AGENDA ITEM No. 4

EAST RENFREWSHIRE COUNCIL

AUDIT AND SCRUTINY COMMITTEE

3rd March 2016

Report by Head of Accountancy/Chief Financial Officer

Treasury Management Strategy Report for 2016/17

PURPOSE OF REPORT

1. To advise the Audit and Scrutiny Committee on the treasury management strategy for the financial year 2016/17.

RECOMMENDATIONS

2. It is recommended that Members:-

(a) consider the content of the Treasury Management Strategy Report for 2016/17; and

(b) recommend to the Council that the Treasury Management Strategy for 2016/17 be approved, including the amendment of Treasury Management Practices in accordance with Annex F.

BACKGROUND

3. In line with the revised CIPFA Treasury Management Code of Practice 2011, the Audit and Scrutiny Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. The attached Treasury Management Strategy Report for the financial year 2016/17 is submitted in accordance with this requirement.

TREASURY MANAGEMENT STRATEGY FOR 2016/17 (TMS)

5. The TMS for 2016/17 is attached (see Appendix 1).

EQUALITY IMPACT

6. A screening exercise has revealed that the Treasury Management Strategy has no direct relevance to the Council's equality duties

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Report Date - 19 December 2015

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

APPENDIX 1

EAST RENFREWSHIRE COUNCIL

TREASURY MANAGEMENT STRATEGY 2016/17

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1 Purpose and Scope

1.1 The Council is required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimated and actual figures. These reports are as follows:-

a) **Treasury Management Strategy 2016/17** (this report).
This report is the most important of the three reports and covers:
- The capital plans of the Council (including prudential indicators);
- The treasury management strategy (how the investments and borrowings are organised). Including treasury indicators, and
- An investment strategy (investment options and limits applied).

b) **Mid Year Treasury Management Report** – This will update members with the progress of the capital investment position, amending prudential indicators as necessary, and assess whether the actual treasury operations are adhering to the approved strategy, or whether any policies require revision.

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

1.2 Scrutiny
These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Scrutiny Committee.

1.3 The treasury management issues covered by this report are:

Capital Issues
- The capital plans and associated prudential indicators

Treasury management issues
- The current treasury position
- Treasury indicators which will limit the treasury risk and activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy
- Creditworthiness policy and
- Policy on use of external service providers

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

1.5 Treasury Management Consultants

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

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

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

1.6 The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations i.e. East Renfrewshire Culture & Leisure Trust).

2 Background

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

2.2 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, being essentially longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 The Prudential and Treasury Indicators (summarised in **Annex A**) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. These Indicators have been developed in line with both the Prudential and Treasury Codes. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992. The Treasury Management Strategy therefore forms an integral part of the Council's overall financial planning covering both its revenue and capital budgets.

2.4 CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, it 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."

3 The Capital Prudential Indicators 2016/17 - 2018/19

The Council's longer term planning for its financial management is required to:

(i) Raise the funds required by the Council to meet approved service levels in the most effective manner;

(ii) Manage the effective deployment of those funds in line with the Council's corporate objectives and priorities; and

(iii) Provide stability in resource planning and service delivery as expressed through revenue and capital budgets and approved Corporate Plans.

As part of achieving these aims the Council's plan to continue to invest in infrastructure through a sustainable capital programme financed by £11.582m capital financing revenue implications per annum (increasing to £12.365m per annum from 2017/18). This creates the affordability and sustainability financial boundaries for the development of the Council's Capital Financial Plan.

