Inverclyde council

AGENDA ITEM NO: 14

Report To:	**Inverclyde Council**	**Date:**	**21 February 2019**
Report By:	**Corporate Director Environment, Regeneration & Resources**	**Report No:**	**RMcG/LP/026/19**
Contact Officer:	**Rona McGhee**	**Contact No:**	**01475 712113**
Subject:	**Treasury Management Strategy Statement and Annual Investment Strategy – 2019/20–2022/23: Remit from Policy & Resources Committee**		

1.0 PURPOSE

1.1 The purpose of this report is to request the Council to consider a remit from the Policy & Resources Committee.

2.0 SUMMARY

2.1 The Policy & Resources Committee at its meeting on 5 February 2019 considered a report by the Chief Financial Officer on the Treasury Management Strategy Statement and Annual Investment Strategy for 2019/23, Treasury Policy Limits, a policy on the repayment of Loans Fund advances, the Council's Prudential and Treasury Management Indicators for the next 4 years and the List of Permitted Investments.

2.2 A copy of the report to the Policy & Resources Committee is attached as Appendix 1. This provides background information and information on the capital/treasury management position, prudential indicators, treasury management indicators and policy limits and the proposed treasury strategy and investment strategy.

2.3 The Committee decided that the following be remitted to the Inverclyde Council for approval:

(a) Treasury Management Strategy and Annual Investment Strategy;
(b) Authorised Limits for 2019/23;
(c) Treasury Management Policy Statement set out in paragraph 5.2 of the report;
(d) Policy on repayment of Loans Fund advances set out in paragraph 8.2 of the report;
(e) Treasury Policy Limits;
(f) Prudential Indicators and Treasury Management Indicators; and
(g) List of Permitted Investments (including those for the Common Good Fund).

3.0 RECOMMENDATION

3.1 The Council is asked to consider the remit from the Policy & Resources Committee.

Gerard Malone
Head of Legal & Property Services

Inverclyde council

APPENDIX 1
AGENDA ITEM NO.

Report To:	**Policy & Resources Committee**	**Date**:	**5 February 2019**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/16/19/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No**:	**01475 712223**
Subject:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY – 2019/20-2022/23**		

1.0 PURPOSE

1.1 The purpose of this report is to seek approval for the Treasury Management Strategy Statement and Annual Investment Strategy for 2019/23, Treasury Policy Limits, a policy on the repayment of Loans Fund advances, the Council's Prudential and Treasury Management Indicators for the next 4 years and the List of Permitted Investments.

2.0 SUMMARY

2.1 The report sets out the Council's proposed Treasury Management Strategy and Annual Investment Strategy for 2019/23, Treasury Policy Limits, and Prudential and Treasury Management Indicators for the next 4 years including the proposed Authorised Limits.

2.2 The report also proposes a List of Permitted Investments listing the types of investments and limits for those investments. The only change in proposed Permitted Investments from that agreed in 2018 relates to specifying the categories of Money Market Funds following changes to Money Market Funds regulations.

2.3 The Treasury Management Strategy, Annual Investment Strategy, Treasury Policy Limits, Prudential Indicators, and Treasury Management Indicators have been set based on the Council's current and projected financial position (including the proposed 2019/23 Capital Programme) and the latest estimated interest rate levels.

2.4 The report also requests the annual approval of the Council's Treasury Management Policy Statement and approval of the Council's policy on the repayment of Loans Fund advances.

2.5 The Council's contracts for banking services and for treasury management advisers both end in 2019. Officers are progressing the issuing of tenders for these services and are seeking delegated authority to accept the bank tender.

2.6 In line with the Council's Financial Regulations, the proposals in this report require approval by the Full Council.

3.0 RECOMMENDATIONS

3.1 It is recommended that the Committee remits to the Inverclyde Council, for their approval, the following, as outlined in this report:

a. Treasury Management Strategy and Annual Investment Strategy
b. Authorised Limits for 2019/23
c. Treasury Management Policy Statement set out in paragraph 5.2
d. Policy on repayment of Loans Fund advances set out in paragraph 8.2
e. Treasury Policy Limits
f. Prudential Indicators and Treasury Management Indicators
g. List of Permitted Investments (including those for the Common Good Fund).

3.2 It is recommended that the Committee grants delegated authority to the Head of Legal & Property Services and the Chief Financial Officer to accept the successful bank tender for the period from 1 April 2019 to 31 March 2024 and with an option to extend for a further three 1 year periods until 31 March 2027.

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

4.1 This report presents, for approval, a Treasury Management Strategy Statement and Annual Investment Strategy, Treasury Policy Limits, a policy on the repayment of Loans Fund advances, and Prudential and Treasury Management Indicators for 2019/23.

4.2 CIPFA produced the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management and revised both documents in December 2017. Inverclyde Council has adopted the Code of Practice on Treasury Management and complies with the Prudential Code.

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

4.4 The Act and supporting regulations require 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) which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.5 It is a statutory requirement 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 are affordable within the projected income of the Council for the foreseeable future. The projected revenue impact of the 2019/23 Capital Programme is built into the Revenue Budget for which approval is being sought.

