Inverclyde council

AGENDA ITEM NO. 5

Report To:	**The Inverclyde Council**	**Date: 14 April 2011**
Report By:	**Corporate Director Regeneration & Environment**	**Report No: SL/LA/692/11**
Contact Officer:	**Sharon Lang**	**Contact No: 01475 712112**
Subject:	**Treasury Management Strategy Statement and Annual Investment Strategy 2011/12-2013/14 - 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 of 29 March 2011.

2.0 SUMMARY

2.1 The Policy & Resources Committee on 29 March 2011 considered the attached report by the Chief Financial Officer on the Treasury Management Strategy Statement and Annual Investment Strategy 2011/14, Treasury Policy Limits, the Council's Prudential and Treasury Management Indicators for the next three years and the List of Permitted Investments. APPENDIX

3.0 DECISION OF POLICY & RESOURCES COMMITTEE

3.1 The Policy & Resources Committee decided to remit the following, as outlined in the report, to The Inverclyde Council for approval:

(a) Treasury Management Strategy;
(b) Annual Investment Strategy;
(c) Treasury Policy Limits;
(d) Prudential Indicators;
(e) Treasury Management Indicators; and
(f) List of Permitted Investments (including those for the Common Good Fund).

4.0 RECOMMENDATION

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

Sharon Lang
Legal & Democratic Services

Inverclyde council

APPENDIX
AGENDA ITEM NO 5

Report To:	**Policy & Resources Committee**	**Date:**	**29 March 2011**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/34/11/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY - 2011/12-2013/14**		

1.0 PURPOSE

1.1 The purpose of this report is to request a remit to the Full Council, for their approval, of the Treasury Management Strategy Statement and Annual Investment Strategy for 2011/14, Treasury Policy Limits, the Council's Prudential and Treasury Management Indicators for the next 3 years, and the List of Permitted Investments.

2.0 SUMMARY

2.1 The report proposes the Council's Treasury Management Strategy and Annual Investment Strategy for 2011/14, Treasury Policy Limits, and Prudential and Treasury Management Indicators for the next 3 years.

2.2 The report also proposes a List of Permitted Investments listing the types of investments and limits for those investments.

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 projected capital expenditure) and on expected interest rate levels.

3.0 RECOMMENDATIONS

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

a. Treasury Management Strategy
b. Annual Investment Strategy
c. Treasury Policy Limits
d. Prudential Indicators
e. Treasury Management Indicators
f. List of Permitted Investments (including those for the Common Good Fund).

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

Statutory Requirements

4.1 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 as paragraphs 5.25 to 5.39 of this report) which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

4.2 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 15th April 2010.

4.3 Treasury Management is defined in the Code 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. "

4.4 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 body is the Policy & Resources Committee.

4.5 The proposed strategy for 2011/14 in respect of the following aspects of the treasury management function is based upon the officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury consultants.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential and Treasury Management Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy;
- policy on the use of external service providers; and
- any extraordinary treasury issues.

4.6 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.

4.7 Treasury Management is a complex area with its own terminology and acronyms. In order to aid the Committee's understanding a Glossary of Terms is attached as Appendix 4.

5.0 PROPOSED TREASURY STRATEGY, PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT INDICATORS

Treasury Limits For 2011/12 To 2013/14

5.1 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. This amount is termed the "Affordable Capital Expenditure Limit".

5.2 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 levels is 'acceptable'.

5.3 Whilst termed an "Affordable Capital Expenditure Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability (such as PPP arrangements). The affordable capital expenditure limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential and Treasury Management Indicators For 2011/12 To 2013/14

5.4 Inverclyde Council adopted the original 2001 CIPFA Code of Practice on Treasury Management and has adopted the revised 2009 Code.

5.5 Members should note that, due to changes in accounting rules from 2009/10 onwards, the Prudential and Treasury Management Indicators include, where required, the effect of assets being provided to the Council under the PPP arrangements.

