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The Highland Council

12 March 2015

Agenda Item	20a
Report No	HC/8/15

Treasury Management Strategy Statement and Investment Statement – 2015/16

Report by Director of Finance

Summary

The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities. A requirement of the Code is for an annual Treasury Management Strategy Statement and Investment Statement to be approved by Council for the forthcoming financial year.

In compliance with the Code, the attached Treasury Management Strategy Statement and Investment Statement for 2015/16 was submitted to Resources Committee for scrutiny on 25 February and is now submitted to the Council for approval.

1. Introduction

1.1 Background

Treasury management is defined as:

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

1.2 Statutory Requirements

The Local Government in Scotland Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in Section 10 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 CIPFA Requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 4th March 2010. The Code was further updated in November

2011.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated Committee is the Resources Committee.

1.4 Treasury Management Strategy for 2015/16

The proposed strategy for 2015/16 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita.

The strategy covers:

- treasury limits for 2015/16 to 2017/18 (which will limit the treasury risk and activities of the Council);
- the current treasury position;
- the borrowing requirement, based upon the Council's current capital programmes;
- Prudential and Treasury Indicators;
- prospects for interest rates;
- the borrowing strategy (including policy on borrowing in advance of need);
- debt rescheduling;
- annual investment strategy.

1.5 Balanced Budget Requirement

It is a statutory requirement under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from the following, are limited to a level which is

affordable within the projected income of the Council for the foreseeable future:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure; and
- any increases in running costs from new capital projects.

1.6 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny (the Resources Committee).

The training needs of treasury management officers are periodically reviewed, with training provided throughout the year using a number of mediums; in-house training, meetings with and training provided by Treasury advisers, external training courses, attendance at treasury forum meetings with other Councils.

1.7 Treasury management advisors

The Council uses Capita as its external treasury management advisors who were appointed to this role effective from 1 July 2014 for a three year period with an option to extend for 1 year. .

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

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

2. Treasury Limits for 2015/16 to 2017/18

2.1 It is a statutory duty under part 7 of the Local Government in Scotland Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to allocate to capital expenditure.

2.2 The Council must have regard to the Prudential Code when setting the Affordable Capital Expenditure Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council house rent levels is ‘acceptable’.

2.3 Whilst termed an “Affordable Capital Expenditure Limit”, the capital plans to be considered for inclusion may incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The affordable capital expenditure limit is to be set, on a rolling basis, for the forthcoming financial year

and two successive financial years.

2.4 The Council's current General Fund capital programme was agreed in June 2013. The Housing Revenue Account capital programme reflects the updated Scottish Housing Quality Standard delivery plan reported to members in October 2013, and current new build programme. It should be noted that revisions will be made to the capital plans and presented to Council on 12 March 2015 but this should not impact on borrowing plans.

3. Current Treasury Position

3.1 For information and contextual purposes, the Council's treasury portfolio position at the most recent month end (31 December 2014) is as shown below, including a comparison with the equivalent prior year. Both debt (borrowing) and investments show a year on year decrease in the average interest rate over that period.

Table 1 – Current Treasury Position

	At 31 Dec 2014		**At 31 Dec 2013**		**Year on Year**	
	Balance £m	**Avg. Rate (%)**	**Balance £m**	**Avg. Rate (%)**	**Balance £m**	**Avg. Rate (%)**
1.Debt:						
a.Fixed Interest Rate						
PWLB	606.2	4.98	550.4	5.04	+55.8	-0.06
Market	69.7	1.81	85.4	1.59	-15.7	+0.22
b.Variable Interest Rate						
PWLB	0	0	0	0	0	0
Market	92.3	5.07	92.3	5.07	0	0
Total Debt	**768.2**	**4.57**	**728.1**	**4.54**	**+40.1**	**+0.16**

2.Investments:						
Fixed Interest Rate	45.7	0.58	32.6	0.80	+13.1	-0.22
Variable Interest Rate	51.4	0.47	65.2	0.48	-13.8	-0.01
Total Investments	**97.1**	**0.52**	**97.8**	**0.59**	**-0.7**	**-0.23**

4. Borrowing Requirement

4.1 The following table sets out the borrowing requirement, showing current year, as well as estimates for future years. The borrowing requirement takes account of borrowing to support the agreed capital programmes, less the projected instalments as capital repayments are charged to revenue accounts through loan charges. This figure is then adjusted to take account of any further borrowing required to go towards the capital financing requirement, or to replace existing loans maturing in these years.

Table 2 – Borrowing Requirement (current year and next 3 years)

	2014/15 Est. outturn	**2015/16 Est-imate**	**2016/17 Est-imate**	**2017/18 Est-imate**
New borrowing for capital (net Capital Programme less estimated instalments)	£71.0m	£63.9m	£20.4m	£26.8m
Additional long term borrowing towards Capital Financing Requirement	0	0	0	0
Loan Maturities - Replacement Borrowing	£10.0m	£21.7m	£20.8m	£22.5m
Total Long Term Borrowing Requirement	£81.0m	£85.6m	£41.2m	£49.3m

5. Prudential and Treasury Indicators

5.1 Prudential and Treasury Indicators as set out in **Appendix 2** to this report and are relevant for the purposes of setting an integrated treasury management strategy. These Indicators are based on the Council's current capital programme including the updated General Fund programme from June 2013. As noted in paragraph 2.4, revisions will be made to the capital plans and presented to Council on 12 March 2015.