4.6 A glossary of treasury management terms is attached as Appendix 4.

5.0 SUMMARY OF ISSUES

5.1 The main issues from this report are:

a. The Capital/Treasury Management position, Prudential Indicators, Treasury Management Indicators and Policy Limits are shown in Section 6 below.
b. The proposed Treasury Strategy and Investment Strategy are shown in Section 7 below.
c. The Full Council is requested to approve the Authorised Limits for 2019/23 as shown in paragraph 6.5.
d. The Full Council is requested to approve the policy on the repayment of Loans Fund advances as shown in paragraph 8.2.
e. There remains considerable economic uncertainty affecting forecasts for interest rates and inflation, including in relation to the Brexit arrangements. This will have implications for UK interest rates, new borrowing rates (due to the impact of market sentiments on UK gilt prices), investment rates, and inflation. The Council will continue to monitor the situation and take advice from its treasury advisers.
f. The only change in proposed Permitted Investments (in Appendix 2) from that agreed in 2018 relates to specifying the categories of Money Market Funds that are permitted following changes to Money Market Funds regulations.
g. The Council's current contract with its treasury advisers ends on 30 June 2019. The Council will issue tenders for treasury management advisers' services for the three year period from 1 July 2019 with an optional one year extension until 30 June 2023.
h. The Council's contract with the Bank of Scotland for banking services ends on 31 March 2019. The Council has issued tenders for a new contract for banking services for the 5 year period from 1 April 2019 to 31 March 2024 and with an option to extend for a further three 1 year periods until 31 March 2027.

5.2 The Council has a formal Treasury Management Policy Statement as follows that is required to be approved by the Full Council:

1. This organisation 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”.
2. This organisation 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 organisation, and any financial instruments entered into to manage these risks.
3. This organisation 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 employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Council is being requested to approve this Treasury Management Policy Statement.

6.0 CAPITAL/TREASURY MANAGEMENT POSITION, PRUDENTIAL INDICATORS, TREASURY MANAGEMENT INDICATORS AND POLICY LIMITS

Current Treasury Management Position

6.1 The Council’s treasury management position at 8 January 2019 comprised:

		Principal		Average Rate
		£000	£000	
Fixed rate funding	PWLB	94,286		
	Market	56,000	150,286	3.97%
Variable rate funding	PWLB	0		
	Market	46,670	46,670	4.94%
			196,956	4.20%
Other long term liabilities			62,734	---
TOTAL DEBT			**259,690**	
TOTAL INVESTMENTS			**31,795**	**0.83%**

Capital Expenditure and Borrowing

6.2 The Council’s Gross Capital Expenditure is estimated as:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
Capital Programme	26,876	34,226	17,625	9,593	9,976

6.3 The Council's borrowing requirement (which takes account of the estimated Capital Expenditure, borrowing maturing and requiring to be refinanced, and estimated future Council investment balances) is as follows:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
New borrowing	5,000	5,000	0	0	0
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	25,000	5,000	10,000	5,000
TOTAL	5,000	30,000	5,000	10,000	5,000

6.4 The Council's Gross Debt compared to the Capital Financing Requirement from this and previous Capital Expenditure as at each year-end (including the effect of the proposed borrowing in paragraph 6.3) is as follows:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
External Debt (Including PPP)	264,309	277,456	275,659	273,997	269,378
Capital Financing Requirement (CFR)	304,127	311,820	303,326	293,238	283,269
Under/(Over) Against CFR	39,818	34,364	27,667	19,241	13,891

The above table shows that the Council expects to be under borrowed each year. Under borrowing means that the Council is using cash it already has (e.g. in earmarked reserves and other balances) to cash flow capital expenditure rather than bringing in new funds from borrowing. The projected level of under borrowing is considered manageable but the position is kept under review in light of Council capital financing and other funding requirements.

6.5 The Council's Authorised Limit is a control on the maximum level of debt whilst the Operational Boundary is a limit that debt is not normally expected to exceed. It is proposed that the limits are:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Limit	**Limit**	**Limit**	**Limit**	**Limit**
Authorised limit for external debt	£000	£000	£000	£000	£000
Borrowing	250,000	249,000	243,000	235,000	226,000
Other long term liabilities	64,000	63,000	61,000	59,000	58,000
TOTAL	314,000	312,000	304,000	294,000	284,000
Operational boundary for external debt	£000	£000	£000	£000	£000
Borrowing	230,000	239,000	233,000	225,000	216,000
Other long term liabilities	64,000	63,000	61,000	59,000	58,000
TOTAL	294,000	302,000	294,000	284,000	274,000

Approval is being sought for the Authorised Limits for 2019/20 to 2022/23.

6.6 The Council sets limits on the maturity of fixed rate and variable rate borrowing for the coming financial year. The limits proposed for 2019/20 are:

Maturity Structure	Fixed Rate		Variable Rate	
	Upper Limit	Lower Limit	Upper Limit	Lower Limit
Under 12 months	45%	0%	35%	0%
12 months and within 24 months	45%	0%	35%	0%
24 months and within 5 years	45%	0%	35%	0%
5 years and within 10 years	45%	0%	35%	0%
10 years and within 30 years	45%	0%	35%	0%
30 years and within 50 years	45%	0%	35%	0%
50 years and within 70 years	45%	0%	35%	0%

These limits are the same as set in 2018. They reflect the requirement that the Council's Market debt is treated based not on when the debt is due to actually mature but on when the lender could request an increase in the interest rate (when the Council could accept the increase or repay the debt).

6.7 The Council sets limits relating to the management of debt. The limits proposed are:

	2019/20	2020/21	2021/22	2022/23	2018/19
	Limit	**Limit**	**Limit**	**Limit**	**Projected Outturn at Year-End**
Maximum percentage of debt repayable in any year	25%	25%	25%	25%	19.81%
Maximum proportion of debt at variable rates	45%	45%	45%	45%	23.11%
Maximum percentage of debt restructured in any year	30%	30%	30%	30%	1.49%

The proposed limits are the same as set in 2018.

