

### ANGUS COUNCIL

## 2016/17 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY

*Note: A brief glossary of some of the key technical terms utilised within this strategy statement is included for reference as Annex F at the end of the statement.*

### 1 Introduction

#### 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash income raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that the flow of cash in and out is adequately planned and managed, with cash being available when it is needed. Cash which is surplus for a period of time is invested with banks and other financial institutions (called counterparties). The Council has a low risk appetite for the temporary investment of surplus cash so prioritises security (the safety of the investment first), liquidity (accessibility of cash) second and lastly the return (income received) on the investment made.

The second main function of the treasury management service is to facilitate the funding for the Council's capital plans. These capital plans are therefore the basis on which the Council's need for borrowing is determined, in respect of longer term cash flow planning to ensure that the Council can meet its capital spending plans and obligations. This management of longer term cash flows may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion existing debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

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

It is the responsibility of the Head of Corporate Improvement and Finance to ensure that the Council's Treasury Management activities are in line with the approved Treasury Management Strategy and Annual Investment Strategy.

#### 1.2 Treasury Management Strategy for 2016/17

The Council's suggested strategy for 2016/17 is based upon the treasury officers' views on future interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Asset Services (Capita).

The proposed strategy for 2016/17 covers the following:

- Section 2 - the Council's current treasury position
- Section 3 - the Prudential and Treasury Indicators for 2015/16 to 2018/19
- Section 4 - the prospects for interest rates
- Section 5 - the borrowing strategy for 2016/17
- Section 6 - the investment strategy for 2016/17

Sections 2 to 6 form the core strategy statement (essentially the first 10 pages of this Appendix) for members consideration and approval. This document also however contains a number of Annexes which are required for full compliance with the Treasury Management code of practice and as such are of a necessarily technical nature. In the main however, they contain additional information and explanations of aspects of the core strategy document. The exception is Annex D which contains statutory indicators that require to be considered and approved by members.

The 2016/17 treasury management strategy has been prepared in accordance with the: Local Government in Scotland Act 2003; Chartered Institute of Public Finance and Accountancy Prudential Code 2011; Chartered Institute of Public Finance and Accountancy Treasury Management Code of Practice 2011; and Scottish Government Investment Regulations.

### **1.3 Treasury Management Reports**

The Council is required by the codes of practice to receive and approve, as a minimum, three main treasury management reports each financial year.

- An annual report on the strategy and the plan to be pursued in the coming year (this report)
- A mid year performance review report
- An annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the Council's treasury management policy statement and Treasury Management Practices.

### **1.4 Training**

The Treasury Management Code of Practice requires that members with responsibility for treasury management have access to adequate training in treasury management. In this regard the most recent training session for members was held on 5 June 2015, which focused on the outcome of the work undertaken by the Accounts Commission on Treasury Management Practices within Local Authorities.

One of main outcomes of the training session was a request by members to, where possible, simplify language and content of information presented to them. This Strategy Statement has therefore been considered and reviewed in this light. The existing structure of the strategy document has been retained for consistency and to ensure that the coverage of the strategy is compliant with the Code of Practice, however efforts have been made to simplify the language where possible within the constraints of such a technical area and without losing the context and meaning of the strategy as the underlying guide for actions taken throughout the year by officers within the treasury management section.

### **1.5 Policy on the use of external service providers**

Treasury management is a highly technical and specialist area and the Council recognises that there is value in employing external treasury management advisers to access specialist skills and resources and currently uses Capita Asset Services (Capita) in this regard.

Members are asked to note that the current contract with Capita ends on 31 March 2016 and that under the delegated authority of the Head of Corporate Improvement and Finance a one year extension as been granted until 31 March 2017. This contract will require to be re-tendered during 2016/17.

Responsibility for treasury management decisions however remains with the Council at all times and officers within the treasury management section will ensure that undue reliance is not placed upon the external advisers.

## **2 Current Treasury Position**

At any point in time the Council will have debt owing to external lenders and surplus cash held by approved counterparties.

In respect of surplus cash, the Council had a cash balance of £43.033 million as at 31 March 2015 and it is currently projected that the cash balance at 31 March 2016 will be almost unchanged at £43.000 million.

The Council's external debt position at 31 March 2015, with forward projections is summarised in Table 1 below. The table shows the actual and projected external debt as compared to the underlying need to borrow for capital purposes (known as the Capital Financing Requirement or C F R). This comparison highlights where there may be headroom for potential additional borrowing.

**Table 1 - Movement in External Debt and C F R Position**

<b>External Debt</b>	<b>2014/15 Actual £million</b>	<b>2015/16 Estimate £million</b>	<b>2016/17 Estimate £million</b>	<b>2017/18 Estimate £million</b>	<b>2018/19 Estimate £million</b>
P W L B Debt at 1 April	133.480	130.480	129.184	157.188	156.522
Market Debt at 1 April	30.000	30.000	30.000	30.000	30.000
<b>Total External Debt at 1 April</b>	<b>163.480</b>	<b>160.480</b>	<b>159.184</b>	<b>187.188</b>	<b>186.522</b>
Actual / Estimated New Borrowing (see note 3 below)	5.000	5.000	32.749	4.075	1.302
Loans Maturing	(8.000)	(6.296)	(4.745)	(4.741)	(6.241)
<b>Total External Debt at 31 March</b>	<b>160.480</b>	<b>159.184</b>	<b>187.188</b>	<b>186.522</b>	<b>181.583</b>
<b>CFR</b>	<b>Actual 31/3/15</b>	<b>Actual 31/3/16</b>	<b>Actual 31/03/17</b>	<b>Actual 31/03/18</b>	<b>Actual 31/03/19</b>
<b>Capital Financing Requirement - Excluding Other Long Term Liabilities (see note 4 below)</b>	<b>171.475</b>	<b>186.112</b>	<b>187.188</b>	<b>186.522</b>	<b>181.583</b>
<b>Borrowing Headroom Against C F R (see note 5 below)</b>	10.995	26.928	0.000	0.000	0.000

**Note 1** – the values in table 1 above reflect the proposals agreed at the Council's special budget setting meeting on 18 February 2016.

**Note 2** – the values in table 1 above represent the cash value of the Council's external debt. This differs slightly from those presented in the Council's Annual Accounts as the result of the application of specific accounting rules.