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

3.1 Capital Expenditure (Prudential Indicator PI-1)

a) This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this planning cycle. The indicator also includes additional expenditure which, for the purposes of financial planning and reporting, must be treated as capital expenditure. This expenditure relates to the construction of the new Barrhead High School and is the estimated investment which will be supported by the Scottish Government through ongoing revenue grant.

b) The following capital expenditure forecasts are in line with the general fund capital plan for 2016/17-2023/24 and housing capital plan 2016/17- 2020/21 which will be submitted to Council on 9 March 2016 together with the additional expenditure outlined above:

Capital Expenditure (PI-1) £'000	**2014/15 Actual**	**2015/16 Probable**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund					
– Capital Programme	16,910	25,175	48,239	27,462	31,736
– Other Relevant Expenditure				22,103	
General Fund Subtotal	16,910	25,175	48,239	49,565	31,736
Housing	3,774	6,330	4,319	3,851	4,247
Total	**20,684**	**31,505**	**52,558**	**53,416**	**35,983**

3.2 Capital Financing Assumptions

a) The table below summarises the capital expenditure plans for general fund and how these plans are being financed. Any shortfall of resources results in financial need.

General Fund £'000	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Expenditure	16,910	25,175	48,239	27,462	31,736
Other Relevant Expenditure				22,103	-
Total	**16,910**	**25,175**	**48,239**	**49,565**	**31,736**
Financed by:					
Capital Receipts	214	2,175	2,775	675	2,225
Capital Reserve	4,000	10,050	14,750	-	150
Developer Contributions	186	10	1,368	654	1,483
Govt. General Capital Grants	8,312	7,662	5,798	7,755	6,418
Govt. Specific Capital Grants	140	1,913	2,081	1,326	1,200
Other Grants & Contributions	684	954	272	75	75
Repairs & Renewals Fund/CFCR	718	91	448	-	-
Net financing need for the year	**2,656**	**2,320**	**20,747**	**39,080**	**20,185**

b) The table below summarises the capital expenditure plans for housing and how these plans are being financed. Any shortfall of resources results in financial need.

Housing £'000	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Expenditure	3,774	6,330	4,319	3,851	4,247
Financed by:					
Capital Receipts – Right to Buy	478	680	490	-	-
Capital Receipts – Land Disposal	-	-	-	-	500
Recharges to Owners	476	400	462	569	465
Govt. Specific Capital Grants	149	778			
Commuted Sums	53	752			
Insurance Fund/CFCR	225				
Net financing need for the year	**2,393**	**3,720**	**3,367**	**3,282**	**3,282**

c) The table below summarises the financial need resulting from both the general fund and housing capital plans.

Financial Need £'000	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund	2,656	2,320	20,747	39,080	20,185
Housing	2,393	3,720	3,367	3,282	3,282
Net financing need for the year	**5,049**	**6,040**	**24,114**	**42,362**	**23,467**

3.3 The Council's Borrowing Need
(the Capital Financing Requirement – Prudential Indicator PI-2)

a) 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 identified above, which has not immediately been paid for (e.g. via grants), will increase the CFR. The CFR does not increase indefinitely, as scheduled debt amortisation (loans charges) broadly reduces the borrowing need in line with each asset's life.

b) The CFR includes any other long term liabilities (e.g. PPP schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council has £81.655m of liabilities relating to such schemes within the 2014/15 Balance Sheet.

c) The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £'000	**2014/15 Actual**	**2015/16 Probable**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund	**160,651**	**152,692**	**164,172**	**192,822**	**201,270**
Housing	**27,767**	**28,988**	**29,515**	**29,777**	**29,903**
Total CFR (PI-2)*	**188,418**	**181,680**	**193,687**	**222,599**	**231,173**
Movement in CFR represented by:					
Net financing need for the year (above)		6,040	24,114	42,362	23,467
Less scheduled debt amortisation and other financing movements		(12,778)	(12,107)	(13,450)	(14,893)
Movement in CFR		**(6,738)**	**12,007**	**28,912**	**8,574**

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

The significant increase between 2015/16 and subsequent years is driven by the shift in the net financing need for the year as detailed in the tables within section 3.2. The increase in the CFR is mainly related to the increased levels of expenditure within the capital plans. However two main contributors are the City Deal initiative with borrowing of £32,817,000 (over the 3 year period 2016/17 to 2018/19) and the new Barrhead High School project with debt of £22,103,000 (2017/18).

