Inverclyde council

AGENDA ITEM NO. 10

Report To:	**Policy & Resources Committee**	**Date:**	**26 March 2013**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/25/14/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY - 2013/14-2015/16**		

1.0 PURPOSE

1.1 The purpose of this report is to present to Committee the Treasury Management Strategy Statement and Annual Investment Strategy for 2013/16, 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 sets out the Council's proposed Treasury Management Strategy and Annual Investment Strategy for 2013/16, 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.

2.4 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 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).

3.2 It is recommended that the Committee approves the extension of the £70 million Counterparty limit with the Bank of Scotland from the end of April 2013 until the end of June 2014.

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 5.40 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 2011) was adopted by this Council on 12th April 2012.

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 2013/16 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 2013/14 To 2015/16

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 and finance lease 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 2013/14 To 2015/16

5.4 Inverclyde Council has adopted the CIPFA Code of Practice on Treasury Management which was last revised in November 2011.

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 PPP and finance lease arrangements.**

Current Portfolio Position

5.6 The Council's treasury portfolio position at 20/2/2013 (Number 9 – Prudential Indicator) comprised:

		Principal		**Average Rate**
		£000	£000	
Fixed rate funding	PWLB	121,618		
	Market	56,000	177,618	3.97%
Variable rate funding	PWLB	0		
	Market	46,943	46,943	5.04%
			224,561	4.20%
Other long term liabilities			74,033	---
TOTAL DEBT			**298,594**	
TOTAL INVESTMENTS			**81,521**	**2.18%**

Borrowing Requirement

5.7 The Council's borrowing requirement is as follows:

	2011/12	2012/13	2013/14	2014/15	2015/16
	£000 Actual	£000 Projected	£000 Estimate	£000 Estimate	£000 Estimate
New borrowing	0	30,000	13,000	7,000	4,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	4,000	6,000	1,000
TOTAL	0	30,000	17,000	13,000	5,000

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

	2012/13	**2012/13**	**2013/14**	**2014/15**	**2015/16**
	Estimate	**Probable Outturn**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure (Number 5 - Prudential Indicator)	£000	£000	£000	£000	£000
Capital Programme	48,305	50,008	46,609	49,207	17,358
PPP Schools/Finance Leases (incl. accounting adjustments)	(1,833)	(1,833)	(1,953)	(1,969)	(2,098)
Total	46,472	48,175	44,656	47,238	15,260
Ratio of financing costs (including PPP/ Finance Leases) to net revenue stream (Number 1 - Prudential Indicator)					
Non – HRA	10.67%	10.30%	11.47% #	12.49% #	13.49% #
Net borrowing requirement (Number 4 - Prudential Indicator)	£000	£000	£000	£000	£000
As At 31 March	(55,052)	(71,777)	(53,669)	(40,313)	(35,107)
Capital Financing Requirement as at 31 March (Number 6 - Prudential Indicator)	£000	£000	£000	£000	£000
Non – HRA	298,253	295,380	313,606	335,057	329,688
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

- The Council's General Revenue Grant has been reduced for these years due to the loss of the Police and Fire Joint Boards. As a result, the Council's ratio of financing costs to its now-reduced GRG and other income increases.

* - This is the probable outturn of investments beyond 364 days as at 31/3/12 (against an upper limit of £10,000,000). There were no sums invested beyond 364 days during 2012/13.

	2012/13	**2013/14**	**2014/15**	**2015/16**
	Estimate	**Estimate**	**Estimate**	**Estimate**
Authorised limit for external debt (Number 7 - Treasury Management Indicator)	£000	£000	£000	£000
Borrowing	246,787	266,000	291,800	288,200
Other long term liabilities	72,370	71,900	69,900	67,800
TOTAL	319,157	337,900	361,700	356,000
Operational boundary for external debt (Number 8 - Treasury Management Indicator)	£000	£000	£000	£000
Borrowing	240,057	258,800	283,800	280,300
Other long term liabilities	72,370	71,900	69,900	67,800
TOTAL	312,427	330,700	353,700	348,100

	2013/14	**2014/15**	**2015/16**
	Estimate	**Estimate**	**Estimate**
Incremental impact of capital investment decisions			
Incremental increase in council tax (band D) per annum (Number 2 - Prudential Indicator)	£0.09	£0.09	£0.17
Upper limit for fixed interest rate exposure (Number 11 - Treasury Management Indicator)	150%	140%	130%
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 2013/14 (Number 13 – Treasury Management Indicator) are as follows:

Maturity Structure	Upper Limit	Lower Limit	2012/13 Probable Outturn
Under 12 months	40%	0%	0.09%
12 months and within 24 months	40%	0%	2.42%
24 months and within 5 years	40%	0%	27.03%
5 years and within 10 years	40%	0%	34.41%
10 years and within 30 years	40%	0%	9.59%
30 years and within 50 years	40%	0%	26.46%
50 years and within 70 years	40%	0%	0.00%

This Indicator has been prepared in accordance with the revised Treasury Management Code which requires that the Council's Market debt (see 5.6 above) is shown 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).