**Note 3** - The estimated new borrowing amounts included for future years are the maximum that can be undertaken in 2016/17 to 2018/19. Should the maximum borrowing ultimately be taken this would result in the external borrowing position being matched with the C F R. The maximum potential borrowing will however only be undertaken if it is considered appropriate to do so in the prevailing economic and market circumstances and after consideration of the Council's underlying cash balances.

**Note 4** - The C F R represents a 12 month forward looking position in accordance with the Investment Regulations. It therefore reflects the actual or projected borrowing requirement at the end of the following financial year.

**Note 5** – As a matter of policy, the Council does not borrow in advance of need and therefore the Council does not borrow in excess of the C F R at any point in time (Section 5.2 of this strategy statement provides further information).

### **3 Prudential and Treasury Indicators for 2015/16 to 2018/19**

Prudential and Treasury Indicators (as set out in Tables 1, 2 and 3 in Annex D to this strategy statement) are relevant for the purposes of setting an integrated treasury management strategy.

Although the Council has already approved some of these as part of the Council Tax budget setting process (report 65/16 (as amended) to the special budget meeting on 18 February 2016 refers) those already approved are however included in summary form in Table 1 of Annex D for completeness.

Members are however asked to approve the Treasury Indicators for 2016/17 to 2018/19 contained in Table 2 of Annex D and the Upper and Lower Limits in Table 3 of Annex D in compliance with the Treasury Management Code of Practice. A brief description of each Treasury Indicator to be approved and its purpose is provided in the Annex.

The Council is also required to confirm it has adopted in full the Code of Practice on Treasury Management and the Prudential Code. Both of these Codes were adopted by the full council on 25 March 2010 (Report 244/10 refers). Revised versions of these two Codes were produced in 2011,

however there were only minor presentational changes from the versions previously presented to the Council and formal confirmation of adopting the revised versions was not required.

#### **4 Interest Rate Prospects**

Even in stable economic times it is extremely difficult to predict how interest rates will move over the course of a year. It also has to be borne in mind that other factors (mainly the gilt market) affect the rates at which the Council can borrow from the P W L B.

It remains very challenging to predict how interest rates may move because of concerns in the Eurozone, geo-political tensions and changes in market forces which impact on inflation, such as those which have affected the oil price over the last year.

Part of the service provided by Capita is to assist the Council to formulate a view on interest rates and Table 2 below gives the central view from Capita as at 20 January 2016 for key interest rate prospects.

**Table 2 – Interest Rate Prospects**

<b>Date</b>	<b>Bank Base Rate</b>	<b>5 Year P W L B Rate</b>	<b>25 Year P W L B Rate</b>	<b>50 Year P W L B Rate</b>
March 2016	0.50%	2.00%	3.40%	3.20%
March 2017	0.75%	2.40%	3.70%	3.50%
March 2018	1.25%	2.80%	4.00%	3.90%
March 2019	1.75%	3.20%	4.10%	4.00%

For clarity in respect of the P W L B rates at which the Council could potentially borrow, the interest rates contained within Table 2 above are stated after allowing for the 0.20% certainty rate reduction which is available to the Council as noted in Section 5.1 below.

#### **Economic Background and Outlook (commentary from Capita)**

Capita has provided a summary of their view of the future economic position, which gives the context for their interest rate projections in Table 2 above. This summary is contained in Annex E attached to this strategy statement for members' information.

#### **5 Borrowing Strategy for 2016/17**

##### **5.1 Borrowing Strategy**

It is currently expected that any borrowing undertaken by the Council in 2016/17 will be sourced from the Public Works Loans Board (P W L B) and would be expected to be undertaken at fixed interest rates with repayment of the loan amount taking place when the loan matures.

Borrowing from the wider financial market will however be considered should competitive rates make this beneficial to the Council. Officers will also monitor the borrowing potential from the Municipal Bonds Agency in England as a potential further option.

Members are asked to note that the Council will continue to have access to the Government certainty rate which affords the Council a reduction of 0.20% on the interest rate applicable to new borrowing sourced from the P W L B during financial year 2016/17.

Any one or a combination of the options detailed below can be used to continue to ensure that the loans portfolio delivers maximum benefit to Angus Council during the forthcoming financial year.

##### **Variable Rate Borrowing**

P W L B variable interest rates in 2016/17 may be lower over the short term than fixed interest rates. Taking loans at variable rates could be attractive compared to taking loans only on the basis of fixed interest rates and consideration will be given to borrowing at variable rates, but only over a relatively short term. This is because there is greater financial risk in terms of the potential for adverse movement in the variable interest rate where such borrowing is taken over a medium to long term.

### Short Term Fixed Rate Borrowing

Interest rates in 2016/17 for P W L B loans of a shorter term nature (maturing in 10 years or less) are expected to continue to be lower than longer term P W L B interest rates. This will provide the option to take a variety of loans with a mix of maturity periods to avoid too heavy a concentration of loans with longer term maturity periods.

### Mid Range Fixed Rate Borrowing

There is expected to be little difference between P W L B interest rates for loans of a more medium term nature (15 to 25 years) and longer term loans (up to 50 years). Loans in this medium term period will therefore be considered as a means of managing the Council's debt maturity profile by reducing the concentration of debt in longer term periods.

### Long Term Fixed Rate Borrowing

P W L B interest rates are expected to begin to increase towards the later part of the financial year therefore it may be advantageous to time any new long term borrowing within the first half of the year.

In addition consideration will be given to the following options:

- Internal borrowing – this is the utilisation of temporary surplus cash balances in place of taking new borrowing, foregoing interest earned on the surplus cash, which remains at historically low interest rates at this time. In view of the forecast for long term borrowing rates to increase over the next few years however, the short term advantage which would result from utilising internal borrowing will be weighed against the potential for higher long term costs if the opportunity is foregone for taking longer term loans at rates which may be lower than they are anticipated to be in future years;
- Temporary borrowing from the money markets or other local authorities; and
- Short term borrowing from non P W L B sources.

Against this background the interest rates available will be monitored and a practical and prudent approach to any changing circumstances adopted. The maturity structure limits set as part of the Treasury Indicators (Annex D – Table 3 refers) will also be considered prior to undertaking any new borrowing.