Current Portfolio Position

5.6 The Council's treasury portfolio position at 23/2/2011 (Number 9 – Prudential Indicator) comprised:

		Principal		**Average Rate**
		£000	£000	
Fixed rate funding	PWLB	95,776		
	Market	40,000	135,776	4.117%
Variable rate funding	PWLB	0		
	Market	62,932	62,932	4.979%
			198,708	4.390%
Other long term liabilities			20,820	---
TOTAL DEBT			**219,528**	
TOTAL INVESTMENTS			**72,328**	**1.418%**

Borrowing Requirement

5.7 The Council's borrowing requirement is as follows:

	2009/10	2010/11	2011/12	2012/13	2013/14
	£000 Actual	£000 Projected	£000 Estimate	£000 Estimate	£000 Estimate
New borrowing	25,000	20,000	11,000	26,000	25,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	5,000	4,000	4,000	0
TOTAL	25,000	25,000	15,000	30,000	25,000

5.8 The main Prudential and Treasury Management Indicators are as follows:

	2010/11	2010/11	2011/12	2012/13	2013/14
	Estimate	**Probable Outturn**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure (Number 5 - Prudential Indicator)	£000	£000	£000	£000	£000
Capital Programme	26,384	21,716	41,357	65,123	34,069
PPP Schools (incl. accounting adjustments)	(419)	(419)	54,692	(1,531)	(1,557)
Total	25,965	21,297	96,049	63,592	32,512
Ratio of financing costs to net revenue stream (Number 1 - Prudential Indicator)					
Non – HRA	9.05%	8.37%	9.01%	9.93%	10.50%
Net borrowing requirement (Number 4 - Prudential Indicator)	£000	£000	£000	£000	£000
As At 31 March	(38,173)	(49,058)	(40,705)	(36,525)	(33,100)
Capital Financing Requirement as at 31 March (Number 6 - Prudential Indicator)	£000	£000	£000	£000	£000
Non – HRA	219,376	209,522	285,290	323,076	336,752
Upper limit for total principal sums invested for over 364 days (Number 14 - Treasury Management Indicator)	£10,000,000	£0 *	£10,000,000	£10,000,000	£10,000,000

* - This is the probable outturn of investments beyond 364 days as at 31/3/11 (against an upper limit of £10,000,000). During the year the maximum invested beyond 364 days at any time was £5,000,000 which was invested for 365 days.

	2010/11	2010/11	2011/12	2012/13	2013/14
	Estimate	**Probable Outturn**	**Estimate**	**Estimate**	**Estimate**
Authorised limit for external debt (Number 7 - Treasury Management Indicator)	£000	£000	£000	£000	£000
Borrowing	218,270	218,270	230,756	274,005	290,761
Other long term liabilities	20,949	20,949	75,512	73,981	72,424
TOTAL	239,219	239,219	306,268	347,986	363,185
Operational boundary for external debt (Number 8 - Treasury Management Indicator)	£000	£000	£000	£000	£000
Borrowing	212,317	212,317	224,462	266,532	282,831
Other long term liabilities	20,949	20,949	75,512	73,981	72,424
TOTAL	233,266	233,266	299,974	340,513	355,255

	2011/12	2012/13	2013/14
	Estimate	**Estimate**	**Estimate**
Incremental impact of capital investment decisions			
Incremental increase in council tax (band D) per annum (Number 2 - Prudential Indicator)	£0.11	£0.95	£0.59
Upper limit for fixed interest rate exposure (Number 11 - Treasury Management Indicator)	120%	120%	120%
Upper limit for variable rate exposure (Number 12 - Treasury Management Indicator)	40%	40%	40%

5.9 The limits on the maturity of fixed rate borrowing during 2011/12 (Number 13 – Treasury Management Indicator) are as follows:

Maturity Structure	Upper Limit	Lower Limit	2010/11 Probable Outturn
Under 12 months	30%	0%	3.00%
12 months and within 24 months	30%	0%	0.17%
24 months and within 5 years	30%	0%	8.31%
5 years and within 10 years	30%	0%	22.92%
10 years and within 30 years	30%	0%	1.52%
30 years and within 50 years	40%	0%	34.62%
50 years and within 70 years	45%	0%	29.46%

Treasury Policy Limits

5.10 In addition to the Prudential Indicators and Treasury Management Indicators, the Council has Policy Limits, as follows:

	2011/12 Estimate	**2012/13 Estimate**	**2013/14 Estimate**	**2010/11 Probable Outturn**
Maximum Percentage of Debt Repayable In Any Year	25%	25%	25%	20.130%
Maximum Proportion of Debt At Variable Rates	40%	40%	40%	31.670%
Maximum Percentage of Debt Restructured In Any Year	30%	30%	30%	0.000%

Prospects For Interest Rates

5.11 The Council has appointed Sector Treasury Services Ltd as treasury consultants and part of their service is to assist the Council to formulate a view on interest rates. The table in 5.12 gives the Sector view.

5.12 Sector interest rate forecast – 21st February 2011

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%	3.00%	3.25%	3.25%
3 month LIBID	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.60%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.10%	3.20%	3.40%	3.70%	4.00%	4.20%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.50%	4.60%	4.70%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.00%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

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

Borrowing Strategy

5.14 Sector's forecast for the PWLB new borrowing rates is:

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.75%	1.00%	1.00%	2.25%	3.25%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.30%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.20%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.70%

5.15 In view of the above forecast it is proposed that the Council's borrowing strategy take account of the following suggested order of priority for borrowing:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities.
- PWLB variable rate loans for up to 10 years.
- Short dated borrowing from non-PWLB sources.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) whilst seeking to maintain an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for shorter periods where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.

5.16 In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Officers, in conjunction with the treasury consultants, 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 would be postponed, and potential rescheduling from fixed rate funding into short term borrowing would 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.

5.17 <u>External v. Internal Borrowing</u>

Comparison of Gross and Net Debt Positions At Year-End	2009/10	2010/11	2011/12	2012/13	2013/14
	£000 Actual	£000 Projected	£000 Estimate	£000 Estimate	£000 Estimate
Actual External Debt (Gross)	204,944	219,527	285,109	313,350	332,492
Cash Balances	43,723	59,063	40,524	26,799	28,840
Net Debt	161,221	160,464	244,585	286,551	303,652

The above table shows movement of £84,121,000 in net debt between 2010/11 and 2011/12. Of this, £29,421,000 relates to borrowing for capital expenditure whilst the remaining £54,700,000 relates to assets funded from PPP and not actual borrowing by the Council.

- The Council is currently projected to have a difference at the 2010/11 year-end of £59,063,000 between gross debt and net debt.
- The general aim of this treasury management strategy is to seek to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. One factor which will be carefully considered 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.
- The next financial year is expected to see continued abnormally low Bank Rates. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
- Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.
- However, short term savings by avoiding new long term external borrowing in 2011/12 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.
- The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has potentially meant that large premiums would be incurred by such action; such levels of premiums may not be justifiable on value for money grounds. This situation will be monitored in case these differentials are narrowed by the PWLB at some future date.

5.18 Against this background, caution will be adopted with the 2011/12 treasury operations. The Chief Financial Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Policy & Resources Committee.

5.19 <u>Policy on Borrowing in Advance of Need</u>
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. In accordance with the revised Treasury Management Code, 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 above for 2011/2014.

Debt Rescheduling

5.20 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt has been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates. This has meant that PWLB-to-PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. Some interest savings might, however, still be achievable through using LOBO (Lenders Option Borrowers Option) loans and other market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

5.21 As short term borrowing rates will be considerably cheaper than longer term rates, there are likely to be significant 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.

5.22 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 currently held debt.

5.23 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).

5.24 All rescheduling will be reported to the Policy & Resources Committee and the Full Council and will be within the Treasury Policy Limits.