3.4 Affordability Prudential Indicators

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

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

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

Ratio of Financing Costs to Net Revenue Stream (PI-3)	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund	**9.8%**	**8.6%**	**8.4%**	**9.3%**	**10.7%**
Housing	**34.7%**	**36.2%**	**39.2%**	**38.7%**	**38.6%**

The estimates of financing costs include current commitments and the proposals in the capital plans for 2015/16 to 2018/19. The increase from 2017/18 to 2018/19 within the ratio for the general fund is a result of the increased finance costs associated with new Barrhead High School. This increased cost will be covered in full by a revenue grant scheme provided by the Scottish Government/Scottish Futures Trust.

Incremental impact of capital investment decisions on council tax (Prudential Indicator PI-4a)

c) This indicator calculates the impact of capital investment decisions on council tax and takes account of the level of support provided by the Scottish Government – both capital grant support and ongoing revenue support. The impact of additional borrowing will be covered in full by corresponding revenue savings or by an additional revenue income stream (Scottish Government support for Barrhead High School). On this basis there is no impact on council tax over the three year period. The levels of Government support for 2017/18 and 2018/19 have not been issued and this indicator is based on estimates. However it may be necessary to revise this indicator when the support figures are issued.

Incremental Impact of Capital Investment Decisions on the Band D Council Tax (PI-4a)	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Incremental Impact on Band D Council Tax	£0.00	£0.00	£0.00

Incremental impact of capital investment decisions on rents (Prudential Indicator PI-4b)

d) This indicator calculates the impact of capital investment decisions on rents before taking into account savings which have been identified to mitigate the additional costs.

Incremental Impact of Capital Investment Decisions on Rents (PI-4b)	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Incremental Impact on Rents (52 weeks)	£1.74	£0.93	£0.76

4 Treasury Management Strategy

Section 3 provides a summary of the capital expenditure plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional Codes, so that sufficient cash is available to meet its liabilities as they fall due. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

a) The Council's actual and projected debt portfolio is summarised below. The table compares the actual and projected external debt against the Council's estimated borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

£'000 as at 31 March	2014/15 Actual	2015/16 Probable	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	68,083	60,598	113,510	116,755	114,147
Other Long Term Liabilities	81,665	78,862	76,199	94,956	90,311
Total Gross Debt (Prudential Indicator PI-5)	**149,748**	**139,460**	**189,709**	**211,711**	**204,458**
CFR – the borrowing need	**188,418**	**181,680**	**193,687**	**222,599**	**231,173**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(38,670)**	**(42,220)**	**(3,978)**	**(10,888)**	**(26,715)**

b) Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-6) is that the Council needs to ensure that its gross debt figure (shown above) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and following two financial years. This allows some flexibility for limited borrowing for future years, but ensures that borrowing in advance of need is not undertaken for revenue purposes.

c) The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded by external loan debt as the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains both prudent and cost effective as investment returns are low and counterparty risk is relatively high

4.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary (Prudential Indicator PI-7)

a) This indicator takes account of capital expenditure and financing requirements and projects the expected level of external debt for operational purposes. Temporary breaches of the operational boundary are quite acceptable and the Head of Accountancy/Chief Financial Officer has delegated authority to manage the movement between borrowing and other long term liabilities such as finance leases in accordance with option appraisal and value for money considerations. Any such movement will be reported to Council following the change.