**Sensitivity of the forecast** – In conjunction with the Council's treasury advisers, the interest rates available along with market conditions and forecasts will be continually monitored, adopting the following responses to a change of sentiment:

- If it is felt that there is a significant risk of a sharp rise in long and short term interest rates, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the loan portfolio position will be re-appraised and the possibility of undertaking fixed interest rate borrowing will be considered whilst interest rates are still relatively low.
- If it is felt that there is a significant risk of a sharp fall in long and short term interest rates – e.g. due to a marked increase of risks that could result in a fall back into recession or of risks of deflation, then long term borrowing will be postponed and the possibility of debt rescheduling will be considered with a view to possibly reducing the level of longer term fixed interest rate loans and replacing these with shorter term fixed or variable interest rate loans.

Ultimately, and because the position is so difficult to anticipate in advance, the Council's proposed strategy for borrowing in 2016/17 is to be as flexible as possible within the constraints of the Prudential Indicators set so that any borrowing is undertaken at what is considered to be the best time (based on the information, intelligence and advice available at the time of making the decision).

The foregoing references to borrowing will, of course, always be assessed in terms of estimated funding requirements and prudent debt management. Such assessment of borrowing will also consider as a significant factor in the decision making process, the cost of holding the debt between the time the loan is taken and the time the loan is applied to fund capital expenditure.

## **5.2 Policy on borrowing in advance of need**

As a matter of policy the Council will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed as such action is illegal.

Whilst the Council does not intend to borrow in advance of need (as defined in the Investment Regulations), the position will be kept under review. Any decision to borrow in advance of need will be considered carefully to ensure value for money can be demonstrated and that the security of such funds can be ensured. Members will be asked to approve any proposal to borrow in advance of need.

## **5.3 Debt Rescheduling**

Angus Council has over a number of years used changing market conditions to take advantage of debt rescheduling and restructuring opportunities. Significant financial savings have previously been made through such action and opportunities to restructure the Council's debt portfolio will continue to be sought during 2016/17.

### Debt Rescheduling Opportunities

There may be opportunities to generate savings by switching from longer term debt to shorter term debt as the shorter term borrowing interest rates are expected to be lower than longer term rates. These benefits do however need to be weighed against the potential disadvantage of giving up long term loans which may still have attractive interest rates over the longer term, as well as the risks associated with replacing a shorter term loan when it matures.

Where short term interest rates on investments in 2016/17 are lower than rates paid on current debt, consideration will be given to repaying some loans prematurely, or not replacing loans that mature naturally, by running down investment balances thus potentially making significant savings.

### Reasons for Debt Rescheduling

The reasons for any debt rescheduling will include one or more of the following:

- the generation of cash savings and or discounted cash flow savings at minimum risk;
- help fulfil the strategy outlined in section 5.1 above; and
- enhance the balance of the debt portfolio (amend the maturity profile and or the balance of volatility).

Any debt rescheduling undertaken will be reported as part of the treasury management mid year report or treasury management annual report.

## **6 Annual Investment Strategy**

### **6.1 Investment Policy**

Opportunities for investment arise naturally through treasury management activity and in particular the management of the timing of cash paid out and cash received, which can result in peaks and troughs in the amounts of surplus cash at any point during the year.

The Council can also choose to have its various funds and reserves (as included on its Balance Sheet) backed by cash held rather than simply being accounting reserves not backed by cash held.

Accordingly at any given point in time the Council can have sizeable sums of surplus cash available and in a best value context it is incumbent upon the Council to generate income from such surplus cash by investing it wisely. Income generated on surplus cash helps to fund the services the Council delivers.

The Council's investment policy must have regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the Chartered Institute of Public Finance and Accountancy Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes.

In line with these regulations and the code of practice, the Council's investment priorities will be security (the safety of the investment) first, liquidity (accessibility of cash when needed) second, and then return (income received) last. In accordance with these principles and to minimise risk to

investments, the Council has clearly stipulated at 6.3 below the minimum acceptable credit quality of counterparties for inclusion on the permitted counterparty lending list. In this regard the Council utilises Capita's creditworthiness service as described at 6.3 below.

The Investment Regulations require the Council to approve all types of investments that can be used for the investment of surplus cash and to set limits for the amount that can be held in each investment type. In this regard the types of investment (and their associated limits) that have been identified for potential use in the 2016/17 financial year are listed in Annex C.

Cash flows relating to Common Good Funds and Charitable Trusts administered by the Council are not separately identifiable from those of Angus Council therefore investments undertaken by the Council incorporate an element of Common Good and Charitable Trusts in respect of available surplus cash only. The permitted investments identified for use in Tables 1 to 5 in Annex C therefore cover investment of available cash balances for Angus Council, the Common Good and Charitable Trusts. For clarity however, investments held by the Strangs Mortification Trust and Angus Council Charitable Trust are not covered by this investment policy. These investments are managed on behalf of the Trusts by external portfolio managers and are subject to their own separate investment policies agreed with the Trustees.

## **6.2 Investment Strategy**

The Council's investments will be managed by officers within the treasury management section but they will seek advice from Capita as required. The Council's investments are determined with reference to the core surplus cash balance and cash flow requirements. The outlook for short-term interest rates will be a key factor when making investment decisions.

The benchmark rate against which the Council will measure its investment income returns will be the six month LIBID (London Interbank Bid) rate – currently 0.56%. For this 2016/17 strategy the Council will aim to achieve a return of 0.65% on investments placed during the financial year.

For its cash flow generated balances, the Council will seek to utilise its business reserve, instant access and notice accounts, money market funds and short-dated deposits in order to benefit from the compounding of interest whilst still maintaining adequate accessibility of cash to deal with unforeseen needs for cash which might arise during the year.

## **6.3 Creditworthiness Policy**

The Council utilises the creditworthiness service provided by Capita to compare counterparties with the Council's view of the minimum acceptable credit quality. This view is set out under the counterparty criteria headings below. This service uses a sophisticated modelling approach based on credit ratings from all three of the main credit rating agencies (Fitch, Standard & Poors and Moodys). However, Capita does not rely solely on the current credit ratings of counterparties but also uses the following to refine their creditworthiness view:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps (C D S) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries; and
- Information from other sources such as the financial press, share prices and the wider financial sector.