Annual Investment Strategy

5.25 <u>Investment Policy</u>
The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular and the 2009 revised CIPFA Treasury Management in 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.

5.26 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.

5.27 There are a large number of investment instruments that the Council could use. The list of investment instruments proposed for possible use by the Council (including those for the Common Good Fund) 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 the list of proposed investments from that agreed in 2010 is a change in the maximum percentage of Common Good funds that can be deposited with Inverclyde Council (from 50% to unlimited). This change has been made to ensure 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.

One investment type under investigation (but not proposed for inclusion as a Permitted Investment this year) is Money Market Funds. These Funds are highly regulated investment products into which funds can be invested and they offer the highest possible credit rating (AAA) whilst offering instant access and the diversification of risk. Such Funds are used by a number of other Councils but they are not yet proposed for use by this Council and would only be proposed in future after investigation and if considered appropriate.

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

5.29 Appendix 3 is a list of forecasts of investment balances.

5.30 <u>Creditworthiness Policy</u>
The Council uses the creditworthiness service provided by Sector Treasury Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys, and Standard and Poors forming the core element. It does not rely solely on the current credit ratings of counterparties but also uses the following as 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.

5.31 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. This service gives a much improved level of security for its investments. It is also a service that the Council would not be able to replicate using in-house resources.

5.32 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. 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 3 months
- No Colour Not to be used.

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 Investment instruments.

5.33 This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, it does not give undue preponderance to just one agency's ratings.

5.34 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 Sector 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 Councils 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.

5.35 Country Limits
It is proposed that the Council will only use approved counterparties either 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.

5.36 Investment Strategy
The Bank Rate has been unchanged at 0.50% since March 2009. It is forecast to commence rising in quarter 3 of 2011 and then to rise gently from thereon. Bank Rate forecasts for financial year ends (March) are as follows:

- 2010/11 0.50%
- 2011/12 1.00%
- 2012/13 2.25%
- 2013/14 3.25%.

There is downside risk to these forecasts if economic growth is weaker than expected. There is also a risk that the Monetary Policy Committee could decide to start raising the Bank Rate in quarter 2 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public.

5.37 Sector advise that, for 2011/12, clients should budget for an investment return of 1.10% on investments placed during the financial year for periods of less than 3 months.

5.38 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.

5.39 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.

Policy on Use of External Service Providers

5.40 The Council uses Sector Treasury Services as its external treasury management advisers and uses the services of brokers for investment deals as required.

5.41 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.

5.42 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

5.43 The Policy & Resources Committee will undertake a detailed examination of the Treasury Management Practices (TMPs) of the Council. These set out all the 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. When it is satisfied with these TMPs it will pass a resolution to adopt them.

5.44 The TMPs have been revised and submitted to the Policy & Resources Committee in March 2011 for approval (as required every 3 years). Any further changes in the TMPs will be submitted to the Policy & Resources Committee for approval prior to implementation.

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

6.0 IMPLICATIONS

6.1 Legal: None.

6.2 Finance: Adopting the Treasury Strategy and the Investment Strategy for 2011/12 and the following two years will allow a balance to be maintained between opportunities to continue to generate savings for the Council and minimising the risks involved.

Financial Implications: None.

6.3 Human Resources: None.

6.4 Equalities: None.

7.0 CONSULTATIONS

7.1 This report has been produced based on advice from the Council's treasury consultants (Sector Treasury Services Limited).

8.0 LIST OF BACKGROUND PAPERS

8.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – Second Edition 2009
CIPFA - Treasury Management in the Public Services – Guidance Notes For Local Authorities Including Police Authorities And Fire Authorities – Third Edition 2009
CIPFA – The Prudential Code for Capital Finance in Local Authorities – Fully Revised Second Edition 2009
Scottish Government – 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.