5.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted in February 2002 and the revised 2009 Code was adopted on by the Council on 4 March 2010. The Code was further updated in November 2011, and it is recommended the Council continues to adopt the Code.

6. Economic Context and Prospects for Interest Rates

6.1 The Council has appointed Capita as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates and longer fixed interest rates. The following table gives the Capita central view.

Table 3 – Capita view of interest rates (as at 07/01/15)

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2014 (actual)	0.50	2.27	3.50	3.49
March 2015	0.50	2.20	3.40	3.40
June 2015	0.50	2.20	3.50	3.50
Sept 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
March 2016	0.75	2.60	4.00	4.00
June 2016	1.00	2.80	4.20	4.20
Sept 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
March 2017	1.25	3.20	4.50	4.50
June 2017	1.50	3.30	4.70	4.60
Sept 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
March 2018	2.00	3.60	4.80	4.80

6.2 There is risk to these forecasts if recovery from the economic downturn proves to be weaker and slower than currently expected or conversely, recovery is quicker than expected. The UK unemployment levels have already dropped at a faster pace than had been forecast, however, the Bank of England is expected to amend its forward guidance, with it unlikely there is an imminent 'trigger' in an increase in bank rate. A detailed view of the current economic background is contained within **Appendix 3** to this report.

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

- Greece: the general election on 25 January 2015 brought political change and a party which is anti-austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. The indirect effects of the likely strenthening of anti austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such

countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2015/16 and beyond;

- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, plus the ECB commenced quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served the Council well over the last few years. However, this needs to be carefully managed 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 in the short term. This will create a revenue loss between borrowing costs and investment returns, clearly every effort will be made to keep the cost of carry to a minimum.

7. Context

7.1 Since the consideration of the last Treasury and Investment Strategy in early 2014, there are some matters relating to the Council's strategies and external environment that are highlighted below for context.

- Investment counter-parties – Money Market Funds

  The Council continues to use Money Market Funds (MMF) as part of its Investment counter-party strategy which are a permitted counter-party in accordance with the current strategy. As a result, the Council has not had to use the HM Treasury Debt Management Office (DMO) where the returns available were significantly below that available through other options within the Council's risk appetite.

  However, the European Commission has now issued proposals relating to MMFs which are expected to alter the risk profile of these funds, as well as the liquidity and return levels. These changes are unlikely to be finalised until mid-2015 at the earliest, and the Council will assess the implications of any change and use alternative counter-parties if necessary.

- Investment counter-parties – Government Backed Banks

  The UK Government has already commenced disposal of some of its holding in Lloyds, and long-term clearly the expectation is both Lloyds and RBS are returned fully to the private sector. In the short to medium term there is no expectation of Government support altering or reducing, however, future annual strategies would review the Council's counter-party approach when it became clear any implications in relation to risk.

- Investment counter-parties – Other UK Banks

  During the year, the credit ratings for Barclays, Santander and Nationwide were upgraded and rated red (Capita recommend maximum deposits duration is 6 months).

  From August 2014 onwards, the Council placed fixed term deposits with Goldman Sachs which is a UK registered Bank. Goldman Sachs is rated Red (it is recommended that deposits are only placed up to 6 months) by our Treasury Adviser. As for all other non-Government backed counterparties, the maximum amount that can be placed with Goldman Sachs is £15m. Goldman Sachs will not deal direct with Local Authorities due to the level of deposits so these deposits are pooled and placed by our Treasury Advisers as agents.

- PWLB Certainty Rate

  The PWLB certainty rate which was introduced in 2012 continues to apply. A 0.20% discount in existing PWLB borrowing rates was available for Councils who were willing to provide HM Treasury with future forecasts of their borrowing requirements. The Council submitted the necessary forecasts and can now benefit from the discount. Entry into the certainty rate arrangement does not commit, nor limit the Council, to a notified level of borrowing.

- Financial Services (Banking Reform) Act 2013

  This act became law in December 2013 and a report outlining the implications to the Council was presented to the Resources Committee in August 2014. The “bail in” approach is a risk to the Council given that the Council is deemed an “institutional investor”. However first and most effective mitigation the Council has against this risk is to avoid institutions at risk of failure and the investment strategy is low risk with a primary focus on security of investment

8. Borrowing Strategy

8.1 Over the past few years the Council has benefitted from lower borrowing costs due to low interest rates, in particular temporary borrowing and internal borrowing (use of existing cash). The Council having approved significant Treasury Management savings for next financial year will continue to make the best use of the low rates available on temporary borrowing but towards the end of the financial year, Council officials will give consideration to a strategy of de-risking by taking longer-term borrowing, with the aim of mitigating the risk of increased borrowing costs as interest rates start to rise.

The Council will however ensure its strategy remains flexible, and will give consideration to new borrowing from the following sources based on prevailing market conditions:

1. Appropriately dated PWLB borrowing.
2. Temporary borrowing from the money markets or other local authorities.
3. Short dated borrowing from non PWLB below sources.

4. Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
5. Consideration of any government supported or promoted lending initiatives, which may offer attractive sources of finance e.g. low cost borrowing for specific energy efficiency projects.

8.2 Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

8.3 External v. Internal Borrowing

As reflected in the table below, the Council's objective is to maintain a level of temporary investments which will ensure a level of liquid cash available to the Council. The level shown takes account of the level of Council reserves and balances, and potential for these to be utilised through planned use or unforeseen events. Through this approach, the Council seeks to mitigate re-financing risk, particularly were the Council's reserves to be eroded due to unforeseen events.

Table 4 – Comparison of gross and net debt positions at year end

	2013/14 Actual	**2014/15 Est-imate**	**2015/16 Est-imate**	**2016/17 Est-imate**	**2017/18 Est-imate**
External Debt (gross)	£743.0m	£796.1m	£845.8m	£865.8m	£892.6m
Temporary Investments	£76.9m	£50.0m	£50.0m	£50.0m	£50.0m
External Debt (net)	**£666.1m**	**£746.1m**	**£795.8m**	**£805.8m**	**£842.6m**

Table excludes long-term liabilities e.g. PPP schemes

- Another factor in considering the level of investments held is the

difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments and mitigating of re-financing risk.

- The expectation is for continuing low bank rates for deposits in 2015/16, therefore the Council will keep its range of available counter-parties under regular review, to maximise value for money considerations. However, as clearly stated within this strategy, the priorities for the Council's investments are security and liquidity first, and only then looking at investment yield.

Given continued uncertainty relating to the economic outlook, the Council will continue to adopt a cautious approach in relation to its treasury operations.

The Director of Finance will monitor the interest rate market, take advice from professional advisors, and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Resources Committee at the next available opportunity.

8.4 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed. In accordance with the revised Code, any decision to borrow in advance will be within the approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated, and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- consider the merits and demerits of alternative forms of funding.
- consider the prevailing and projected interest rates based on best available information.
- Consider appropriate maturity profiles of new borrowing.
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

The maximum extent to which borrowing in advance would be undertaken will be based upon the existing and projected capital financial requirement, and existing level of debt.

9. Debt Rescheduling

9.1 At this time, and due to the early repayment penalties imposed by PWLB, there are limited opportunities for debt rescheduling. However, this position will be kept under regular review.

9.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings,
- helping to fulfil the strategy outlined in section 8 above, and
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

9.3 Consideration will also be given to the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Resources Committee, at the earliest meeting following its action.

10. Annual Investment Strategy

10.1 Investment Policy

The Council's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). **The Council's investment priorities will be security first, liquidity second, then return.**

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

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

The Council's policy in relation to Investment instruments and counter-parties identified for use in the financial year are listed in **Appendices 4, 5, 6, 7 and 8** and explanatory notes on investment types and risks are detailed in **Appendix 9**.

10.2 Creditworthiness policy

The Council recognises the vital importance of credit-worthiness checks on the counter-parties it uses for investments, and as described above the Council has a low risk appetite in relation to investments.

This Council uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with further credit overlays to provide a colour coded system based on recommended durational band for use of the counter-party.

This Council does not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Capita creditworthiness service uses a wider array of information than just primary ratings, from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

The Capital creditworthiness service is used on an advisory basis, with the decision on creditworthiness ultimately resting with officers.

10.3 Foreign Exposures/Country limits

In relation to Money Market Funds, only AAA rated Sterling denominated funds will be used.

At present the Council uses only UK based institutions for investment.

Examples of the institutions that the Council will invest in include UK banks and building societies, UK Local Authorities, non UK banks and building societies of high credit worthiness, HMT Treasury Debt Management Office.

Due to the potential downgrading in rating of certain UK institutions it is considered desirable in future to add non-UK counterparties of high credit worthiness to the list of available options. The Capita Treasury Services rating model will be used in the same way as currently for UK institutions. In addition only institutions registered in countries with an AAA or AA+ will be considered. The list of countries where the Council will consider investing are at **Appendix 7**.

Appendices 4, 5, 6, 7 and 8 set out further details on the Council's permitted investments and approach to use of counter-parties.

10.4 Investment Strategy

In-house funds are mainly cash-flow derived and investments will be made in accordance with cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

10.5 Investment return expectations

As detailed in section 6, Table 3 Capita view of interest rates, Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 4 of 2015. Bank Rate forecasts (as at 09/02/15) for financial year ends (March) are:

- 2014/2015 0.50%
- 2015/2016 0.75%
- 2016/2017 1.25%
- 2017/2018 2.00%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows (as at 09/02/15):

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

10.6 For its cashflow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day notice accounts, short-dated deposits and money market funds in order to benefit from the compounding of interest.

10.7 End of Year Investment Report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Forecasts of investment balances for the next three years are provided in **Appendix 2**.

10.8 Policy on the Use of External Service Providers

The Council's tendered Treasury Management advisor contract is subject to regular review. The Council currently uses Capita Treasury Services as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

10.9 Treasury Management Scheme of Delegation

Please see **Appendix 10**.