This modelling approach uses a weighting system to assess overall creditworthiness with the aim of generating a list of suitably creditworthy counterparties which will also enable diversification and thus avoidance of concentration of risk. The ultimate output from this approach is a series of colour coded bands which indicate the relative creditworthiness of counterparties along with the recommended maximum duration for investments with those counterparties – these are referred to under the investment duration heading below as durational bands.

All credit ratings are effectively monitored on a real time-basis and the Council's treasury team is alerted in real-time to changes to ratings through the receipt of regular market update bulletins from Capita. A comprehensive weekly review is however also undertaken, based on a weekly update received from Capita. These updates are available as a result of the Council's use of the Capita creditworthiness service.

If a change highlighted through the Capita service results in a counterparty no longer meeting the Council's minimum acceptable credit quality criteria, it will not be considered for investment of surplus cash until a future update results in it once again meeting the Council's criteria.

It should be noted however, that investments already placed with such counterparties will be retained until their planned maturity, unless there are major concerns over the eventual return of the investment, in which case early repayment (likely to incur penalty charges) may be sought.

- The one exception to this rule is the Council's own banking services provider, currently the Clydesdale Bank. Further details regarding the utilisation of the Clydesdale Bank for investment purposes in the event of their ratings falling outwith the Council's minimum acceptable credit quality criteria are provided after Table 5 in the Investment Level section below.

As an added measure, sole reliance will not be placed on the use of this external service. In addition Council officers will independently use information from other sources such as the financial press and the wider financial sector when considering whether or not to make a specific investment.

### **Counterparty Criteria (Call Accounts, Term Deposit or Certificates of Deposit Investments)**

In deciding suitable counterparties for Call Accounts, Term Deposit or Certificates of Deposit investment purposes the following criteria must be met at the time of making the investment:

- the counterparty must be authorised with the U K Financial Conduct and Prudential Regulation Authorities
- the counterparty must be authorised by the Bank of England to accept deposits through a branch in the U K
- the counterparty must have minimum Fitch credit ratings as follows:

**Table 3 – Counterparty Minimum Rating Criteria**

Rating	Minimum Rating
Long Term Rating	A minus
Short Term Rating	F 1

and

- the counterparty must have a colour code according to the Capita Creditworthiness model (a no colour code rating would exclude the counterparty).

Alternatively the counterparty must be a U K bank which has been part or fully nationalised by the U K Government.

If the above relevant tests are met, then the counterparty will be deemed suitable for inclusion on Angus Council's permitted counterparty lending list which is updated at least weekly following receipt of updated information from Capita.

### **Counterparty Criteria (Money Market Fund Investments)**

In order to be included on the Councils' permitted Funds list, for the investment of surplus cash balances, a Money Market Fund must meet the following criteria at the time of making the investment:

- the Fund must be registered with the Institutional Money Market Funds Association (I M M F A);  
and
- the Fund must have a Fitch triple A long term credit rating.

### **Investment Duration**

The maximum length of term an investment can be placed with any one counterparty will be determined at all times by reference to Capita's durational bands (unless there are exceptional circumstances). The durational bands currently are:



**Table 4 – Capita Durational Bands**

Durational Band Colour	Maximum term of investment
Yellow	5 years (this category is for triple A rated Government debt or its equivalent)
Dark Pink	5 years (Enhanced Money Market Funds (EMMF's) with a credit score 1.25)
Light Pink	5 years (Enhanced Money Market Funds (EMMF's) with a credit score 1.50)
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

In practice, investments undertaken may marginally exceed the suggested durational band but only where the Head of Corporate Improvement and Finance considers this appropriate on a case by case basis in respect of the risk profile of the investment.

### Investment Level

Members should note that premiums payable on Banks' Credit Default Swaps have reduced considerably over recent years indicating a reduction in the inherent risk in these institutions. As a result of this the limits for the levels of investments which can be placed with permitted counterparties have been set as detailed in Table 5 below.

**Table 5 – Permitted counterparty investment levels**

Long Term Fitch Rating / Institution type	Maximum Value of Investment per Institution £ million	Maximum Level of Total Council Investments with Same Rated Institutions
A minus	£2.5	35%
A / A plus	£5.0	60%
AA minus or greater (UK Domiciled)	£10.0	100%
AA minus or greater (Non-UK Domiciled)	£10.0 (£15.0 in total)	50%
Nationalised Banks	£15.0	100%
Money Market Funds	£20.0	100%

The one exception to the above mentioned limits is the Council's own bank, currently the Clydesdale Bank, for which an overall investment limit of £20.0 million is maintained for operational reasons. However, the overall £20.0 million limit applies only to investments of up to one month. Within the £20.0 million investment limit a maximum amount can be invested for a longer term (i.e. greater than one month), this amount being in line with those stated above relative to the Clydesdale's rating at the time of the longer term investment. If the Clydesdale Bank's credit rating or colour rating is however below the minimum acceptable credit quality requirements, then the placement of funds would be limited to overnight only, until such time that the credit rating, or colour rating, meets the Council's minimum criteria.

### 6.4 Country Limits

The Council has determined that it will only use approved counterparties authorised by the Bank of England to take deposits through a branch in the United Kingdom. Per table 5 above, a maximum of £15m or 50% of the Council's total investments would be placed with non-UK domiciled banks.

## **6.5 Longer term investments**

The investment regulations allow the Council to consider investing surplus funds for terms over a longer term (defined as greater than 364 days). It is prudent for the Council to have the ability to make use of this power at times when such investing is both appropriate and attractive.

The Regulations require however that the risks of such longer term investing are explained and the following risks are highlighted in this regard:

- longer term investments have an increased risk of potential repayment default. The Council will manage this risk through the application of the Capita credit rating durational bands.
- the risk associated with movements in interest rates increases as rates could move unexpectedly compared to the expectations at the time the investment was made. The Council will manage this risk by having a view of the future course of interest rates and then formulating a treasury management strategy which aims to maximise investment earnings consistent with control of risk.

Longer term investing could be attractive where there is an expectation that interest rates will fall and it is beneficial to lock in a higher level of earnings than would be available from a series of shorter term investments successively renewed over the same period. It can also be attractive in times when the market is over ambitious in its expectations of the speed with which interest rates will rise and is exposed to a fall back in rates when more realistic expectations eventually come to the fore.