6.8 The Prudential Code requires that the Council states how interest rate exposure is managed and monitored:

All of the Council's PWLB debt is currently at fixed rates. The Market debt contains some debt at fixed rates, some small elements at variable rates and some where the rates can change (subject to the terms of the debt contract). The Council's investments, which are all for less than 1 year, are all variable or regarded as variable under the treasury management rules.

These interest rate exposures are managed and monitored by the Council through management reports on treasury management that are received and reviewed by the Chief Financial Officer.

6.9 In relation to affordability, the ratio of financing costs (including for PPP) to the Council's net revenue stream is estimated as:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Ratio of financing costs (including PPP) to net revenue stream	14.20%	14.75%	15.45%	12.36%	12.25%

The estimated fall in the ratio in 2021/22 is largely due to the final charges for former Strathclyde Regional Council debt being made in 2020/21.

6.10 The ratio of net debt to the Council's net revenue stream is estimated as:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Ratio of net debt (debt and PPP less investments) to net revenue stream	125.7%	137.0%	135.7%	134.9%	133.6%

Capital Strategy

6.11 The Prudential Code revised in 2017 requires the preparation of a formal Capital Strategy that is "intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future sustainability".

Investments

6.12 The Council's estimated investments position (after the proposed borrowing in paragraph 6.3) is shown in Appendix 3 and includes transactions treated as investments under the Investment Regulations. Included in Appendix 3 (as Cash balances managed in house) are the following estimated Bank Deposits:

	2019/20	2020/21	2021/22	2022/23
	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000
Cash balances managed in house				
1 April	25,000	19,426	18,771	17,483
31 March	19,426	18,771	17,483	14,164
Change in year	(5,574)	(655)	(1,288)	(3,319)

6.13 The Council sets upper limits for the total investments invested for over 365 days. The proposed limits are as follows:

	2018/19	2019/20	2020/21	2021/22	2022/23
	Limit	Limit	Limit	Limit	Limit
Upper limit for total principal	£000	£000	£000	£000	£000
sums invested for over 365 days	10,000	10,000	10,000	10,000	10,000

The Council has not entered into any investments of more than 365 days during 2018/19 to date and does not expect to do so during the remainder of the year.

7.0 PROPOSED TREASURY STRATEGY AND INVESTMENT STRATEGY

Economic Background

7.1 Appendix 1 explains the Economic Background affecting the proposed Treasury Management Strategy and Annual Investment Strategy.

7.2 The Council has appointed Link Treasury Services Limited as treasury advisers with part of their service being to assist the Council to formulate a view on interest rates. Link's latest interest rate forecasts (as at 6 November 2018) are:

As At	Bank Rate	Investment (LIBID) Rates			PWLB Borrowing Rates			
		3 month	6 month	1 year	5 year	10 Year	25 year	50 year
	%	%	%	%	%	%	%	%
March 2019	0.75	0.90	1.00	1.20	2.10	2.50	2.90	2.70
June 2019	1.00	1.00	1.20	1.30	2.20	2.60	3.00	2.80
Sept 2019	1.00	1.10	1.30	1.40	2.20	2.60	3.10	2.90
Dec 2019	1.00	1.20	1.40	1.50	2.30	2.70	3.10	2.90
March 2020	1.25	1.30	1.50	1.60	2.30	2.80	3.20	3.00
June 2020	1.25	1.40	1.60	1.70	2.40	2.90	3.30	3.10
Sept 2020	1.25	1.50	1.70	1.80	2.50	2.90	3.30	3.10
Dec 2020	1.50	1.50	1.70	1.90	2.50	3.00	3.40	3.20
March 2021	1.50	1.60	1.80	2.00	2.60	3.00	3.40	3.20
June 2021	1.75	1.70	1.90	2.10	2.60	3.10	3.50	3.30
Sept 2021	1.75	1.80	2.00	2.20	2.70	3.10	3.50	3.30
Dec 2021	1.75	1.90	2.10	2.30	2.80	3.20	3.60	3.40
March 2022	2.00	2.00	2.20	2.40	2.80	3.20	3.60	3.40

7.3 As Appendix 1 and the interest rate forecast above indicate, there remains considerable economic uncertainty which suggests that investment returns are likely to continue to be relatively low and there will remain a cost of carry to any new borrowing that would cause an increase in investments (for the difference between borrowing and investment interest rates).

Treasury Strategy – Borrowing

7.4 The proposed borrowing is as shown in paragraph 6.3 whilst the proposed authorised limit for 2019/20 is shown in paragraph 6.5.

7.5 Any borrowing will depend on an assessment by the Chief Financial Officer based on the Council's requirements and financial position, adopting a cautious but pragmatic approach and after seeking advice and interest rate/economic forecasts from the Council's treasury advisers.

Any borrowing decisions will be reported to the Policy & Resources Committee.

7.6 Policy on Borrowing in Advance of Need
The Council does not and will not borrow more than its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure 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:

- Consider the definition of such borrowing within the Code on the Investment of Money By Scottish Local Authorities
- 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 for the 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 alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- 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 by this Council is the borrowing requirement identified in paragraph 6.3 above for 2019/2022.

Treasury Strategy - Debt Rescheduling

7.7 PWLB-to-PWLB debt restructuring, whilst an option and having been done in the past before changes to PWLB rules in 2007 and 2010, would give rise to large premiums that would be incurred by prematurely repaying existing PWLB loans. It remains possible but very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

7.8 As short term borrowing rates are expected to be considerably cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

7.9 The Council is more likely to look at making savings by running down investment balances as short term rates on investments are expected to continue to be lower than the rates paid on the debt currently held.

