash type instruments				
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	Unlimited
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. 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.	£20m per counterparty – 2 Years	£20m per counterparty – 2 Years
c. Money Market Funds (MMFs) **(Low to Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has an 'AAA' rated status from Fitch, Moody's or Standard and Poor's.	£20m	£20m

Type of Investment	***Treasury Risks***	***Mitigating Controls***	***Council Limits***	***Common Good Limits***
d. Ultra short dated bond funds **(low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has an 'AAA' rated status from Fitch, Moody's or Standard and Poor's.	£10m	£10m
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, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with these criteria will be further strengthened by the use of additional market intelligence.	See credit policy	See credit policy
f. Term deposits with financial institutions (banks and building societies) **(Low to medium risk depending on period and credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with these criteria will be further strengthened by the use of additional market intelligence.	See credit policy	See credit policy

Type of Investment	*Treasury Risks*	*Mitigating Controls*	*Council Limits*	*Common Good Limits*
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.	See credit policy	See credit policy
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, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with these criteria will be further strengthened by the use of additional market intelligence.	See credit policy	See credit policy
i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period and credit rating)**	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures.	See credit policy	See credit policy

Type of Investment	***Treasury Risks***	***Mitigating Controls***	***Council Limits***	***Common Good Limits***
		On day to day investment dealing with these criteria will be further strengthened by the use of additional market intelligence.		
j. Corporate bonds **(Medium to high risk depending on period and credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. . Corporate bonds will be restricted to those meeting the base criteria. Day to day investment dealing with these criteria will be further strengthened by the use of additional market intelligence.	See credit policy	See credit policy

Other types of Investment

Type of Investment	Credit Criteria	Liquidity Risk	Market Risk	Mitigating Controls	Council Limits
Common Good	Not applicable	Not applicable	No	Any Common Good, loan or investment would be subject to a separate panel report and the approval of Members before progressing. Each loan would therefore be assessed on a case by case basis and be supported by the rationale behind the investment and likelihood of any loss.	Term – 20 years - unlimited
Registered Social Landlord	Not applicable	Not applicable	No	Any RSL loan or investment would be subject to a separate panel report and the approval of Members before progressing. Each loan would therefore be assessed on a case by case basis and be supported by the rationale behind the investment and likelihood of any loss.	Term – 20 years - unlimited
Third Party (Soft Loans)	Not applicable	Not applicable	No	Any third party loan or investment would be subject to a separate panel report and the approval of Members before progressing. Each loan would therefore be assessed on a case by case basis and be supported by the rationale behind the investment and likelihood of any loss.	Term – 5 years - £1m
hubSW/ SFT Project Investment	Not applicable	Minimum 25 years term	No	Investment is subject to a separate panel report and the approval of Members before progressing. The investment would therefore be assessed on a case basis and be supported by the rationale behind the investment and likelihood of any loss.	Term – 25 years - £1m

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Asset Services, including when ratings change, and counterparties are checked promptly.

On occasion 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 Head of Finance and ICT, and if required new counterparties which meet the criteria will be added to the list.

Appendix 2

South Ayrshire Council **Equality Impact Assessment Scoping**

1. Proposal details

Proposal Title	Lead Officer
Treasury Management and Investment Strategy 2019/20	**Tim Baulk**

2. Which communities, groups of people, employees or thematic groups do you think will be, or potentially could be, impacted upon by the implementation of this proposal? Please indicate whether these would be positive or negative impacts

Community, Groups of People or Themes	Negative Impacts	Positive impacts
The whole community of South Ayrshire	-	x
People from different racial groups, ethnic or national origin.	-	-
Women and/ or men (boys and girls)	-	-
People with disabilities	-	-
People from particular age groups for example Older people, children and young people	-	-
Lesbian, gay, bisexual and heterosexual people	-	-
People who are proposing to undergo, are undergoing or have undergone a process to change sex	-	-
Pregnant women and new mothers	-	-
People who are married or in a civil partnership	-	-
People who share a particular religion or belief	-	-
Thematic Groups: Health, Human Rights, Rurality and Deprivation	-	-

3. Do you have evidence or reason to believe that the proposal will support the Council to:

General Duty and other Equality Themes	Level of Negative and/ or Positive Impact (high, medium or low)
Eliminate discrimination and harassment faced by particular communities or groups	Low positive
Promote equality of opportunity between particular communities or groups	Low positive
Foster good relations between particular communities or groups	Low positive
Promote positive attitudes towards different communities or groups	Low positive
Increase participation of particular communities or groups in public life	Low positive
Improve the health and wellbeing of particular communities or groups	Low positive
Promote the human rights of particular communities or groups	Low positive
Tackle deprivation faced by particular communities or groups	Low positive

4. Summary Assessment

Is a full Equality Impact Assessment (EQIA) required? (A full EQIA must be carried out on all high and medium impact proposals**)**	**Yes** ☐ **No** x
Rationale for decision: **The strategy outlines the approach to be taken in managing the Council's cash flow and capital funding arrangements and is a mechanism for ensuring that budget targets are achieved: a full EQIA is, therefore, not required.**	
Signed : **Tim Baulk** Head of Service	
Date: **15 February 2019**	Copy to equalities@south-ayrshire.gov.uk