Notwithstanding the ability to invest on a longer term basis, a cautious approach will continue to be adopted to the freedoms allowed in the Investment Regulations. Except where specifically indicated in the permitted investments list (Annex C to this Appendix), the maximum period which the council will invest for in excess of one year will be limited to up to two years.

## **6.6 End of year investment report**

After the end of the financial year, the Council will report on its investment activities as part of its Annual Treasury Report. This report will be placed before the full Council by 30 September.

### **Angus Council - Treasury Management Policy Statement**

The need to prepare a Treasury Management Policy Statement is a requirement of the Treasury Management in the Public Services Code of Practice published by the Chartered Institute of Public Finance and Accountancy.

The Treasury Management Policy Statement for the Council is, as follows:

- The Council defines its treasury management activities as: the management of the authority's investments and cash flows; its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.
- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is, therefore, committed to the principles of achieving value for money in treasury management and to employ suitable comprehensive performance measurement techniques, within the context of effective risk management.
- The Council's policy regarding borrowing is to borrow as required to meet our Capital Financing Requirement all in accordance with the Council's Annual Treasury Management Strategy. The Council will also not borrow for the purpose of re-investing.
- The Council's policy regarding investments is to invest surplus funds with reference to the Council's core cash balances and cashflow requirements all in accordance with the Council's Annual Investment Strategy.

## **CIPFA Treasury Management Code of Practice Key Principles and Clauses**

### **Key Principles**

The Chartered Institute of Public Finance and Accountancy Treasury Management in the Public Services Code of Practice identifies the following 3 Key Principles in respect of Treasury Management in the public services:

1. Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities;
2. Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy and should ensure that priority is given to security and liquidity when investing funds; and
3. They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

### **Approved Clauses**

The Chartered Institute of Public Finance and Accountancy Treasury Management recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1. This organisation will create and maintain, as the cornerstones for effective treasury management:
  - a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - suitable Treasury Management Practices (T M P), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and T M P will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. The full Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its T M P.
3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Policy and Resources Committee, and for the execution and administration of treasury management decisions to the Head of Corporate Improvement and Finance who will act in accordance with the organisation's policy statement and T M P and, if he or she is a Chartered Institute of Public Finance and Accountancy member, the Standard of Professional Practice on Treasury Management.
4. This organisation nominates the Scrutiny and Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

**PERMITTED INVESTMENTS**

This Council approves the following forms of investment instrument for use as permitted investments as set out in Tables 1 to 5 below. The columns within Tables 1 to 5 below represent the following:

**Table 1 - Deposits**

Investment Type	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max maturity period
Debt Management Agency Deposit Facility (D M A D F)	Not Applicable	Term of investment	No	Unlimited	2 Years
Term deposits with UK local authorities	Not Applicable	Term of investment	No	Unlimited	2 Years
Call accounts – banks and building societies	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Instant	No	Unlimited	2 Years
Term deposits – banks and building societies	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Term of investment	No	Unlimited	2 Years
UK part or fully nationalised banks	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Term of investment	No	Unlimited	2 Years
Fixed term deposits with variable rate and variable maturities (structured deposits).	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Term of investment	No	40%	2 Years
Collateralised deposit	UK Sovereign Rating	Term of investment	No	40%	2 Years

**Table 2 – Collective investment schemes structured as Open Ended Investment Companies**

Investment Type	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max maturity period
Government Liquidity Funds	U K Sovereign Rating	Instant	No	5%	2 Years
Money Market Funds	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Instant	No	Unlimited	2 Years
Enhanced Cash Funds	U K Sovereign Rating	Transaction plus more than 1 day	Yes	5%	2 Years
Gilt Funds	U K Sovereign Rating	Transaction plus more than 1 day	Yes	5%	2 Years
Bond Funds	U K Sovereign Rating	Transaction plus more than 1 day	Yes	5%	2 Years

**Table 3 – Securities issued or guaranteed by governments**

Investment Type	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max maturity period
Treasury Bills	U K Sovereign Rating	Transaction plus 1 day	Yes	Note 1 refers	2 Years
UK Government Gilts	U K Sovereign Rating	Transaction plus 1 day	Yes	Note 1 refers	2 Years
Bonds issued by a financial institution which is explicitly guaranteed by the U K Government	U K Sovereign Rating	Transaction plus 3 days	Yes	Note 1 refers	2 Years

**Note** – Investments in securities issued or guaranteed by the Government are limited to a maximum of £15million in any one of the investment types listed however 100% of the Council's investments can be placed in these types of investments and is therefore classed as unlimited.

**Table 4 – Securities issued by corporate organisations**

Investment Type	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max maturity period
Certificates of deposit	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Transaction plus 1 day	Yes	Unlimited	2 Years
Commercial paper	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Transaction plus 1 day	Yes	5%	2 Years
Corporate Bonds issuance	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Transaction plus 3 days	Yes	5%	2 Years
Other debt issuance by U K banks	Refer to Section 6.3 of Strategy Statement – Counterparty Criteria	Transaction plus 3 days	Yes	5%	2 Years

**Note – Accounting treatment of investments** - The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**Table 5 – Non Treasury Investments**

Investment Type	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max maturity period
Property Fund	Not Applicable	Not Applicable	Yes	5%	2 Years
Local authority mortgage guarantee scheme	Not Applicable	Not Applicable	No	5%	7 Years
Investment Properties	Not Applicable	Not Applicable	Yes	Unlimited	Unlimited
Home Loans	Not Applicable	Not Applicable	No	Unlimited	Unlimited
East Central Territory DBFM Projects	Not Applicable	Minimum 5 Year Term per project	No	£1.5m	30 Years
Common Good Loans	Not Applicable	Not Applicable	No	Unlimited	30 Years
RSL Loans	Not Applicable	Not Applicable	No	Unlimited	20 Years
Third Party Loans	Not Applicable	Not Applicable	No	Unlimited	10 Years

**Note** – Any Common Good, RSL Loans or Third Party loans would in practice be subject to separate committee reporting arrangements and the agreement of members before progressing. Each loan would be assessed on a case by case basis and this would include an assessment of the appropriate loan term up to the maximum in Table 5 above.

### **Treasury risks**

All the investment instruments in Tables 1 to 5 above are subject to the following risks:

- 1. Credit and counterparty risk** - this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although triple A rated organisations have a very high level of creditworthiness.
- 2. Liquidity risk** - this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment (for example gilts, certificates of deposits, 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; and
  - 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 the Tables 1 to 5 above headed as 'liquidity risk' will show each investment instrument as being instant access, transaction date plus 1 to 3 business days before cash is received, or term, for example, money is locked in until an agreed maturity date.