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

- The generation of cash savings and/or discounted cash flow savings but at minimum risk;
- Helping to fulfil the strategy outlined above; and
- Enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

7.11 Any debt rescheduling will be reported to the Policy & Resources Committee and the Full Council and will be within the Treasury Policy Limits.

Investments – Policies/Strategy

7.12 Investment Policy
The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular and the revised CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:
(a) The security of capital
and
(b) The liquidity of its investments.

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 the security of its investments.

7.13 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.

7.14 Counterparty limits will be as set through the Council's Treasury Management Practices.

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

7.16 Permitted Investment Types
There are a large number of investment instruments that the Council could use, each having different features and risks.

The list of investment instruments proposed for possible use by the Council (including those for the Common Good Fund) and for which Council approval is being sought are listed in Appendix 2 along with details of the risks from each type of investment.

The list of proposed investments reflects a low risk appetite and approach to investments by the Council.

The only change in proposed Permitted Investments from that agreed in 2018 relates to specifying the categories of Money Market Funds that are permitted and that follows changes to Money Market Funds regulations.

7.17 Creditworthiness Policy
The Council's proposed Creditworthiness Policy for 2019/20, as follows, is unchanged from that agreed in 2018.

7.18 The Council uses the creditworthiness service provided by Link Treasury Services Limited. This service uses a sophisticated modelling approach using credit ratings from the three main rating agencies - Fitch, Moody's, and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:
- Credit watches and credit outlooks from credit rating agencies (indicating the likelihood of ratings changes for a counterparty or the expected direction of ratings for a counterparty)
- Credit Default Swap ("CDS") spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries.

7.19 This modelling approach combines credit ratings, credit watches and credit outlooks in a risk 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.

The approach is reviewed by Link as required in light of banking system and regulatory changes e.g. the reduction in importance of support ratings for individual banks due to the removal of implied government support to banks.

7.20 The Council will use counterparties within the following durational bands and with the following limits per counterparty (bands and limits as set through the Council's Treasury Management Practices):

Colour Category	Maximum Period for Individual Investments	Current Limit for Total Investments with Individual Counterparty
Purple	2 Years	£15m
Blue (Nationalised or Semi-Nationalised UK Banks)	1 Year	£15m
Orange	1 Year	£15m
Red	6 Months	£15m
Green	100 Days	£10m
No Colour	Not To Be Used	£NIL

The maximum period for individual investments with the Council's own bankers will be as in accordance with the above table whilst the limit for total investments with them will be £50m or as agreed by the Committee.

Members should note that these are the maximum periods for which any investment with a counterparty meeting the criteria would take place but subject to the Council's policy on Permitted Investments and instruments.

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

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

7.22 All credit ratings are monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap spreads against a benchmark (the iTraxx index) and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. The Council also uses (where available) market data and market information, information on government support for banks and the credit ratings of that government support.

7.23 It is proposed that the Council will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if not issued by Fitch). Countries currently meeting this criterion include Australia, Canada, France, Germany, Sweden, the USA, and the UK.

7.24 <u>Investment Strategy</u>
Appendix 3 includes forecasts of investment balances.

7.25 The Bank Rate was increased to 0.75% in August 2018. It is forecast to increase in quarter 2 of 2019, quarter 1 and quarter 4 of 2020, quarter 2 of 2021 and in quarter 1 of 2022. Bank Rate forecasts for financial year ends (March) are as follows:

- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%.

If expectations for economic growth weaken then increases in the Bank Rate could be delayed. If, however, the pace of growth quickens and/or forecasts for inflation rise then there could be an upside risk i.e. Bank Rate increases occur earlier and/or at a quicker pace.

7.26 Link advise that, for 2019/20, clients should budget for an investment return of 1.00% on investments placed during the financial year for periods of up to 100 days.

7.27 The Council uses an investment benchmark to assess the performance of its investments. The benchmark used is the 3 month LIBID (uncompounded) interest rate.

7.28 The Council will avoid locking into longer term deals 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.

Policy on Use of External Service Providers

7.29 The Council uses Link Treasury Services Limited as its external treasury management advisers and uses the services of brokers for investment deals as required. The Council's current contract with Link finishes on 30 June 2019. It is proposed to undertake a tendering exercise for these services.

7.30 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 external service providers.

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

Policy on Scrutiny, Monitoring and Change of Investment Policies and Practices

7.32 The Treasury Management Practices (TMPs) of the Council set out the operational policies and procedures in place to implement the treasury management strategy and the principles set out in the treasury management policy statement. They are intended to minimise the risk to the capital sum of investments and for optimising the return on the funds consistent with those risks.

7.33 The TMPs are kept under review, with a full revision every 3 years, with the latest review having taken place in 2018 to reflect changes required by the revised Prudential Code and the Treasury Management in the Public Services – Code of Practice.

7.34 A copy of the TMPs may be obtained from Finance Services.

Training for Members

7.35 The last training session on Treasury Management was held for Members on 4 August 2017.

Other Issues

7.36 The Council's contract with the Bank of Scotland for banking services is for 5 years from 1 April 2012 until 31 March 2017 with an option to extend for a further two 1 year periods until 31 March 2019. The Council has now exercised both of these options.