Operational boundary for external debt (PI-7) £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	**115,598**	**118,510**	**116,755**
Other Long Term Liabilities	**79,112**	**98,302**	**94,956**
Total	**194,710**	**216,812**	**211,711**

The Authorised Limit for External Debt (Prudential indicator PI-8)

a) This indicator is similar to the operational boundary but includes headroom to accommodate adverse cash flow movements. It represents a limit which external debt is not expected to exceed and reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. In circumstances where a breach takes place the reasons shall be reported to the next meeting of the Council and the limit revised if appropriate. The same delegated powers are in place as for the operational boundary.

b) 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.

c) The proposed Authorised Limit for the Council is as follows:

Authorised limit for external debt (PI-8) £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	**132,938**	**136,287**	**134,268**
Other Long Term Liabilities	**79,112**	**98,302**	**94,956**
Total	**212,050**	**234,589**	**229,224**

4.3 Prospects for Interest Rates

a) The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Annex B draws together a number of current city forecasts for short term (Base Rate) and longer fixed interest rates and the following table and commentary below gives the central view of Capita Asset Services.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	**25 year**	**50 year**
Mar 2016	0.50	2.40	3.70	3.60
Jun 2016	0.75	2.60	3.80	3.70
Sep 2016	0.75	2.70	3.90	3.80
Dec 2016	1.00	2.80	4.00	3.90
Mar 2017	1.00	2.80	4.10	4.00
Jun 2017	1.25	2.90	4.10	4.00
Sep 2017	1.50	3.00	4.20	4.10
Dec 2017	1.50	3.20	4.30	4.20
Mar 2018	1.75	3.30	4.30	4.20
Jun 2018	1.75	3.40	4.40	4.30
Sep 2018	2.00	3.50	4.40	4.30
Dec 2018	2.00	3.50	4.40	4.30
Mar 2019	2.00	3.60	4.50	4.40

b) **UK.** UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

c) The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee (MPC) will decide to make a start on increasing Bank Rate.

d) **USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1.5% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now resulted in a first rate rise of 0.25% in December.

e) **EZ.** In the Eurozone, the European Central Bank (ECB) fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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

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

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenomenally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

h) **Annex C** contains a more comprehensive Economic Background narrative from Capita Asset Services.

4.4 Borrowing Strategy

a) The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded by external loan debt as the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains both prudent and cost effective as investment returns are low and counterparty risk is relatively high.

b) Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *If it was felt that there was a significant risk of a sharp FALL in long and short term rates*, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast*, perhaps arising from a faster than currently anticipated unwinding of quantitative easing in the US, or an unexpected increase in work 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 are still lower than they will be in the next few years.

c) Any decisions will be reported to Members at the next available opportunity.

Treasury Management Limits on Activity

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

i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)

This covers a maximum limit for borrowing exposure to fixed interest rates, based on the debt position and is set at 100%.

ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)

This identified a maximum limit for borrowing exposure to variable interest rates based upon the debt position and is set at 30%.

iii) Maturity structure of borrowing (Treasury Indicator TI-3)

Gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing. The Council has set the limit of debt maturing in any one year to 15%.

4.5 Policy on borrowing in advance of need

a) The Council will not borrow in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

b) 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.

c) Borrowing in advance is defined as any borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the capital financing requirement (CFR) of the local authority for the following twelve month period. This twelve month period is on a rolling twelve month basis.

d) The Chief Financial Officer has the authority to borrow in advance of need under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. The Chief Financial Officer will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:

- The benefits of borrowing in advance,
- The risks created by additional levels of borrowing and investment, and
- How far in advance it is reasonable to borrow considering the risks identified

e) Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

4.6 Debt Rescheduling

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

b) The reasons for any rescheduling to take place will include:

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

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

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

5 Investment Strategy

5.1 Investment Objectives and Policy

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

b) The Council's primary investment objectives are:
   i) The safeguarding or **security** of the re-payment of principal and interest of investments on a timely basis; and
   ii) The **liquidity** of its investments

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

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

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

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

5.2 Council Permitted Investments

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

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

Cash type instruments
- Deposits with the Debt Management Account Facility (DMADF) (UK Government)
- Deposits with other local authorities or public bodies
- Money Market Funds
- Call account deposit accounts with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- Term deposits with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- UK Government Gilts and Treasury Bills
- Certificates of Deposit with financial institutions (banks and building societies)
- Fixed Bonds: Financial / Corporate / Supranational / Covered
- Floating Rate Note