- 3. Market risk** - this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

- 4. Interest rate risk** - this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.
- 5. Legal and regulatory risk** - this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

#### **Controls on treasury risks**

- 1. Credit and counterparty risk** - the Council has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to enable investments to be made safely. Section 6 of the Strategy Statement provides additional information in this regard.
- 2. 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.
- 3. Market risk** - the Council may purchase investment instruments (for example Gilts and Treasury Bills) which are subject to market risk in terms of fluctuation in their value only if they are not held to maturity. In this regard the Council will not trade any investment instruments prior to maturity (unless it would be beneficial to the Council) and therefore market risk will not exist for the Council.
- 4. 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 maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.
- 5. Legal and regulatory risk** - this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

In addition the Council's external treasury adviser will be consulted when forming views or taking decisions in respect of controls on treasury risk. However, sole reliance will not be placed on the treasury advisers and any treasury decisions will be made by Council officers.

#### **Unlimited investments**

Paragraph 24 of the Investment Regulations states that an investment can be shown in an authority's permitted investments as being unlimited in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

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

- 1. Debt Management Agency Deposit Facility (D M A D F)** - 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 (the U K Government's sovereign rating stands behind the D M A D F). It is also a deposit account and avoids the potential complications of buying and holding Government issued treasury bills or gilts.
- 2. High credit worthiness banks and building societies (including Certificates of Deposit) –** Section 6 of the Strategy Statement provides an explanation of this authority's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with sufficiently high credit worthiness, Angus Council will ensure diversification of its portfolio by limiting the value of investments that can be placed with any one institution or group.
- 3. Deposits with U K Local Authorities** – It is considered that there is negligible counterparty risk with such lending (local authorities effectively having the same credit rating as the Government itself). On this basis such lending should have no limits placed upon it.
- 4. Money Market Funds** – These investments are considered relatively low risk as they are normally triple A rated (the highest credit rating available), offer instant access to funds and are a widely diversified form of investment. Additional protection is afforded by limiting the value of investment that can be placed with any one fund.



5. **Securities issued or guaranteed by the Government** – These investment types are considered low risk as they are issued by the Government and therefore are backed by the sovereign rating of the U K.
6. **Investment Properties** – The values of the properties held by the Council are driven by external market forces and therefore they are subject to fluctuations in value upwards or downwards. It is considered that setting an upper limit would not be practical operationally and these have, therefore, been classed as an unlimited investment.
7. **Home Loans** – In order for the Council to be as flexible as possible when considering loan applications, home loans will be regarded as an unlimited investment as placing an upper limit on these would not be practical operationally.
8. **R S L Loans** – In order for the Council to be as flexible as possible when considering any lending in this category, R S L loans will be regarded as an unlimited investment as placing an upper limit on these would not be practical operationally.
9. **Third Party Loans** – In order for the Council to be as flexible as possible when considering any lending in this category, third party loans will be regarded as an unlimited investment as placing an upper limit on these would not be practical operationally.

#### **Objectives of each type of permitted investment instrument**

Paragraph 25 of the Investment Regulations guidance notes requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted'.

In this regard, the objective of the Council in utilising any permitted investment is to protect the capital invested whilst optimising the return on the investment with a minimum possible risk. This is in line with Key Principle 2 identified in the Code, which notes that organisations should ensure that priority is first given to security and liquidity when investing funds.

#### **1. DEPOSITS**

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

**a) Debt Management Agency Deposit Facility (D M A D F)** - 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 potential 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 at a time when many authorities remain disappointed at the failure in 2008 of credit ratings to protect investors from the Icelandic bank failures and are both cautious about other forms of investing and are prepared to bear the loss of income to the treasury management budget compared to earnings levels in previous years. The longest term deposit that can be made with the D M A D F is 6 months.

**b) Term deposits with high credit worthiness banks and building societies** - This is the most widely used form of investing by local authorities. It offers a much higher rate of return than the D M A D F (dependent on term) and now that measures have been put in place to avoid over reliance on credit ratings, it is considered that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. Angus Council will ensure diversification of its portfolio by limiting the value of investments that 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 interest rates ahead of an expected fall in the level of interest rates. At other times, longer term interest 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 D M A D F. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date, unless early repayment (with associated penalties) is sought.

**c) Call accounts with high credit worthiness banks and building societies** - The objectives are as for 1(b) above however 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. However, there are a number of call accounts which at the time of

writing, offer rates 2 or 3 times more than term deposits with the D M A D F. Some utilisation of call accounts is highly desirable to ensure that the treasury team has access to cash when required.

**d) Fixed Term Deposits with variable rate and variable maturities (structured deposits) –** This 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 the Council with greater flexibility to adopt new instruments as and when they are brought to the market.

**e) Collateralised Deposits –** These are deposits placed with a bank which offers collateral backing based on Lender Option Borrower Option loans borrowed by local authorities. Such deposits are effectively lending to a local authority as that is the ultimate security.

## **2. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES**

**a) Government liquidity funds -** These are very similar to money market funds (see below) but only invest in government debt issuance with highly rated governments. They offer a lower rate of return than Money Market Funds but slightly higher than the returns from the D M A D F. As this is an investment placed with highly rated governments it is regarded as a low risk investment with high security on the principal sum invested.

**b) Money Market Funds –** Money Market Funds are normally triple A rated and are widely diversified, using many forms of money market securities including types which the Council does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the extensive sums of money invested in Money Market Funds, and the fact that the weighted average maturity cannot currently exceed 60 days, Money Market Funds offer a combination of high security, instant access to funds, high diversification and reasonable rates of return compared to equivalent instant access facilities.

**c) Enhanced cash funds -** These funds are similar to Money Market Funds, can still be triple A rated but have variable Net Asset Values as opposed to a traditional Money Market Fund which has a stable Net Asset Value. They aim to achieve a higher yield and to do this by either taking more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have Weighted Average Maturities and Weighted Average Life of 90 to 365 days or even longer. Their primary objective is yield and capital preservation is second, which does not follow the Council's "security, liquidity, yield" priority order. They are, therefore, a higher risk than Money Market Funds and correspondingly have the potential to earn higher returns than Money Market Funds.