The Council has issued tenders for banking services for the 5 year period from 1 April 2019 to 31 March 2024 and with an option to extend for a further three 1 year periods until 31 March 2027. Delegated authority is being sought to allow the successful tender to be accepted.

7.37 This Strategy has been prepared on the basis of the counterparty limits and methodology proposed by the Council's current treasury advisers and for the Council's current bank. If there are changes following the tendering exercises then appropriate changes will be made to the counterparty limits and methodology without increasing risk to the Council and these changes will be reported to the Committee.

8.0 LOANS FUND ADVANCES

8.1 Where capital expenditure is funded by borrowing (referred to as loans fund advances), the debt financing costs are paid from the Revenue Budget as loan charges comprised of the repayment of debt and interest and expenses costs on the borrowing.

8.2 The Council is required to set out its policy for the repayment of loans fund advances from options set by the Scottish Government.

For loans fund advances made before 1 April 2016 the policy will be to maintain the practice of previous years and use the Statutory Method with annual principal repayments being calculated using the annuity method.

The same method is proposed for loans fund advances made after 1 April 2016 for the permitted 5 year transitional period. In applying the annuity method to new advances in any year, the interest rate used in the annuity calculation will be the Council's loans fund pool rate for the year (including expenses) as rounded up to the nearest 0.01%.

8.3 The outstanding loans fund advances (representing capital expenditure still to be repaid from the Revenue Budget) are:

	2017/18	2018/19	2019/20
	Actual	Projected	Estimated
	£000	£000	£000
Balance As At 1 April	243,438	246,043	243,417
Add: Advances For The Year	13,987	9,095	21,648
Less: Repayments For The Year	11,382	11,721	12,245
Balance As At 31 March	246,043	243,417	252,820

8.4 For the projected loans fund advances outstanding as at 31 March 2019, the liability to make future repayments (excluding debt interest and expenses) is as follows:

	£000
Year 1	12,245
Years 2-5	37,983
Years 5-10	41,527
Years 10-15	41,598
Years 15-20	37,119
Years 20-25	31,975
Years 25-30	24,839
Years 30-35	11,458
Years 35-40	3,997
Years 40-45	560
Years 45-50	116
TOTAL	243,417

9.0 IMPLICATIONS

Finance

9.1 Adopting the Treasury Strategy and the Investment Strategy for 2019/20 and the following three years will allow a balance to be maintained between opportunities to continue to generate savings for the Council and minimising the risks involved.

Legal

9.2 There are no Legal implications arising from this report.

Human Resources

9.3 There are no HR implications arising from this report.

Equalities

9.4 There are no equalities implications arising from this report

Repopulation

9.5 There are no repopulation implications arising from this report.

10.0 CONSULTATIONS

10.1 This report has drawn on advice from the Council's treasury advisers (Link Treasury Services Limited).

11.0 LIST OF BACKGROUND PAPERS

11.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition
CIPFA – The Prudential Code for Capital Finance in Local Authorities – 2017 Edition
Scottish Parliament – The Local Government Investments (Scotland) Regulations 2010 (Scottish Statutory Instrument 2010 No. 122)
Scottish Government - Finance Circular 5/2010 - Investment of Money by Scottish local authorities 1.4.10
Scottish Parliament – The Local Government (Capital Finance and Accounting) (Scotland) Regulations 2016 (Scottish Statutory Instrument 2016 No. 123)
Scottish Government - Finance Circular 7/2016 - The Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016 – Loans Fund Accounting

Appendix 1

ECONOMIC BACKGROUND

The following economic background is a summary based on information from the Council's treasury advisers, Link Treasury Services Limited:

There remains continued and significant global economic uncertainty and volatility arising from a number of economic and political factors including Brexit.

In the UK, the flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the Monetary Policy Committee repeated that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the 2008 crash; indeed they gave a figure for this of around 2.5% in ten years but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is thought unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel is expected to take well into Spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.00% in February 2022.

The interest rate forecasts provided by Link Treasury Services Limited are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, they think that it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

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

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

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

- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- Bank of England monetary policy takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Eurozone factors including a resurgence of the Eurozone sovereign debt crisis, weak capitalisation of some European banks, and political uncertainties.
- Further increases in interest rates in the US could spark a sudden flight of investment funds from more risky assets e.g. shares, into bonds yielding a much improved yield. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

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

PERMITTED INVESTMENTS
AND RISKS/CONTROLS/OBJECTIVES FOR EACH TYPE OF PERMITTED INVESTMENT

The Council approves the following forms of investment instrument for use as Permitted Investments:

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of Total Investments	Max. Maturity Period
Deposits					
Debt Management Agency Deposit Facility (DMADF)	---	Term	No	Unlimited	6 Months
Term Deposits – Local Authorities	---	Term	No	80%	2 Years
Call Accounts – Banks and Building Societies	Link Colour Category GREEN	Instant	No	Unlimited	Call Facility
Notice Accounts – Banks and Building Societies	Link Colour Category GREEN	Notice Period	No	80%	6 Months
Term Deposits – Banks and Building Societies	Link Colour Category GREEN	Term	No	95%	2 Years
Deposits With Counterparties Currently In Receipt of Government Support / Ownership					
Call Accounts – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Instant	No	Unlimited	Call Facility
Notice Accounts – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Notice Period	No	80%	6 Months
Term Deposits – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Term	No	95%	1 Year
Securities					
Certificates of Deposit – Banks and Building Societies	Link Colour Category GREEN	See Note 1 Below	See Note 1 Below	80%	2 Years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV or LVNAV)	AAAmmf with Fitch or equivalent with Moody's/Standard & Poors	See Note 2 Below	See Note 2 Below	50%	Call Facility