Treasury Policy Limits

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

	2013/14 Estimate	**2014/15 Estimate**	**2015/16 Estimate**	**2012/13 Probable Outturn at Year-End**
Maximum Percentage of Debt Repayable In Any Year	25%	25%	25%	17.82%
Maximum Proportion of Debt At Variable Rates	40%	40%	40%	20.92%
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 forecasts – 20th February 2013

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 2013	0.50	0.50	0.70	1.00	1.80	2.90	4.10	4.20
June 2013	0.50	0.50	0.70	1.00	1.80	2.90	4.10	4.20
Sept 2013	0.50	0.50	0.70	1.00	1.80	2.90	4.10	4.20
Dec 2013	0.50	0.50	0.70	1.00	1.80	2.90	4.10	4.20
March 2014	0.50	0.50	0.70	1.10	1.90	3.00	4.20	4.40
June 2014	0.50	0.60	0.80	1.10	2.00	3.10	4.20	4.40
Sept 2014	0.50	0.60	0.90	1.20	2.10	3.20	4.30	4.50
Dec 2014	0.50	0.70	1.00	1.30	2.20	3.30	4.40	4.60
March 2015	0.75	0.80	1.10	1.30	2.40	3.50	4.60	4.70
June 2015	1.00	1.10	1.30	1.50	2.50	3.60	4.60	4.80
Sept 2015	1.25	1.40	1.60	1.80	2.60	3.80	4.80	4.90
Dec 2015	1.50	1.70	1.90	2.10	2.80	3.90	4.90	5.00
March 2016	1.75	1.90	2.20	2.40	3.00	4.10	5.00	5.10

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

Borrowing Strategy

5.14 The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the latest data revision shows that the economy grew in 2012 by 0.2%. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

5.15 This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a possible cost of carry – any borrowing undertaken that results in an increase in investments could incur a revenue loss between borrowing costs and investment returns.

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>Gross Debt v. Capital Financing Requirement</u>

Comparison of Gross Debt and Capital Financing Requirement At Year-End	2011/12	2012/13	2013/14	2014/15	2015/16
	£000 Actual	£000 Projected	£000 Estimate	£000 Estimate	£000 Estimate
External Debt (Including PPP and Finance Leases)	270,244	298,182	308,886	314,125	315,835
Capital Financing Requirement	271,815	295,380	313,606	335,057	329,688
Under/(Over) Against Latest CFR Projection For Year	1,571	(2,802)	4,720	20,935	13,853

As shown in 5.7 above, the Council borrowed earlier in 2012/13 to fund its estimated capital expenditure in year but some of that estimated expenditure has since been rephased to 2013/14 (as advised in reports on the Capital Programme), hence the projected 2012/13 position shown in the table above.

5.18 Against this background, caution will be adopted with the 2013/14 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 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 above for 2013/2016.

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 The Council is more likely to look at 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 Investment Policy
The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross-Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities 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.

There are no changes to the list of proposed investments from that agreed in 2012.

One investment type being considered (but not proposed for inclusion as a Permitted Investment this year, as was the case last 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 may be proposed in future.

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 Bank of Scotland – Counterparty Limit
The Council's Counterparty Limit for investments with the Bank of Scotland is currently £70m but is due to revert back to £50m at the end of April 2013.

The Council has a continuing unusual situation with a high level of approved capital investment and it needs to ensure it has sufficient funds to meet its requirements as they arise. This means holding a high level of investments.

In light of ongoing and forthcoming activity in the next 12-18 months, the Committee is requested to extend the current £70m limit of investments that may be held with the Bank of Scotland until the end of June 2014.

5.31 Creditworthiness Policy
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, Moody's, and Standard and Poor's forming the core element. 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.

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

5.33 The Council will 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.

5.34 The Sector 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 F1, Long Term rating A-, Viability ratings of A-, and a Support rating of 1. 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.

5.35 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.

5.36 <u>Country Limits</u>
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 Fitch does not provide). Countries currently meeting this criterion include Australia, Canada, France, Germany, Sweden, the USA, and the UK.

5.37 <u>Investment Strategy</u>
The Bank Rate has been unchanged at 0.50% since March 2009. It is forecast to remain at this level until quarter 1 of 2015 and then to rise gently from thereon. Bank Rate forecasts for financial year ends (March) are as follows:

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%.