ECONOMIC BACKGROUND

The following economic background is based on information from the Council's treasury consultants, Sector Treasury Services Ltd:

1. **Global Economy**
   a. The Eurozone sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland in November, culminated in Ireland also having to take a bail out. There was another crisis in early January 2011 when Portugal narrowly avoided having to resort to taking a similar bail out package. However, this looks as if Portugal has only delayed what appears to be inevitable so there are widespread expectations that there will be another sovereign debt crisis in 2011.
   b. The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for low (but not negative) growth in 2011 in the UK and EU, though growth in the US looks as if it could be about twice as strong on the back of fiscal cuts increasing consumer disposable income and confidence.

2. **UK Economy**
   a. Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The result of fiscal contraction will be major job losses during this period, in particular in public sector services. This is likely to have a knock-on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a generally negative trend from mid 2010. Mortgage approvals are also at very weak levels, all of which indicates that the housing market is likely to remain weak in 2011.
   b. **Economic Growth** – GDP growth has peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 at +0.7% was also unexpectedly high but the first estimate for quarter 4 was a huge shock at -0.5% and reflected the effect of snow in December. Overall, the outlook is for low growth in 2011/12 and the Bank of England has downgraded its estimate for growth in 2011 from 2.6% to 2.0% in the February 2011 Inflation Report.
   c. **Unemployment** – The trend for 2011 is likely to be one of steadily increasing unemployment.
   d. **Inflation and Bank Rate** – CPI has remained high during 2010. It peaked at 3.7% in April and then gradually declined to 3.1% in September (RPI 4.6%) before returning to a rising path and hitting 4.0% in January 2011. The outlook is for further upward pressure with CPI to reach as much as 5% in early 2011 before starting to subside again. Although inflation has remained stubbornly above the Monetary Policy Committee's 2% target, they are confident that inflation will fall back over the next two years and should then be near to the target level.
   e. The Bank of England finished its programme of quantitative easing with total purchases of £200bn by November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, evaporated after the surprises of the quarter 3 GDP figure of +0.7% and the November Inflation Report revising the forecast for short term inflation sharply upwards.
   f. Sector's central view is that Bank Rate will start to increase in quarter 3 of 2011 (August) but there are risks both ways on this timing.
   g. **AAA rating** – Prior to the General Election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, the UK's AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June 2010, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors viewed UK government gilts as being a safe haven from EU government debt during mid 2010. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates during the first half of 2010/11.

3. **Sector's Forward View**
   a. It is currently difficult to have confidence as to exactly how strong UK economic growth is likely to be during 2011/12, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:
      - The strength / weakness of economic growth in the UK's major trading partners (the US and EU)
      - The danger of currency war and resort to protectionism and tariff barriers if China does not adequately address the issue of its huge trade surplus due to its undervalued currency
      - The degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
      - Changes in the consumer savings ratio
      - The speed of rebalancing of the UK economy towards exporting and substituting imports
      - The potential, in the US, for more quantitative easing and the timing of this and its subsequent reversal in both the US and UK
      - The speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
      - The potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy
      - Political risks in the Arab world, Middle East and Korea and the knock on potential effects on oil production in the first two areas.
   b. The overall balance of risks is weighted to the downside. However, concerns around some residual risk of a double dip recession and deleveraging (debt reduction), creating a downward spiral of falling demand, falling jobs and falling prices, have now been replaced with concerns around the inflationary effects of increases in world commodity prices adding to existing pressures on inflation.
   c. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major Western countries. However, most of this increase has already occurred in the second half of 2010/11 as a result of a major change in market sentiment.