Notes:

1. The Liquidity Risk on a Certificate of Deposit is for the Term of the Deposit (if the Certificate is held to maturity) or the Next Banking Day (if sold prior to maturity). There is no Market Risk if the Certificate is held to maturity, only if the Certificate is sold prior to maturity (with an implied assumption that markets will not freeze up and so there will be a ready buyer).
2. The objective of Money Market Funds is to maintain the value of assets but such Funds hold assets that can vary in value. The credit ratings agencies, however, require the unit values to vary by almost zero. Following EU Money Market reforms that came into effect in 2018/19 and include new Money Market Fund categories, the table above specifies CNAV or LVNAV funds. CNAV funds are Public Debt Constant Net Asset Value funds whilst LVNAV funds are Low Volatility Net Asset Value funds. There are also Variable Net Asset Value funds (VNAV) but these are <u>not</u> to be included as Permitted Investments.

Investments will only be made with banks/building societies that do not have a credit rating in their own right where the Council's treasury advisers have confirmed that any obligations of that bank/building society are guaranteed by another bank/building society with suitable ratings.

The Council will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). Countries currently meeting this criterion include Australia, Canada, France, Germany, Sweden, the USA, and the UK.

Non-Treasury Investments

In addition to the table of treasury investments above, the definition of “investments” under the Investment Regulations includes the following items:

“(a) All share holding, unit holding and bond holding, including those in a local authority owned company, is an investment.
(b) Loans to a local authority company or other entity formed by a local authority to deliver services, is an investment.
(c) Loans made to third parties are investments.
(d) 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 are not investments.
(e) Investment property is an investment.”

The Council approves items in categories (a), (b), (c), and (e) above as Permitted Investments as set-out below:

	Minimum Credit Criteria	**Liquidity Risk**	**Market Risk**	**Max % of Total Investments**	**Max. Maturity Period**
Non-Treasury Investments					
(a) Share holding, unit holding and bond holding, including those in a local authority owned company	Assessment would be made of company in which any holding was to be made	Period of holding	Yes	10%	Unlimited
(b) Loans to a local authority company or other entity formed by a local authority to deliver services	Assessment would be made of company or entity to which any loan was to be made	Period of loan	No	20%	Unlimited
(c) Loans made to third parties	Assessment would be made of third party to which any loan was to be made	Period of loan	No	25%	Unlimited
(e) Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	10%	Unlimited

In relation to the above, Members should note that the Council is unlikely to become involved with category (a), has a loan under category (b) (to Inverclyde Leisure), will have loans to third parties under category (c) arising from decisions on such loans made by the Council, and may have investment property under category (e) should there be a reclassification, due to accounting rules, of individual properties held by the Council.

Permitted Investments – Common Good

The Common Good Fund’s permitted investments are approved as follows:

	Minimum Credit Criteria	**Liquidity Risk**	**Market Risk**	**Max % of Total Investments**	**Max. Maturity Period**
Funds deposited with Inverclyde Council	---	Instant	No	Unlimited	Unlimited
Share holding, unit holding and bond holding, including those in a local authority owned company	Assessment would be made of company in which any holding was to be made	Period of holding	Yes	10%	Unlimited
Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	95%	Unlimited

Treasury Risks Arising From Permitted Instruments
All of the investment instruments in the above tables are subject to the following risks:

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

2. **Liquidity risk**
   This is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. The column in the above tables headed as 'market risk' show each investment instrument as being instant access, notice period i.e. money is available after the notice period (although it may also be available without notice but with a loss of interest), or term i.e. money is locked in until an agreed maturity date.

3. **Market risk**
   This is the risk that, through adverse market fluctuations in the value of the principal sums that the Council borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.

4. **Interest rate risk**
   This is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Prudential Indicators and Treasury Management Indicators in this report.

5. **Legal and regulatory risk**
   This is the risk that the Council, 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 Council suffers losses accordingly.

   The risk exposure of various types of investment instrument can be summarised as:
   - low risk = low rate of return
   - higher risk = higher rate of return.

   For liquidity, the position can be summarised as:
   - high liquidity = low return
   - low liquidity = higher returns.

Controls on Treasury Risks

1. **Credit and counter-party risk**
   This Council has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes.

2. **Liquidity risk**
   This Council undertakes cash flow forecasting to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk**
   The only investment instruments that the Council has agreed as Permitted Investments and that can have market risk are Certificates of Deposit. Although they have a market value that fluctuates, the market risk does not arise if the Certificates are retained until maturity - only if they were traded prior to maturity if the need arose.

4. **Interest rate risk**
   This 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 Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited Investments
Investment Regulation 24 states that an investment can be shown in the above Permitted Investments tables 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 (DMADF)
   This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government's credit rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government-issued treasury bills or gilts.

2. High Credit Worthiness Banks and Building Societies
   See paragraphs 7.17 to 7.23 for 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 high credit worthiness, the authority will seek to ensure diversification of its portfolio with the following limits:
   - Limit for any single institution (except Council's bankers): £15m
   - Limit for Council's bankers: £50m (or as approved by the Council or Committee)
   - Limit for any one group of counterparties: £30m (£50m or as approved by the Council or Committee for the group including the Council's bankers).

3. Funds Deposited with Inverclyde Council (for Common Good funds)
   This has been included so that, under the Permitted Investments, all funds belonging to the Common Good can be deposited with Inverclyde Council (and receive interest from the Council) rather than requiring the Common Good funds to be invested under separate Treasury Management arrangements.