10.10 The Treasury Management Role of Section 95 Officer

Please see **Appendix 10**.

11. Implications

11.1 The resource and risk implications are covered in the attached tables. There are no specific legal, equality or climate change/Carbon Clever implications relating to this report.

Recommendation

In compliance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities, the attached Treasury Management Strategy Statement and Investment Statement for 2015/16 is submitted to Council for approval.

Designation: Director of Finance

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Date: 2 March 2015

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Appendices

1. Interest Rate Forecasts
2. Prudential and Treasury Indicators
3. Economic Background
4. Permitted Investments – Common Good, Charitable, Educational and Other Trust Funds
5. Permitted Investments – Non Treasury Investments
6. Permitted Investments – Treasury Investments
7. Approved countries for investment
8. Current counter party list as at 16/01/2015
9. Treasury Management Practice 1 (TMP1) Credit and Counterparty Risk Management
10. Treasury Management Scheme of Delegation and Role of the Section 95 Officer

Appendix 1

Interest Rate Forecasts 2015 to 2018 (provided by Capita as at 09/02/15)

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

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	1.80%	2.05%	2.30%	2.55%	2.80%	2.80%	3.05%	3.05%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.30%	2.55%	2.55%	2.80%	3.05%	3.05%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	2.95%	3.15%	3.15%	3.50%	3.90%	3.90%	4.15%	4.15%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.10%	3.30%	3.30%	3.60%	4.00%	4.00%	4.30%	4.30%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

Appendix 2

Prudential and Treasury Indicators

The borrowing set out within the Prudential Indicators is based upon the General Fund capital programme agreed by the Council in June 2013.
In relation to the HRA, borrowing is as per the Scottish Housing Quality Standard Delivery Plan updated, plus agreed new build programme.
The Estimates of Capital Expenditure below in indicator 3 and 4 include expenditure in relation to the National Housing Trust which is self-financing. It should be noted that revisions will be made to the capital plans and presented to Council on 12 March 2015.

A. Indicators for Affordability, Prudence and Capital Expenditure

Indicator 1 - Capital Expenditure

Gross Capital Expenditure in absolute terms rather than as a ratio, these show the overall levels of estimated capital investment irrespective of how they are being funded.

	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
General Fund	£87.4m	£96.2m	£132.5m	£113.3m	£88.0m	£88.5m
Housing Revenue Account	£42.2m	£70.6m	£51.5m	£39.7m	£29.6m	£30.0m
Total	**£129.6m**	**£166.8m**	**£184.0m**	**£153.0m**	**£117.6m**	**£118.5m**

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

General Fund	£49.2m	£53.8m	£70.8m	£70.4m	£47.5m	£54.9m
Housing Revenue Account	£27.4m	£52.9m	£35.4m	£19.2m	£13.7m	£10.0m
Total	£76.6m	**£106.7m**	**£106.2m**	**£89.6m**	**£61.2m**	**£64.9m**

Indicator 2 – Capital Financing Requirement (CFR)

These indicators represent the level of the Council's underlying need to borrow or finance by other long-term liabilities for a capital purpose. This includes past and future borrowing or funding.

	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
General Fund excluding PPP	£547.3m	£573.2m	£570.3m	£611.0m	£627.9m	£651.0m
PPP	£129.5m	£125.9m	£125.9m	£122.0m	£118.2m	£114.5m
Total	**£676.8m**	**£699.1m**	**£696.2m**	**£733.0m**	**£746.1m**	**£765.5m**
Housing Revenue Account	£184.8m	£229.0m	£213.2m	£222.6m	£227.1m	£231.9m
Total	**£861.3m**	**£928.2m**	**£909.4m**	**£955.6m**	**£973.2m**	**£997.4m**
Joint Boards	£24.3m	£23.2m	£23.2m	£22.2m	£21.2m	£20.1m
Total CFR (incl Police/Fire) (1)	**£885.9m**	**£951.4m**	**£932.6m**	**£977.8m**	**£994.4m**	**£1,017.5m**

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

Gross Borrowing	£743.0m	£809.5m	£772.0m	£821.1m	£841.5m	£868.3m
Other Long Term Liabilities	£129.5m	£125.9m	£125.9m	£122.0m	£118.2m	£114.5m
Total Gross Debt (2)	**£872.5m**	**£935.4m**	**£897.9m**	**£943.1m**	**£959.7m**	**£982.8m**
Investments	£76.9m	£50.0m	£50.0m	£50.0m	£50.0m	£50.0m
Net Borrowing	**£795.6m**	**£885.4m**	**£847.9m**	**£893.1m**	**£909.7m**	**£932.8m**

Difference between CFR (1) and Total Gross Debt (2)

This indicator shows the difference between the Capital Financing Requirement, and the Estimated Gross Debt. The difference represents an 'under-borrowed' position, with capital financed from internal cash flows.

	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Difference between CFR (1) and Total Gross Debt (2)	£13.4m	£16.0m	£34.7m	£34.7m	£34.7m	£34.7m

Indicator 3 – Authorised Limit for Borrowing

The Authorised Limit is the maximum level of external borrowing which should not be exceeded. The limit is linked to the estimated level of capital financing requirement, with some capacity for variations from that sum e.g. if capital expenditures are exceeded.