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

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

5.3 Creditworthiness Policy

a) This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties (**Annex E**) 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

b) This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use selected counterparties within the following durational bands after considering our own risk appetite:

Creditworthiness Colour Banding	Maximum Investment Duration
Yellow	5 years
Dark pink	5 years for Enhanced Money market Funds (EMMFs) with a credit score of 1.25
Light pink	5 years EMMFs with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi-nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	Not to be used (i.e. don’t invest)

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yr	Up to 5yr	Up to 5yr	Up to 2 yr	Up to 1 yr	Up to 1 yr	Up to 6mths	Up to 100days	No colour

c) The creditworthiness service provided by Capita uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weight to just one agency’s ratings.

d) 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 and, with the exception of the Council’s own banker, these institutions will fall outside the lending criteria.

e) Using the Capita Asset Services creditworthiness service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

f) Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information.

g) The time and monetary limits for Institutions on the Council's counterparty list are shown in **annex F**

5.4 Country and Council's Banker

Country Limits

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

Council's Own Banker

b) The Council's own banker (Clydesdale bank) will be maintained on the Council's counterparty list in situations where rating changes mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities overnight and short-term investment facilities.

5.5 The Monitoring of Investment Counterparties

a) All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service of Capita Asset Services.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads 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.

b) If the Council has funds invested in an institution which is downgraded to below the acceptable rating criteria, the Council will enter discussions with the counterparty to establish if the funds can be returned early. This however will be subject to an appropriate cost versus risk assessment of the specific situation.

c) The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Under exceptional market conditions, the Chief Financial Officer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out in this Strategy. These restrictions will remain in place until the Chief Financial Officer is of an opinion that the banking system has returned to 'normal'. Similarly a restriction may be placed on the duration of investments.

5.6 Types of Investments

a) For institutions on the approved counterparty list, investments will be restricted to safer instruments (as listed in Annex D). Currently this involves the use of money market funds, the DMADF and institutions with higher credit ratings than the minimum permissible rating outlines in the investment strategy, as well as the Council's own bank.

b) Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:

- ICAP Securities Limited
- Sterling International Brokers Limited
- Tradition (UK) Limited
- Martins Brokers
- King and Shaxson Capital Limited

5.7 Investment Strategy and bank rate projections

In-house funds

a) 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).

Bank Rate

b) Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2016. Bank Rate forecasts for financial year-ends (March) as at January 2016 are:

2016/2017	1.00%
2017/2018	1.75%
2018/2019	2.00%

c) There are downside risks to these forecasts (i.e. start of increase in Bank Rate occurs later). However, should the place of growth quicken and or forecasts for increases in inflation rise, there could be an upside risk.

Investment Treasury Indicator And Limit (Treasury Indicator TI-4)
Total Principal Funds Invested for Greater Than 364 days

d) 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.

e) The treasury indicator and limit proposed is:

Maximum principal sums invested > 364 days (TI-4)			
£m	2015/16	2016/17	2017/18
Principal sums invested > 364 days	5%	5%	5%

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

5.8 Risk Benchmarking

These benchmarks are simple guides to minimise risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmarks is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or annual report.

a) Security

The Council's **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

0.062% historic risk of default when compared to the whole portfolio for 1 year.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £100,000

c) Yield

Local Measures of yield benchmarks are:

Investments – **Internal returns above the 7 day LIBID rate**

d) Activity

At the end of the financial year, the Chief Financial Officer will report on its investment activity as part of the annual treasury report.

6 Performance Indicators

6.1 The CIPFA Code requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

6.2 Debt Performance Indicators

(i) Average "Pool Rate" charged by the Loans Fund compared to Scottish Local Authority average Pool Rate

Target is to be at or below the Scottish Average for 2015/16

(ii) Average borrowing rate movement year on year
Target is to maintain or reduce the average borrowing rate for the Council versus 2015/16.