**d) Gilt funds -** These are funds which invest only in U K Government gilts. They offer a lower rate of return than bond funds (see below) but are highly rated both as a fund and through investing only in triple A rated gilts. They offer a higher rate of return than investing in the D M A D F but they do have an exposure to movements in market prices of assets held.

**e) Bond funds -** These 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 bonds. They do have an exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

## **3. 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.

**a) Treasury bills -** These are short term bills (up to 12 months) issued by the Government and so are backed by the sovereign rating of the U K. The yield is higher than the rate of interest paid by the D M A D F and another advantage compared to a time deposit in the D M A D F 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 U K Government and are backed by the sovereign rating of the U K. The yield is higher than the rate of interest paid by the D M A D F and another advantage compared to a time deposit in the D M A D F 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. 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 U K Government (refers solely to Guaranteed Export Finance Corporation)** - This is similar to a gilt due to the explicit Government guarantee.

#### **4. SECURITIES ISSUED BY CORPORATE ORGANISATIONS**

The following types of investments are where an authority directly purchases a particular investment instrument security, for example 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. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations 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** - These are shorter term securities issued by deposit taking institutions (mainly banks) so they can be sold if there is a need for access to cash at any point in time.

**b) Commercial Paper** - These are similar to certificates of deposits but are 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 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 lower creditworthiness than government issued debt and so usually offer higher rates of yield.

**d) Other debt issuance by U K banks** – For example, Floating Rate Notes are bonds on which the rate of interest is established periodically with reference to short term interest rates.

#### **5. NON TREASURY INVESTMENTS**

**a) 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 unless a long term commitment is made to retain exposure to the property market.

**b) Local Authority Mortgage Guarantee Scheme** – Authorities who are participating in the Local Authority Mortgage Guarantee Scheme may be required to place a deposit with the mortgage provider up to the full value of the guarantee. The deposit will be in place for the term of the guarantee which is 5 years (with the possibility of a further 2 year extension if the account is 90 or more days in arrears at the end of the initial 5 years) – and may have conditions / structures attached. The mortgage provider will not hold a legal charge over the deposit.

**c) Investment Properties** – A property not held by the Council for the achievement of service objectives and which generates rental income and or capital gains. Examples include cemetery and park lodge houses, schoolhouses, bowling pavilions and shops.

**d) Home Loans** – The Council currently considers loan applications to enable applicants who are unable to obtain a mortgage to purchase their Council house and to enable applicants who cannot obtain a mortgage due to the structure of the property to purchase their ex Council House.

**e) East Central Territory DBFM Projects** – The Council is a participant in the East Central Territory Hub established under the direction of the Scottish Futures Trust. This is a private

limited company (East Central HubCo) which will take forward various infrastructure projects. A separate subsidiary private limited company (Sub HubCo) will be established to progress each individual project and the Council will have an opportunity to invest on a subordinated debt basis in these separate companies. Full details of the investment principles, opportunities, returns and risks (credit, counterparty, liquidity, market and interest rate) are contained in report 72/14 to the Policy and Resources Committee of 4 February 2014. The maturity period for the permitted investment entry in the above table 5 to this Annex C, has been set at 30 years which is at variance to the 25 years approved by report 72/14. This is to allow flexibility to respond to the potential for Sub HubCo projects to extend beyond the currently anticipated 25 years as project agreements develop.

- f) RSL Loans** – The Scottish Government issued a specific consent which allows, in certain circumstances, the Council to borrow to on-lend to Registered Social Landlords (RSLs). A requirement of this consent is that it is included as a permitted investment within the Council's Treasury Management strategy.
- g) Third Party Loans** – Such loans are included within Table 5 above as a permitted investment in order to provide flexibility for the Council to consider circumstances where it may be beneficial to make a loan of this nature for service reasons.

## APPENDIX A - ANNEX D

It should be noted that the figures contained within Table 1 below reflect the proposals agreed at the Council's special budget setting meeting on 18 February 2016 and the Special Communities committee meeting on 9 February 2016 and were approved at those committee meetings, but are presented here for completeness.

It should also be noted that the Capital Financing Requirement (C F R) in Table 1 below has been presented on a slightly different basis to the C F R figures approved in reports 65/16 (as amended) and 46/16. Members are assured however that the indicators in Table 1 are identical in total terms to those already approved.

The presentation in Table 1 below differs in that the C F R figure is split between the borrowing and other long term liability elements for the General Fund and Housing Revenue Account combined, whereas report 65/16 details just the total General Fund element of the C F R. This alternative presentation informs the borrowing against C F R comparison in Section 2 in the body of Appendix A. In addition the C F R figures in Table 1 (in Section 2 of Appendix A) have been advanced by one financial year from the C F R figures detailed in the table below to allow for the rolling 12 month forward looking basis.

**Table 1**

Prudential Indicator	2014/15 Actual £million	2015/16 Outturn £million	2016/17 Estimate £million	2017/18 Estimate £million	2018/19 Estimate £million
<b>Gross capital expenditure</b>					
General Fund	35.060	49.700	32.387	18.327	16.952
HRA	13.222	8.569	12.368	19.831	15.994
<b>Total</b>	<b>48.282</b>	<b>58.269</b>	<b>44.755</b>	<b>38.158</b>	<b>32.946</b>
<b>Ratio of financing costs to net revenue stream</b>					
General Fund	8.86%	8.71%	9.97%	10.35%	10.99%
HRA	8.91%	10.38%	8.89%	10.01%	12.84%
<b>Capital Financing Requirement as at 31 March</b>					
Borrowing	161.265	171.475	186.112	187.188	186.522
Other Long Term Liabilities	85.824	83.749	81.752	113.968	111.199
<b>Total</b>	<b>247.089</b>	<b>255.224</b>	<b>267.864</b>	<b>301.156</b>	<b>297.721</b>
<b>Incremental impact of capital investment decisions</b>					
Increase in council tax (band D) per annum	n/a	n/a	n/a	n/a	n/a
Increase in average rent per week	n/a	n/a	1.64	1.87	0.11
<b>Treasury Indicators</b>					
<b>Authorised limit for external debt</b>					
Borrowing	220.000	220.000	220.000	220.000	220.000
Other long term liabilities	86.434	84.414	82.394	115.372	111.849
<b>Total</b>	<b>306.434</b>	<b>304.414</b>	<b>302.394</b>	<b>335.372</b>	<b>331.849</b>
<b>Operational boundary for external debt</b>					
Borrowing	205.000	205.000	205.000	205.000	205.000
Other long term liabilities	86.434	84.414	82.394	115.372	111.849
<b>Total</b>	<b>291.434</b>	<b>289.414</b>	<b>287.394</b>	<b>320.372</b>	<b>316.849</b>

The four indicators relating to treasury management (shown in Tables 2 and 3 below) are no longer required under the Prudential Code; they are instead now set as part of the Treasury Management

Strategy Statement which is a requirement of the Chartered Institute Public Finance and Accountancy Treasury Management Code of Practice.