Authorised Limit	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	£773.1m	£916.5m	£916.5m	£924.3m	£924.3m	£924.3m
Other Long Term Liabilities	£129.5m	£125.9m	£125.9m	£121.9m	£118.2m	£114.5m

Indicator 4 - Operational Boundary for Borrowing

An Operational Boundary is also required which represents the Director of Finance's estimate of the day to day limit for the Treasury Management activity based on the most likely i.e. prudent but not worst case scenario.

Operational Boundary	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	£848.8m	£773.1m	£773.1m	£907.1m	£912.6m	£909.4m
Other Long Term Liabilities	£129.5m	£125.9m	£125.9m	£121.9m	£118.2m	£114.5m

Indicator 5 – Ratio of financing costs to net revenue stream

These indicators show the capital financing costs (interest charges, the provision for the repayment of debt and the financing of PPP outstanding capital investment liability) as a percentage of government grant (revenue), Council Tax, Rents and other income. This allows the authority to track how much of its annual income is needed to pay for its capital investment plans and outstanding funding liabilities compared to its day to day running costs.

	2013/14 Actual	**2014/15 Original Estimate**	**2014/15 Revised Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
General Fund including PPP	12.2%	12.6%	12.2%	13.0%	13.2%	13.8%
Housing Revenue Account	31.9%	35.5%	30.5%	33.8%	36.6%	40.3%

Indicator 6 – Estimates of the Incremental impact of capital investment decisions on the Band D Council tax and housing rents levels

These indicators demonstrate the **notional** impact of varying new capital investment expressed as a cost on the Band D Council Tax and Rents. These are notional rather than actual increases in Council Tax and rent, as the Council has or will utilise savings and other measures to fund its capital plans, to minimise the impact on tax and rent levels.

	2013/14 Actual	**2014/15 Original Estimate**	**2014/15 Revised Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Estimates of the Incremental impact of capital investment decisions on the Band D Council tax	£15.46	£38.53	£18.43	£56.32	£22.13	£44.30
Estimates of the Incremental impact of capital investment decisions on the housing rent levels (weekly figures based on a 48 week year are shown in brackets)	£69.72 (£1.45)	£174.90 (£3.64)	£60.68 (£1.26)	£114.03 (£2.38)	£139.59 (£2.91)	£139.59 (£2.91)

Indicator 7- Interest rate exposures of debt net of investments

Interest rate exposures of debt net of investments are required to be set in compliance with the Code. This limits the Council's exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for Treasury Management activities. It promotes a prudent strategy aimed to avoid the adverse effects of fluctuating interest rates. The limits are based on the Capital Financing Requirement with variable exposures limited to 35% of fixed.

Interest rate exposures of debt net of investments	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Upper Limit (Fixed)	£756.5m	£825.5m	£815.9m	£865.1m	£885.5m	£912.3m
Upper Limit (Variable)	£264.7m	£288.9m	£285.5m	£302.8m	£309.9m	£319.3m

Maturity structure of fixed rate borrowing during 2015/16

This indicator identifies the amount of debt maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. The Council currently applies the prudent practice of ensuring that no more than 30% of its total gross fixed rate debt matures in any one financial year unless triggered through specific debt restructuring exercises.

	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	25%

Maximum principal invested for period longer than 364 days

The maximum total principal sum which may be invested with a maturity for a period longer than 364 days and within the permitted investment limits is £20m

Compliance with other prudential indicators

In addition to the above, the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice.
- Ensure that over the medium term borrowing will only be for a capital purposes (i.e. net external borrowing is less than the CFR)

The compliance with these indicators is highlighted in the body of the report.

The above indicators have been set to contain the Council's exposure to the possibility of loss that might arise as a result of having to seek early redemption of principal sums invested over the longer term.

The Council's current investment strategy is to maintain only temporary, shorter-term investments for portfolio management purpose. This affords operational flexibility and enables returns to be compounded more frequently.

Appendix 3

Economic Background Provided by Capita Treasury Services (as at 09/02/15)

The UK economy

Economic growth

After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.7% Q3 and 0.5% Q4 (annual rate for 2014 of 2.6%), there are good grounds for optimism that growth could pick back up again during 2015 after cooling towards the end of 2014, as the positive effects from the fall in the price of oil feeds through to consumers and other parts of the economy.

For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is not expected to take any action for at least the first half of 2015 as inflation could even turn negative in this period. However, even if oil was to remain at around the $50-60 per barrel price throughout all of 2015, the positive effect of the initial drop in price during Q4 2014 will fall out of the twelve month calculation of CPI towards the end of the year, leaving inflation vulnerable to a sharp jump upwards. The MPC will also be keeping alert as to how quickly slack in the economy is being used up, especially as unemployment continues to fall. It will also be monitoring how strong a stimulative effect the drop in oil prices has on the economy as falling inflation will be comfortably exceeded by wage increases meaning that the disposable incomes of consumers will recover strongly during 2015. One continuing area of weakness in the UK economy is the need for a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates after the positive effect of the fall in oil prices dissipates. Unemployment is expected to keep on its downward trend and this is likely to feed through into a return to significant increases in wage growth at some point during the next few years. However, just how much those increases in pay rates will counteract the dampening effect of stepped increases in Bank Rate, albeit at a slow rate, on consumer confidence, consumer expenditure and the buoyancy of the housing market, is open to conjecture.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014 and then halving to 0.5% in December, the lowest rate since May 2000. Forward indications are that inflation could turn negative during the earlier part of 2015; however, the MPC is focused on where inflation will be over a 2 – 3 year time horizon so too much emphasis should not be placed on the short term outlook in terms of the risks around when Bank Rate is likely to start increasing. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed, being only a fraction lower than the previous year through to December 2014. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated. The flight to quality in January 2015 has seen gilt yields fall to incredibly low levels, reducing interest costs on new and replacement government debt.