6.3 Loan Charges

a) Loan Charges for 2016/17 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in March 2016, which are estimated as follows:

£m	2016/17 Estimate	2017/18 Estimate
Capital Repayments	6.354	7.084
Interest on Borrowing	5.115	5.166
Expenses	0.113	0.115
Total Loan Charges*	**11.582**	**12.365**

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

7 Monitoring and Reporting

7.1 In line with the CIPFA Code the following formal reporting arrangements will be adopted:

Requirement	Purpose	Responsible Body	Frequency
Scrutiny of Treasury Management Strategy	Detailed scrutiny prior to annual approval by Council	Audit & Scrutiny Committee	Annually
Treasury Management Strategy	Reporting on Annual Strategy	Council	Annually prior to start of new financial year
Scrutiny of Treasury Management Mid-Year Report	Detailed scrutiny prior to annual approval by Council	Audit & Scrutiny Committee	Annually in October/November of the current year
Treasury Management Mid-Year Report	Mid-Year Performance Report	Council	Annually after reported to the Audit & Scrutiny Committee
Scrutiny of Treasury Management Annual Report	Detailed scrutiny prior to annual approval by Council	Audit & Scrutiny Committee	Annually in September/ October of the financial year
Treasury Management Annual Report	Annual Performance report for previous financial year	Council	Annually after reported to the Audit & Scrutiny Committee
Treasury Management Practices		Council	As appropriate
Treasury Management Policy Statement	Reviews and Revisions	Council	As required

8 Treasury Management Consultants and Advisers

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

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

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

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

8.4 The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

9 Member and Officer Training

9.1 The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council will address this important issue by:

a) Elected Members
   - Working with members to identify their training needs
   - Working with Capita Asset Services to identify appropriate training provision for elected members

b) Officers dealing with treasury management matters will have the option of various levels of training including:
   - Treasury courses run by the Council's advisers
   - Attendance at CIPFA treasury management training events
   - Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
   - Training identified as part of the Council's Performance Review & Development system in line with the approved Treasury Management Practices (TMPs).

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Reference	Indicator	Page Ref.	2016/17	2017/18	2018/19
PRUDENTIAL INDICATORS					
Capital Expenditure Indicator					
PI-1	Capital Expenditure Limits General Fund Housing Total	7	£’000 48,239 4,319 52,558	£’000 49,565 3,851 53,416	£’000 31,736 4,247 35,983
PI-2	Capital Financing Requirement General Fund Housing Total	9	£’000 164,172 29,515 193,687	£’000 192,822 29,777 222,599	£’000 201,270 29,903 231,173
Affordability Indicator					
PI-3	Ratio of Financing Costs to Net Revenue Stream General Fund Housing	9	8.4% 39.2%	9.3% 38.7%	10.7% 38.6%
PI-4a	Incremental Impact of Capital Investment Decisions on Council Tax	10	£0.00	£0.00	£0.00
PI-4b	Incremental Impact of Capital Investment Decisions on Rents (52 weeks)	10	£1.74	£0.93	£0.76
External Debt Indicators					
PI-5	Gross Debt Borrowing Other Long Term Liabilities Total	11	£’000 113,510 76,199 189,709	£’000 116,755 94,956 211,711	£’000 114,147 90,311 204,458
PI-7	Operational Boundary for External Debt Borrowing Other Long Term Liabilities Total	11	£’000 115,598 79,112 194,710	£’000 118,510 98,302 216,812	£’000 116,755 94,956 211,711
PI-8	Authorised Limit for External Debt Borrowing Other Long Term Liabilities Total	12	£’000 132,938 79,112 212,050	£’000 136,287 98,302 234,589	£’000 134,268 94,956 229,224
Indicators of Prudence					
PI-6	(Under)/Over Gross Borrowing against the CFR	11	£’000 (3,978)	£’000 (10,888)	£’000 (26,715)
TREASURY INDICATORS					
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt	15	100% of debt position		
TI-2	Upper Limit to Variable Interest Rates based on Net Debt	15	30% of debt position		
TI-3	Maturity Structure of Fixed Interest Rate Borrowing	15	15% maturing in any one year		
TI-4	Maximum Principal Sum invested greater than 364 days	20	5%	5%	5%

ANNEX B: INTEREST RATE FORECASTS 2016-2019

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

ANNEX C

Economic Background

UK. UK GDP growth rates of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

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

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q1 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

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

USA. GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 1.5%.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August, has now resulted in the first rate rise of 0.25% in December.