PERMITTED INVESTMENTS

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	Sector Colour Category GREEN	Instant	No	Unlimited	Call Facility
Notice Accounts – Banks and Building Societies	Sector Colour Category GREEN	Notice Period	No	50%	3 Months
Term Deposits – Banks and Building Societies	Sector Colour Category GREEN	Term	No	80%	2 Years
Deposits With Counterparties Currently In Receipt of Government Support / Ownership					
Call Accounts – UK Nationalised/Part-Nationalised Banks	Sector Colour Category BLUE	Instant	No	Unlimited	Call Facility
Notice Accounts – UK Nationalised/Part-Nationalised Banks	Sector Colour Category BLUE	Notice Period	No	50%	3 Months
Term Deposits – UK Nationalised/Part-Nationalised Banks	Sector Colour Category BLUE	Term	No	80%	2 Years
Call Accounts - UK Government Support to the Banking Sector (implicit guarantee) – Abbey (now part of Santander UK), Barclays, HBOS/Lloyds TSB (part of Lloyds Banking Group), HSBC, Nationwide Building Society, RBS, Standard Chartered, Others Agreed by Government	Sector Colour Category GREEN	Instant	No	Unlimited	Call Facility
Notice Accounts - UK Government Support to the Banking Sector (implicit guarantee) – Abbey (now part of Santander UK), Barclays, HBOS/Lloyds TSB (part of Lloyds Banking Group), HSBC, Nationwide Building Society, RBS, Standard Chartered, Others Agreed by Government	Sector Colour Category GREEN	Notice Period	No	50%	3 Months
Term Deposits - UK Government Support to the Banking Sector (implicit guarantee) – Abbey (now part of Santander UK), Barclays, HBOS/Lloyds TSB (part of Lloyds Banking Group), HSBC, Nationwide Building Society, RBS, Standard Chartered, Others Agreed by Government	Sector Colour Category GREEN	Term	No	80%	2 Years

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 consultants have confirmed that any obligations of that bank/building society are guaranteed by another bank/building society with suitable ratings.

It is proposed that the Council will only use approved counterparties either 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%	---
(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	10%	---
(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	15%	---
(e) Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	10%	---

In relation to the above, Members should note that the Council is unlikely to become involved with categories (a) or (b), will have loans to third parties (category (c)) arising from decisions on such loans made by the Council, and may have investment property due to the reclassification, for accounting purposes, of property 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	---
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%	---
Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	90%	---

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' will 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 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 high creditworthiness to enable investments to be made safely.

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

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 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 AAA 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 5.30-5.32 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 (Bank of Scotland): £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 at a time when many authorities are disappointed at the failure in 2008 of credit ratings to protect investors from the Icelandic bank failures and are both cautious about other forms of investing and are prepared to bear the loss of income to the treasury management budget compared to earnings levels in previous years. The longest term deposit that can be made with the DMADF is 6 months.

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

      See paragraphs 5.30-5.32 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) and now that measures have been put in place to avoid over reliance on credit ratings, the Council feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. The Council will seek to ensure diversification of its portfolio of deposits 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 generally means 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. However, there are a number of call accounts which at the time of writing, offer rates 2-3 times more than term deposits with the DMADF. 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 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.

   b) Term deposits, notice accounts and call accounts with high credit worthiness banks and building societies which are specified as being eligible for support by the UK Government
   As for 2.a) above but Government stated support implies that the Government stands behind eligible banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This Council considers that this indicates a low and acceptable level of residual risk.

3. Non-Treasury Investments
   a) 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.

   b) 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.

   c) 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.

   d) 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 undertake investments involving property but may have investment property due to the reclassification, for accounting purposes, of property held by the Council.

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 our capital investment programme. These forecasts are as follows:

INVESTMENT FORECASTS	2011/12	2012/13	2013/14
	Estimate	Estimate	Estimate
	£000	£000	£000
Cash balances managed in house			
1st April	59,063	40,524	26,799
31st March	40,524	26,799	28,840
Change in year	(18,539)	(13,725)	2,041
Average daily cash balances	49,794	33,662	27,820
Cash balances managed by cash fund managers			
1st April	0	0	0
31st March	0	0	0
Change in year	0	0	0
Average daily cash balances	0	0	0
TOTAL CASH BALANCES			
1st April	59,063	40,524	26,799
31st March	40,524	26,799	28,840
Change in year	(18,539)	(13,725)	2,041
Average daily cash balances	49,794	33,662	27,820
Holdings of shares, bonds, units (includes authority owned company)			
1st April	2	2	2
Purchases	0	0	0
Sales	0	0	0
31st March	2	2	2
Loans to local authority owned company or other entity to deliver services			
1st April	0	0	0
Advances	0	0	0
Repayments	0	0	0
31st March	0	0	0
Loans made to third parties			
1st April	531	486	440
Advances	0	0	0
Repayments	45	46	48
31st March	486	440	392
Investment properties			
1st April	0	0	0
Purchases	0	0	0
Sales	0	0	0
31st March	0	0	0

INVESTMENT FORECASTS (Continued)	2010/11	2011/12	2012/13
	Estimate	Estimate	Estimate
	£'000	£'000	£'000
TOTAL OF ALL INVESTMENTS			
1st April	59,596	41,012	27,241
31st March	41,012	27,241	29,234
Change in year	(18,584)	(13,771)	1,993

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.

The "holdings of shares, bonds, units (includes authority owned company)" are for Common Good whilst the Investment properties includes Council property and Common Good property.

Appendix 4

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.

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 each month by the Monetary Policy Committee ("MPC") of the Bank of England. This was previously referred to as the "Base Rate".

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 annual Statement of Recommended Practice (SORP) and for which the Council are able to borrow.

Capital Financing Requirement
This 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.

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.

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

Consumer Prices Index
The Consumer Prices Index ("CPI") is a means of measuring inflation (as is the Retail Prices Index or "RPI"). The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try to keep CPI at or close to the target set by the Government (currently the target is 2%). The calculation of the CPI includes many items of normal household expenditure but the calculation excludes some items such as mortgage interest payments and Council Tax.

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.

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

Eurozone
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 16 countries: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Fed Rate
The interest rate for the US. Rates for the US are set by the Federal Reserve (the central bank for the US and the equivalent of the Bank of England).

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
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.

Flat Yield Curve
A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

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 base 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.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

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").

Inverted Yield Curve
An inverted or negative yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

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 have recently been produced and are proposed to come into effect on 1st 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 Inter Bank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

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".

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 each month (in a meeting over 2 days) to set the Bank Rate for the UK.

Negative Yield Curve
A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

Net Borrowing Requirement
This is the difference between the Council's net external borrowing and its capital financing requirement. Under the Prudential Code the Council's net external borrowing should not, except in the short term, exceed its capital financing requirement. The Net Borrowing Requirement should therefore normally be a negative figure.

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.

Positive Yield Curve
A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).

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 revised in November 2009 with the revisions including the reclassification of some Prudential Indicators as Treasury Management Indicators covered by the Treasury Management Code.

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 Rates
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 close of business on the preceding business day.

Quantitative Easing
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.

Repo Rate
This is another name for the Bank Rate as set by the Monetary Policy Committee.

Retail Prices Index
The Retail Prices Index ("RPI") is a means of measuring inflation (as is the Consumer Prices Index or "CPI"). The calculation of the RPI includes most of the same items as the CPI as well as some items not included in the CPI such as mortgage interest payments and Council Tax whilst excluding items that are in the CPI such as charges for financial services.

Sector
Sector Treasury Services Limited who are the Council's treasury management consultants.

Treasury Management Code
This is the "Treasury Management in the Public Services: Code of Practice" and is a code of practice for Council treasury management activities. It is produced by CIPFA and was revised in November 2009 with changes including the transfer of some Prudential Indicators from the Prudential Code into the Treasury Management Code as Treasury Management Indicators.

Treasury Management Indicators
These are Prudential Indicators specifically relating to Treasury Management issues that were reclassified following the revision of the Prudential Code in November 2009.

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.

Yield Curve
A graph showing the yield on investments plotted against the maturity period for investments:
- A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).
- A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).
- A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Finance Services
Inverclyde Council
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