Eurozone (EZ)

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In January 2015, the inflation rate fell further, to reach a low of -0.6%. However, this is an average for all EZ countries and includes some countries with even higher negative rates of inflation. Initially, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. As this failed to have much of a

discernible effect, the ECB launched a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme will run to September 2016.

Concern in financial markets for the Eurozone had subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause for concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece

The general election on 25 January 2015 has brought to power a coalition which is anti EU imposed austerity. Although it is not certain that Greece will leave the Euro, the recent intractability of the troika (the EU, ECB and IMF), to finding a negotiated compromise with the new Greek government leaves this as a real possibility. However, if Greece was to leave the EZ, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. Nevertheless, the indirect effects of the likely strengthening of anti-austerity political parties throughout the EU, is much more difficult to gauge. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. Of particular concern is the fact that Spain and Portugal have general elections coming up in late 2015. This will give ample opportunity for anti-austerity parties to make a big impact.

There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti-austerity policies. Any loss of market confidence in either of the two largest Eurozone economies, after Germany, would present a huge challenge to the resources of the ECB to defend their debt.

USA

The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 of 4.6%, Q3 of 5.0% and Q4 of 2.6%, (overall 2.4% during 2014 as a whole), provides great promise for strong growth going forward. It is confidently forecast that the first increase in the Fed. rate will occur by the end of 2015.

Capita's 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 transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. 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.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

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 strong economic growth is 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.
- Monetary policy action failing to stimulate sustainable growth and to 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: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government.
- The ECB severely disappointing financial markets with a programme of asset purchases

which proves insufficient to significantly stimulate growth in the EZ.

- The commencement by the US Federal Reserve of increases in the Fed. funds rate in 2015, 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.

Appendix 4

Permitted Investments – Common Good, Charitable, Educational and Other Trust Funds

The Council approves the following forms of investment instruments for use as permitted investments for these Funds as set out in the Table below (these include internally and externally managed funds):

Investments

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

Permitted Investments – Non Treasury Investments

Appendix 5

Definition of non-treasury investments

Regulation 9 of the Local Government Investment (Scotland) Regulations 2010 adds to the normal definition of investments the following categories: -

a) All shareholding, unit holding and bond holding, including those in a local authority owned company, is an investment;
b) Loans to a local authority company or other entity formed by a local authority to deliver services, is an investment;
c) Loans made to third parties are investments;
d) Investment property is an investment.

However, the following loans are excluded from the definition of investments: -

- Loans made by a local authority to another authority or harbour authority using powers contained in Schedule 3, paragraph 10 or 11 of the Local Government (Scotland) Act 1975.

Permitted Investments – Non-Treasury Investments

The Council approves the following forms of investment instruments for use as permitted investments for Non-Treasury Investments as set out in the Table below:

Investments

<table>
<tr><th></th><th>Minimum Credit Criteria</th><th>Liquidity risk</th><th>Market risk</th><th>Max % of total investments</th><th>Max. maturity period</th></tr>
<tr><td>Loans to Companies, including Local Authority owned.</td><td rowspan="5">See Regulation Notes below</td><td>term</td><td>no</td><td rowspan="5" colspan="2">See Regulation requirements and current approvals below.</td></tr>
<tr><td>Shares and Bonds in Companies, including Local Authority owned.</td><td>term</td><td>no</td></tr>
<tr><td>Loans to Third Parties including investments in sub-ordinated debt (see note 1 and 2).</td><td>instant</td><td>no</td></tr>
<tr><td>Local Authority Investment Properties.</td><td>term</td><td>no</td></tr>
<tr><td>Other Investment Deposits (see note 3)</td><td>term</td><td>no</td></tr>
</table>

Regulation 24. A local authority shall state the limits for the amounts which, at any time during the financial year, may be invested in each type of permitted investment, such limit being applied when the investment is made. The limits may be defined by reference to a sum of money or a percentage of the local authority's overall investments, or both. A local authority may state that a permitted investment is unlimited. Where a limit is not placed on any type of permitted investment the risk assessment must support that categorisation and an explanation provided as to why an unlimited categorisation is recommended.

Regulation 25. The local authority should identify for each type of permitted investment the objectives of that type of investment. Further, the local authority should identify the treasury risks associated with each type of investment, together with the controls put into place to limit those risks. Treasury risks include credit or security risk of default, liquidity risk – the

risks associated with committing funds to longer term investments and market risk – the effect of market prices on investment value.