Eurozone. The ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and looks as if it may maintain this pace in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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

China and Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.3% after a short burst of strong growth of 1.0% during Q1. Japan has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

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

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

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

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

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2016.

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

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

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

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

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

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

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

ANNEX D

Credit and Counterparty Risk Management

Permitted Investments, Associated Controls and Limits for East Renfrewshire Council and East Renfrewshire Culture & Leisure Trust

Type of Investment	Treasury Risks	Mitigating Controls	Limits
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk**)	This is a deposit with the UK Government and, as such, counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months	Little mitigating controls required. As this is a UK Government investment, the monetary limit is £5,000,000	£5m, maximum 6 months.
b. Deposits with other local authorities or public bodies (**Very low risk**)	These are considered quasi UK Government debt and, as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment.	£2m (per body), maximum 6 months
c. Money Market Funds (MMFs) (**Very low risk**)	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs use Constant Net Asset Value (CNVA) and the fund has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	£5m per fund/£30m overall
d. Call account deposit accounts with financial institutions (banks and building societies) (**Low risk depending on credit rating**)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Day to day investment dealing with the criteria will be further strengthened by use	As shown in the counterparty listing (Annex F)

		of additional market intelligence.	
e. Term deposits with financial institutions (banks and building societies) (**Low to medium risk depending on period & credit rating**)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty listing (Annex F)
f. UK Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and, as such, counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£5m, maximum 6 months
g. Certificates of Deposit with Financial Institutions (Banks & Building Societies) **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	Dependent on institution as listed in counterparty listing in annex F
h. Fixed bonds: Financial / Corporate /Supranational /	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	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch,	Dependent on institution as listed in counterparty

Covered **(Medium to high risk depending on period and credit rating)**	selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	Moody's and Standard and Poor's. . Fixed bonds will be restricted to those meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	listing in annex F
i. Floating Rate Note **(Medium to high risk depending on period and credit rating)**	This is a money market instrument with a floating /variable rate of interest, which re-fixes over a reference rate , for example LIBOR.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. . The Floating Rate Note will be restricted to those meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	Dependent on institution as listed in counterparty listing in annex F
j. Investment properties (**Medium Risk)**	These are non-service properties which are being held pending disposal or for a longer-term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids)	In larger investment portfolios, some small allocation of property based investment may counterbalance/compliment the wider cash portfolio.	No limit
k. Loans to third parties, including soft loans (**Low to Medium Risk depending on Credit Risk**)	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rationale behind the loan and the likelihood of partial or full default.	£0.5m
l. Loans to a local authority company/ partnership or	These are service investments either at market rates of interest or below market rates (soft loans). These types of	Each loan to a local authority company/LLP requires Member approval and each application is supported by the	£1m

charity (**Low Risk)**	investments may exhibit credit risk and are likely to be highly illiquid	service rationale/business case behind the loan and the likelihood of partial or full default. In general these loans will involve some form of security or clear cash flow that is available to service the debt.	
m. Shares in Hub Schemes (**Very Low Risk**)	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term. These projects are based on robust business cases with a cash flow from public sector organisations (i.e. low credit risk)	Investment limited to HUB schemes where the Council is a major participant

The Monitoring of Investment Counterparties

The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Capita Asset Services, including when ratings change, and counterparties are checked promptly. On occasion rating may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately and if required new counterparties which meet the criteria will be added to the list with written permission of the Chief Financial Officer.