Objectives of Each Type of Investment Instrument
Investment Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted':

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

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

b) Term deposits with high credit worthiness banks and building societies

See paragraphs 7.17 to 7.23 for an explanation of this authority's definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The Council will seek to ensure diversification of its portfolio of deposits as practicable and as explained above. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

c) Notice accounts with high credit worthiness banks and building societies

The objectives are as for 1.b) above but there is access to cash after the agreed notice period (and sometimes access without giving notice but with loss of interest). This can mean accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit.

d) Call accounts with high credit worthiness banks and building societies

The objectives are as for 1.b) above but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

2. Deposits With Counterparties Currently In Receipt of Government Support/Ownership

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

a) Term deposits, notice accounts and call accounts with high credit worthiness banks which are fully or semi nationalised

As for 1.b), 1.c) and1.d) above but Government ownership implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This Council considers that this indicates a low and acceptable level of residual risk.

3. Securities

a) Certificates of Deposit

These are shorter term investments issued by deposit taking institutions (mainly banks) so they can be sold if the need arises. However, that liquidity (and flexibility) comes at a price so the interest rate on a Certificate of Deposit is less than placing a Fixed Term Deposit with the same bank.

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

5. Non-Treasury Investments
   b) Share holding, unit holding and bond holding, including those in a local authority owned company
   The objectives for the holding of shares, units, or bonds (including those in a local authority owned company) will vary depending on whether the Council wishes to undertake actual investments in the market or has the holding as a result of a previous decision relating to the management or provision of Council services. This Council will not undertake investments in the market in shares, units, or bonds but may, if required, hold shares, units, or bonds arising from any decisions taken by the Council in relation to the management or provision of Council services.

   c) Loans to a local authority company or other entity formed by a local authority to deliver services
   Having established a company or other entity to deliver services, a local authority may wish to provide loan funding to assist the company or entity. Any such loan funding would be provided only after consideration of the reasons for the loan, the repayment period for the loan, and the likelihood that the loan would be able to be repaid by the company or entity. Such loan funding would be provided from Council Revenue Reserves rather than from borrowing.

   d) Loans made to third parties
   Such loans could be provided for a variety of reasons such as economic development or to assist local voluntary groups. Any such loan funding would be provided only after consideration of the reasons for the loan, the repayment period for the loan, and the likelihood that the loan would be able to be repaid by the third party concerned.

   e) Investment property
   An investment in property would give the Council exposure to risks such as market risk (movements in property prices), maintenance costs, tenants not paying their rent, leasing issues, etc. This Council does not currently undertake investments involving property but may have investment property should there be a reclassification, due to accounting rules, of individual properties held by the Council.

Appendix 3

FORECASTS OF INVESTMENT BALANCES

Investment Regulation 31 requires the Council to provide forecasts for the level of investments for the next three years, in line with the time frame of the Council's capital investment programme. The following forecasts are for the next four years:

INVESTMENT FORECASTS	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000
Cash balances managed in house				
1 April	25,000	19,426	18,771	17,483
31 March	19,426	18,771	17,483	14,164
Change in year	(5,574)	(655)	(1,288)	(3,319)
Average daily cash balances	22,213	19,099	18,127	15,824
Holdings of shares, bonds, units (includes authority owned company)				
1 April	2	2	2	2
Purchases	0	0	0	0
Sales	0	0	0	0
31 March	2	2	2	2
Loans to local authority company or other entity to deliver services (Inverclyde Leisure)				
1 April	483	441	398	353
Advances	0	0	0	0
Repayments	42	43	45	46
31 March	441	398	353	307
Loans made to third parties (Largely BPRA)				
1 April	2,128	2,106	818	104
Advances	0	0	0	0
Repayments	22	1,288	714	14
31 March	2,106	818	104	90
Investment properties				
1 April	0	0	0	0
Purchases	0	0	0	0
Sales	0	0	0	0
31 March	0	0	0	0
TOTAL OF ALL INVESTMENTS				
1 April	27,613	21,975	19,989	17,942
31 March	21,975	19,989	17,942	14,563
Change in year	(5,638)	(1,986)	(2,047)	(3,379)

The movements in the forecast investment balances shown above are due largely to ongoing treasury management activity in accordance with the Council's treasury management strategy or, for loans made to third parties, in accordance with Council decisions made in respect of such loans.

All of the Council's cash balances are managed in-house with no funds managed by external fund managers.

The "holdings of shares, bonds, units (includes authority owned company)" relate to the Common Good.

TREASURY MANAGEMENT
GLOSSARY OF TERMS

Affordable Capital Expenditure Limit
The amount that the Council can afford to allocate to capital expenditure in accordance with the requirements of the Local Government in Scotland Act 2003 and supporting regulations.

Authorised Limit for External Debt
This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bail In
The use of funds held by a bank or other financial institution (whether in the form of customer bank deposits or bonds) to help prevent the collapse of a bank and in place of Governments stepping in with funds/support. The introduction of Bail In powers is part of the implementation of the Bank Recovery and Resolution Directive.

Bank of England
The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or “MPC”).

Bank Rate
The interest rate for the UK as set at regular meetings of the Monetary Policy Committee (“MPC”) of the Bank of England. This was previously referred to as the “Base Rate”.

Bank Recovery and Resolution Directive (BRRD)
The Bank Recovery and Resolution Directive is a European legislative requirement which sets out a common approach within the EU to how countries will deal with any banks and financial institutions that get into financial difficulty. It includes the use of Bail In powers and was implemented in the UK, Germany and Austria on 1 January 2015 and in most of the other EU countries in 2016.