Members are therefore asked to approve the Treasury Indicators for 2016/17, 2017/18 and 2018/19 contained in Table 2 below and the Upper and Lower Limits in Table 3 in compliance with the Treasury Management in the Public Services Code of Practice. A brief description of each Treasury Indicator and its purpose is provided on the following page.

**Table 2**

Treasury Indicator	2015/16 Actual	2016/17 Outturn	2017/18 Estimate	2018/19 Estimate
Upper limit for fixed interest rate borrowing exposure	100%	100%	100%	100%
Upper limit for variable interest rate borrowing exposure	55%	55%	55%	55%
Upper limit for total principal sums invested for over 364 days	Unlimited	Unlimited	Unlimited	Unlimited

**Table 3**

Maturity structure of borrowing during 2015/16	Upper Limit	Lower Limit
Under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	50%	0%
5 years and 10 years	50%	0%
10 years and above	100%	50%

### Explanations of Treasury Indicators

#### **Fixed and variable Interest rate exposures**

The Council's treasury management activities involve borrowing funds when required. Some of these borrowings will be made for the short term, others for the longer term. The loans the Council takes may also be on a mixture of variable and fixed rates of interest. Striking an appropriate balance between the level of debt the Council has on fixed interest rates and variable interest rates is a matter of professional judgement but it is important that these judgements are made within guidelines agreed by the Council.

The Treasury Management Code of Practice identifies two indicators which will provide the acceptable range for exposure to interest rate risk:

- Upper limits for variable interest rate exposure; and
- Upper limits for fixed interest rate exposure.

By setting these parameters, covering financial years 2016/17, 2017/18 and 2018/19, the Council will limit its exposure to movements in both fixed and variable interest rates.

It is recommended that:

- An upper limit on fixed interest rate exposures of 100% of net outstanding principal sums is set for 2016/17, 2017/18 and 2018/19.
- An upper limit on variable interest rate exposures of 55% of net outstanding principal sums is set for 2016/17, 2017/18 and 2018/19.

The above limits mean that of the Council's total debt no more than 55% would ever be on variable rates of interest. Conversely the above limits would allow flexibility to have all of the Council's debt on fixed rates of interest if this was considered to be in the Council's best interests. Due to the very low

interest rates which have prevailed over recent years the Council currently has most of its debt on fixed rates of interest.

### **Total principal sums of investment for longer than 364 Days**

The purpose of this Treasury Indicator is for the Council to contain its exposure to the possibility of loss that may arise as a result of having to seek early repayment or redemption of any longer term investments which have been made. In this context longer term means for periods of more than one year.

### **Maturity structure of fixed rate borrowing during 2016/17**

The indicator, which requires the Council to set upper and lower limits for the maturity structure of its fixed rate borrowing, is designed to be a control over having large concentrations of fixed rate debt requiring to be replaced at the same time. By ensuring the maturity structure of fixed rate borrowing is managed effectively the Council can avoid having to replace large values of maturing loans during periods of volatile or high interest rates.

The indicator reflects the amount of projected fixed rate borrowing maturing in each of the following periods expressed as a percentage of total projected fixed rate borrowing. The limits shown in Table 3 above which it is recommended the Council set would be applicable to the three financial years 2016/17, 2017/18 and 2018/19.

The above limits in Table 3 would mean, for example, that the Council would never have any more than 25% of its fixed rate debt maturing in less than 1 year and would never have any less than 50% of its fixed rate debt due to mature in more than 10 years. It is important to note that the upper limits represent the maximum level of debt that could mature within the time periods listed and cannot therefore be added together to give a potential profile of the Council's debt maturity.

**Economic Background and Outlook (commentary from Capita)**

Capita has provided the following summary of their view of the future economic position, which gives the context for their interest rate projections (Table 2 within section 4 of the core strategy document refers).

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 12 February 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. 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 2017.

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. At some future point in time, an increase in 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 to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. 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 February 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2018.

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

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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 pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

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.



## **Glossary of Terms**

### **Authorised Limit**

The authorised limit represents a maximum value beyond which the Council's external debt must not exceed.

### **Borrowing In Advance of Need**

Borrowing which results in a net external debt in excess of the Council's capital financing requirement.

### **Credit Default Swaps (C D S)**

C D S are a financial instrument for swapping the risk of debt default. The buyer of a credit default swap pays a premium for effectively insuring against a debt default. If the debt instrument is defaulted the buyer of the C D S receives a lump sum payment. The seller of a credit default swap receives monthly payments from the buyer.

### **Debt Rescheduling**

As part of a wider treasury management policy existing debt is repaid and replaced with new debt. The purpose is to take advantage of changes in interest rate levels.

### **Gilt**

A gilt is a U K Government liability, issued by H M Treasury, listed and traded on the London Stock Exchange. The term gilt or gilt edged security is a reference to the primary characteristic of gilts as an investment, in other words, 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.

### **i Traxx Benchmark**

A benchmark relating to the Credit Default Swap (C D S) index which measures the average level of the most liquid financial C D S spreads in the market.

### **Lender Option / Borrower Option Loans**

A floating rate loan instrument which permits the lender to nominate a revised interest rate at periodic reset dates and lets the borrower decide whether to continue with the loan instrument at the revised interest rate or redeem the loan instrument.

### **Operational Boundary**

The operational boundary differs from the authorised limit in that it is based on expectations of the maximum external debt of the council according to probable, as opposed to possible, events and should be in line with the maximum level of external debt projected by estimates.

### **Weighted Average Maturity**

The average days remaining to maturity of individual funds.