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ANNEX E

Credit Ratings

Long and Short Term Credit Ratings

Audit Commission Grading#	Fitch		Moody's		Standard and Poor's	
	Long Term	Short Term	Long Term	Short Term	Long Term	Short Term
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+ AA AA-	F1+ F1+ F1+	Aa1 Aa2 Aa3	P-1 P-1 P-1	AA+ AA AA-	A-1+ A-1+ A-1+
Strong grade But susceptible to adverse conditions	A+ A A-	F1+/F1 F1 F1	A1 A2 A3	P-1 P-1/P-2 P-1/P-2	A+ A A	A-1+/A-1 A-1/A-2
Adequate Grade	BBB+ BBB BBB-	F2 F2/F3 F3	Baa1 Baa2 Baa3	P-2 P-2/P-3 P-3	BBB+ BBB BBB-	A-2 A-2/A-3 A-2
Speculative Grade	BB+ BB BB-	B B B	Ba1 Ba2 Ba3	NP* NP NP	BB+ BB BB-	B-1 B-2 B-3
Vulnerable Grade	CCC CCC CCC CC C	C C C C C	Caa1 Caa2 Caa3 - Ca	NP NP NP NP NP	CCC+ CCC CCC- CC C	C C C C C
Defaulting Grade	D	D	C	NP	D	D

\# for the purpose of standardisation based on Standard and Poor's credit rating definitions
*NP – Not Prime

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard & Poor's

Viability, Financial Strength and Support Ratings

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectation of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key rating agency information used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As a result of these rating agency changes, the credit element of creditworthiness methodology applied by Capita Asset Services will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process that Standard & Poor's has always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, Credit Default Swap prices will continue to be used as an overlay to ratings in our new methodology.

Annex F **EAST RENFREWSHIRE COUNCIL**

ORGANISATIONS APPROVED FOR THE INVESTMENT OF SURPLUS FUNDS

		Limits	
Banking Group	**Individual Counterparty**	**Deposit**	**Transaction**
Bank of England	Debt Management Office	£5m	£5m
	UK Treasury Bills	£5m	£5m
Goldman Sachs International bank		£5m	£5m
Lloyds Banking Group:	Bank of Scotland	£10m	£10m
Royal Bank of Scotland Group:	Royal Bank of Scotland	£5m	£5m
Barclays Banking Group	Barclays Bank	£5m	£5m
Standard Chartered Bank		£5m	£5m
Santander Group	Santander UK PLC	£5m	£5m
National Australia Bank Group:	Clydesdale Bank	£0	£0
Building Societies			
Nationwide		£2m	£2m
Local Authorities			
All Local Authorities including Police & Fire		£2m	£2m
Money Market Funds			
Maximum limit of £5m per fund		£30m	£5m

Credit Ratings

	Fitch		Moodys		S&P	
	LT	ST	LT	ST	LT	ST
Minimum Criteria	A-	F1	A3	P-1/P-2	A	A-1/A-2

(Unless Government backed)

(please note credit ratings are not the sole method of selecting counterparty)

Limit

Investment of surplus funds is permitted in each of the above organisations, with the limits set on an individual basis by the Chief Financial Officer.

The limit may only be exceeded or another organisation approved with the written permission of the Chief Financial Officer.

Deposit Periods

The maximum period for any deposit is currently set at 6 months with the exception of the Bank of Scotland which is set at 364 days. These limits can only be exceeded with the written permission of the Chief Financial Officer.

Hub scheme deposit periods are dependent on the lifetime of the associated scheme.

GLOSSARY OF TERMS

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
Gilts	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
LIBID	London Interbank Bid Rate The rate at which banks bid on Eurocurrency Deposits, being the rate at which a bank is willing to borrow from other banks.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
Treasury Indicators	These consist of a number of a number of Treasury Management Indicators that local authorities are expected to ‘have regard’ to, to demonstrate compliance with the Treasury Management Code of Practice.