Call Date
A date on which a lender for a LOBO loan can seek to apply an amended interest rate to the loan. The term “call date” is also used in relation to some types of investments with a maturity date where the investments can be redeemed on call dates prior to the maturity date.

Capital Expenditure
Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the Code of Practice on Local Authority Accounting in the United Kingdom and for which the Council are able to borrow.

Capital Financing Requirement
The Capital Financing Requirement (sometimes referred to as the “CFR”) is a Prudential Indicator that can be derived from the information in the Council’s Balance Sheet. It generally represents the underlying need to borrow for capital expenditure (including PPP schemes).

CDS Spread
A CDS Spread or “Credit Default Swap” Spread is the cost of insuring against default by a Counterparty. Increases in the CDS Spread for a Counterparty may indicate concerns within the market regarding a Counterparty.

Certificates of Deposit
Certificates of Deposit (or CDs) are a form of investment and similar to Fixed Term Deposits in that the investment is with a named Bank or Financial Institution, matures on a set date, and is repaid with interest on the maturity date. Unlike a Fixed Term Deposit, a CD can also be traded in the market prior to maturity.

CIPFA
CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Counterparty
Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the "Counterparty".

Credit Ratings
Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

The highest credit rating is AAA.

European Central Bank
Sometimes referred to as "the ECB", the European Central Bank is the central bank that sets interest rates for the Eurozone. It is the equivalent of the Bank of England.

Eurozone
This is the name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 19 countries: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Federal Reserve
Sometimes referred to as "the Fed", the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Rate Funding/Investments
This term refers to funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments is fixed and does not change.

Fixed Term Deposit
A Fixed Term Deposit or Fixed Term Investment is an investment with a named bank or financial institution which matures on a set date and which is repaid with interest on the maturity date. Fixed Term Deposits cannot be traded and cannot be terminated before the maturity date without the payment of a penalty (if at all).

Gilt Yields
A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts
Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on Bank Rate expectations, and on market conditions.

Gross Domestic Product
Gross Domestic Product ("GDP") is a measure of the output of goods and services from an economy.

Inflation
Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index ("CPI") or the Retail Prices Index ("RPI").

Investment Regulations
The Local Government in Scotland Act 2003 allows the Scottish Ministers to introduce Regulations to extend and govern the rules under which Scottish Councils may invest funds. The Local Government Investments (Scotland) Regulations 2010 came into effect on 1 April 2010.

LIBID
This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR
This is the London Interbank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

Link
Link Treasury Services Limited who are the Council's treasury management advisers who were previously named Capita Treasury Solutions Limited.

Liquidity
In relation to investments, liquidity relates to the ability to access invested funds. If funds are in a call account they have high liquidity (because the funds are readily accessible) whilst if funds are invested in bonds the bonds would need to be sold in order to access the funds (lower liquidity).

LOBO
This is a form of loan that the Council has with some lenders. The term is short for the phrase "Lender Option/Borrower Option". A LOBO loan allows the lender to propose adjustments to the loan interest rate at various call dates during the period of the loan (the "lender option") but the borrower does not need to accept the adjustments and can instead redeem the loan (the "borrower option").

MIFID II
The Markets in Financial Instruments Directive (MIFID II) is an EU Directive that came into force on 3 January 2018.

Money Market Fund
A Money Market Fund (or MMF) is a highly regulated investment product into which funds can be invested. An MMF offers the highest possible credit rating (AAA) whilst offering instant access and the diversification of risk (due to the MMF's balances being investing in selected and regulated types of investment product with a range of different and appropriately credit-rated counterparties).

MPC
The MPC or Monetary Policy Committee is a committee of the Bank of England that meets regularly during the year (in a meeting over 2 days) to set the Bank Rate for the UK.

Operational Boundary
This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Prudential Code
Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators. The Prudential Code was last revised in December 2017.

Prudential Indicators
Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB
The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Certainty Rates
PWLB rates for new borrowing at a 0.20% discount to standard PWLB rates for local authorities that submit annual information on their long-term borrowing and capital spending plans. The PWLB Certainty Rates came into effect on 1 November 2012.

PWLB Rates
These are the interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the start of business each day and then updated at least once during the day.

Quantitative Easing
This is the creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

Ratings
Ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an indication of the financial or operational strength of entities including financial institutions and even countries. Ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

Ring Fencing
In banking terms, the legal separation of those parts of a bank that undertake riskier activities (such as investment banking) from those parts that undertake less risky/safer activities (such as the accepting of customer deposits).

Security
In relation to investments, security refers to the likelihood that invested funds will be returned to the investor when due.

Stress Tests
Reviews of the assets and liabilities of banks and financial institutions carried out by regulators such as the European Banking Authority (EBA) and the Prudential Regulation Authority (PRA) in the UK to identify the impact of potential economic scenarios, assess the strength of those banks/financial institutions, and determine any action required by banks/financial institutions to strengthen their financial positions.

Treasury Management Code
This is the "Treasury Management in the Public Services: Code of Practice". It is produced by CIPFA and was last revised in December 2017.

Treasury Management Indicators
These are Prudential Indicators specifically relating to Treasury Management issues.

Treasury Management Practices (TMPs)
This is a Council document that sets out Council policies and procedures for treasury management as required by the Treasury Management Code. The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Variable Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments varies on an agreed basis.

Yield
The yield is the effective rate of return on an investment.

Finance Services
Inverclyde Council
January 2019.