Regulation 32. The Strategy shall include details of the maximum value and maximum periods for which funds may prudently be invested. The Strategy shall set out the local authority objectives for holding longer term investments. The Strategy shall also refer to the procedures for reviewing the holding of longer term investments particularly those investments held in properties, shareholdings in companies or joint ventures.

The policy above, and requirements of regulations 24, 25 and 32, will be considered, and reported to members, as part of any report pertaining to new investment proposals.

In Part 1, section 12 of the Regulations, Consent includes as an investment any loan issued to a third party. Such loans are neither capital nor revenue transactions, but are often made for Service reasons and for which specific statutory provision exists. For Service reasons these loans may be offered at an interest rate below the market rate. All loans to third parties are classified as investments for the purposes of the Consent. Where the loan is advanced at less than a market interest rate there is an associated loss of investment return which would otherwise have been earned on these monies. The Council's Annual Accounts will recognise and present all loans to third parties as investments.

This Council will refrain from issuing loans to third parties at less than market rate. If, in exceptional circumstances, the Council agrees to issue a loan/s to third parties at less than market rate the associated loss of investment return will be chargeable to the budget of the sponsoring Service. In circumstances where investment risk is a predominant factor the rate chargeable will reflect the equivalent market rate where this is greater than the Council's Loans Fund's most recent actual average interest rate. In all other cases the interest rate chargeable will be the Council's Loans Fund's most recent actual average interest rate.

Current Approvals

Note 1 – Subordinated Debt – the Highland Council, on 25 October 2012, agreed to permit an investment, at a maximum level of £1m for all current and future investments, for a maximum maturity period of 25 years, in 'Hub Co' projects.

Note 2 – Land banking Fund and Loan Advances to Registered Social Landlords (RSLs) – the Council has for many years operated a 'land bank fund'. The fund is used to provide loans and grants to partner organisations (including RSLs), enabling strategic sites to be secured or prepared for development of housing. The Land bank Fund is a revolving facility with loans repaid as land and property is resold or developed.

Note 3 – Local Authority Mortgage Scheme (LAMS) – the Highland Council on 9 May 2013 agreed to participate in the LAMS scheme. This would result in the Council placing £1m on deposit with the mortgage lender (Lloyds), for the lender to use that deposit as guarantee to support the advance of mortgages to first time buyers. The mortgage advance would be on terms that required a lower form of deposit from the borrower than ordinarily required, thereby supporting home ownership. The Council would receive a return on its deposit, expected to be at a premium to market rates. The deposit would be at risk in the event of any mortgage default. As at February 2014, the Council has not progressed the LAMS scheme due to the subsequent launch of the UK Help to Buy Scheme. While there are no imminent plans to progress the LAMS scheme at this time, the formal approval for the arrangement remains in place and would allow the Council to progress should circumstances alter.

Permitted Investments – Treasury Management **Appendix 6**

The Council's policy in relation to permitted investments, is a three-stage process as summarised below.

1. Only use of permitted investments per the investment strategy is allowed. See Appendix 8 for definition of the different types of investment.
2. Credit-worthiness of counter-parties will be assessed having taken advice from the Council's treasury management advisers, Capita. Maximum maturity periods for individual counter-parties will be based upon advice from the Adviser, with limits on treasury investments > 364 days as per the prudential indicators, and shown below.
3. Counter-party limits, as set out within the investment strategy will be applied.

The following sections explain each aspect of the 3-stage process in further detail.

Stage 1 - Permitted Investments

The Council approves the following forms of investment instruments for use as permitted treasury management investments as set out in the Tables below. While there is a maximum permitted maturity period set out in the Tables, the actual maturity period will be based on an assessment of risk as part of the credit-worthiness assessment (see stage 2).

In relation to Money Market Funds, only AAA rated Sterling denominated funds will be used.

In relation to all other counter-parties, the Council will mainly use UK based institutions but where there are non-UK counterparties of high credit worthiness these may be used. The list of countries where the Council can invest are at **Appendix 7**. For example UK banks and building societies, UK Local Authorities, non UK banks and building societies of high credit worthiness, HMT Treasury Debt Management Office.

a. Deposits (UK institutions only)

	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments (Stage 2 Below)	Max. maturity period
Debt Management Agency Deposit Facility	--	term	no	**100**	**6 mths**
Term deposits – local authorities	--	term	no	**100**	**2 yrs**
Term deposits – banks and building societies	See Stage 2 below	term	yes	**100**	**2 yrs**
Call accounts – banks and building societies	See Stage 2 below	instant	yes	**100**	**1 yr**

b. Deposits with counterparties currently in receipt of government support/ownership (UK institutions only)

	Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments (Stage 2 Below)	Max. maturity period
UK nationalised banks	See Stage 2 Below	term	limited	**100**	**2 yrs**
Term deposits – banks and building societies	See Stage 2 below	term	limited	**100**	**2 yrs**
UK Government support to the banking sector (implicit guarantee)	See Stage 2 below	term	limited	**100**	**2 yrs**

c. Collective investment schemes structured as Open Ended Investment Companies (OEICs). Sterling Deposits Only.

	Minimum Credit Criteria	Liquidity	Market risk	Max % of total	Max. maturity

		risk		investments	period
Money Market Funds	Short Term F1+ Long-term AAA__ Volatility rating MR1+	instant	See Note 1	**100**	**1 yr**

Note 1 – Money Market Funds: These funds invest in short term instruments such as Government/Treasury issues, short-term corporate paper and Certificates of Deposits. By keeping a short time-frame, these funds attempt to reduce risk. The objective of these Funds is to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero – see Appendix 7 Paragraph 3 (a) for more details. Each Money Market Fund is treated as a single counter-party in relation to counter-party limits.

Note 2 - If forward deposits are to be made, the forward period plus the deal period will not exceed one year in aggregate.

Stage 2 – Credit worthiness policy and assessment

This Council uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

- All credit ratings are monitored from a weekly list which can be updated daily by Capita. The Council is alerted to changes to ratings of all three agencies as these occur through its use of the Capita creditworthiness service.
- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, immediate consideration will be given to whether funds should be withdrawn from this counterparty and the timescale for doing this.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Based on the Capita approach, the Council will therefore use counterparties within the following durational bands:

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

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

In relation to Money Market Funds, the Council will use Capita's weekly investment monitor, and other regular updates, to ensure its MMF counter-parties meet the minimum credit criteria described in the table above.

As set out within the Prudential Indicators, a limit is set on the value of Treasury Investments which can be invested for more than 364 days. The limit is £20m, which represents the maximum sum invested for longer than 364 days. Though the period of investment must be decided using Capita credit ratings and maximum limits in permitted investments.

Stage 3 – Counter-party Limits

The limits described below apply to the Council's treasury management operations. Separate limits apply for the Pension Fund, with Highland Council limits relating to all operations excluding the Pension Fund.

Due to market volatility in treasury management investments and varying levels of investment it is possible that at any time in the year one category of investment could represent 100% of the portfolio although it is likely that investments will carry greater diversification than this.

No more than £15m can be invested with any single counterparty, with the exception of the nationalised or semi nationalised UK banks (see section B above) where no more than £25m can be invested in each bank.

The Council will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers is currently £10m for the Highland Council bank accounts.

The Highland Council Pension Fund will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers is currently £10m. The Pension Fund may also utilise other bank facilities, with a £10m limit applying to each.

Appendix 7

Approved countries for investment

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

AAA

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

AA+

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

Appendix 8

Current counter party list as at 16/01/2015

The following table is for use by the in house treasury management team and is a list of current counterparties used. However, the use of counterparties depends on credit ratings and the Council may stop using certain counterparty's and/or decide to use alternative counterparties within its permitted investments. If for unavoidable short term operational reasons, limits are breached this will be communicated to management immediately.

	At time of investment use Capita rating Current rating 16/01/15	Maximum Duration per TMSS	Investment limits	
			Highland Council	Highland Council Pension Fund (note 1)
Government Backed Deposits				
Debt Management Agency Deposit Facility	Yellow (5 years)	6 months	Unlimited	Not used
Deposits with Counterparties currently in receipt of Government Support/Ownership				
RBS	Blue (1 year)	2 years	£25m	£10m
Bank of Scotland	Blue (1 year)	2 years	£25m	Not used
Term deposits (*restricted to £20m invested >364 days*)				
Term deposits – local authorities	Yellow (5 years)	2 years	£15m	Not used
Term deposits – banks and building societies (UK only)	Varies	2 years	£15m	Not used
Nationwide	Red (6 months)	2 years	£15m	Not used
Call accounts (UK only)				
Clydesdale Bank (Council's Banker)	No colour	1 year	£10m	£10m
Barclays	Red (6 months)	1 year	£15m	Not used
Santander	Red (6 months)	1 year	£15m	Not used
Money Market Funds				
Ignis Asset Management	AAA	1 Year	£15m	Not used
Insight Asset Management	AAA	1 Year	£15m	Not used

Note 1 – the Pension Fund currently uses a limited number of counter-parties as shown above. In line with the limits detailed on appendix 6, additional counter-parties could be considered up to the limits stipulated.

Appendix 9 Treasury Management Practice 1 (TMP1) Credit and Counterparty Risk Management

Type of Investment	Treasury Risks	Mitigating Controls
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non-local authority deposits will follow the approved credit rating criteria.
c. Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a "AAA" rated status from either Fitch, Moody's or Standard and Poor's.
d. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties.
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.

Type of Investment	Treasury Risks	Mitigating Controls
f. 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.
g. Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence
h. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period & credit rating)**	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.
i. Corporate bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.

Type of Investment	Treasury Risks	Mitigating Controls
j. Investment properties	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.
k. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.
l. Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.
m. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.
n. Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.

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

Appendix 10

Treasury Management Scheme of Delegation

(i) The Council

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

(ii) The Council's Resources Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- receiving and reviewing regular monitoring reports and acting on recommendations; including scrutiny/review of annual strategy, annual report and mid-year report;

(iii) Director of Finance

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- approval of the division of responsibilities;
- approving the selection of external service providers and agreeing terms of appointment.

The Treasury Management Role of the Section 95 Officer

The S95 (responsible) Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit

  recommending the appointment of external service providers.