The start of increases in the Bank Rate could be delayed if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected, increases in Bank Rate could be sooner, particularly if the Bank of England inflation forecasts for two years ahead exceed their 2% target rate.

5.38 Sector advise that, for 2013/14, clients should budget for an investment return of 0.50% on investments placed during the financial year for periods of less than 3 months.

5.39 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.

5.40 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

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

5.42 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.

5.43 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

5.44 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.

5.45 The TMPs were 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.

5.46 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 2013/14 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 – 2011 Edition
CIPFA – The Prudential Code for Capital Finance in Local Authorities – 2011 Edition
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.

Appendix 1

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 debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth at 1.0% in quarter 3 is unlikely to prove anything more than a washing-out of the dip in the previous quarter before a probable return to negative growth in quarter 4 (the latest figures, subject to revision, show a reduction of 0.3%); this would leave overall growth in 2012 at 0.2% and could then lead into negative growth in quarter 1 of 2013, which would then mean that the UK was in its first triple dip recession since records began in 1955.
   b. The Eurozone sovereign debt crisis abated following the ECB's commitment to a programme of Outright Monetary Transactions i.e. a pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request (for a national bailout) and so surrendering its national sovereignty to IMF supervision. However, the crisis in Greece has subsided, for the time being, as a result of the Eurozone agreement to provide a further €50bn financial support package in December. Many commentators, though, still view a Greek exit from the Euro as being likely in the longer term as successive rounds of austerity packages could make it more difficult to bring down the annual deficit and total debt as ratios of GDP due to the effect they have on shrinking the economy and reducing employment and tax revenues. However, another possible way out would be a major write down of total Greek debt; this has now been raised by the German Chancellor as a possible course of action, but not until 2014/15, and provided the Greek annual budget is in balance.
   c. Sentiment in financial markets has improved considerably since this ECB action and additional financial support for Greece to ensure that the Eurozone remained intact during 2012. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and do not address the huge obstacle of unemployment rates of over 25% in Greece and Spain. It is also possible that the situations in Portugal and Cyprus could deteriorate further in 2013 and, although they are minor economies, such developments could unnerve financial markets. There are also general elections in 2013 in Italy and Germany which could potentially produce some upsets on the political scene. It is, therefore, quite possible that sentiment in financial markets could turn during 2013 after the initial burst of optimism at the start of the year. While share prices have enjoyed a strong start to 2013, the foundations for this stock market recovery are shallow given the economic fundamentals in Western economies. In addition, Quantitative Easing ("QE") has to come to an end at some point in time and there is a distinct increase in doubt in the central banks of the US and UK as to the effectiveness of any further QE in stimulating economic growth. An end to central purchases of bonds may lead to a fall in bond prices.
   d. The US economy has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of QE combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. The fiscal cliff, and raising the total debt ceiling, still await final resolution (as at the end of February 2013). The housing market, though, does look as if it has, at long last, reached the bottom and house prices are now on the up.
   e. Hopes for a broad based recovery have, therefore, focused on the emerging markets. Recent news from China appears to indicate that the economy has returned to a healthier rate of growth. However, there are still concerns around the unbalanced nature of the economy which is heavily dependent on new investment expenditure. The potential for the bubble in the property sector to burst, as it did in Japan in the 1990s, could have a material impact on the economy as a whole.

2. **UK Economy**
    a. The Government's austerity measures, aimed at getting the public sector deficit into order, have now had to be extended, in the autumn statement, over a longer period than the original four years. Achieving this new extended timeframe will still be dependent on the UK economy returning to a reasonable pace of growth towards the end of this period.
    b. Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. However, the subsiding of market concerns over the Eurozone has unwound some of the attractiveness of gilts as a safe haven and led to a significant rise in gilt yields. There is little evidence that UK consumer confidence levels are recovering, nor that the manufacturing sector is picking up. The dominant services sector disappointed in December with the PMI survey indicating the first fall in activity in two years. On the positive side, banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had time to make a significant impact in respect of materially increasing overall borrowing in the economy. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.
    c. **Economic Growth.** Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly reports for August 2012, November 2012 and February 2013. Quantitative Easing (QE) increased by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE in early 2013 to try to stimulate economic activity. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury was also effectively a further addition of QE.
    d. **Unemployment.** The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.
    e. **Inflation and Bank Rate.** Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased back to 2.7% by the end of the year, though it is expected to fall back to reach the 2% target level within the two year horizon.
    f. **AAA rating.** In February 2013, Moody's, one of the three main ratings agencies, downgraded the UK's sovereign rating by one notch. The other main ratings agencies (Fitch and Standard & Poor's) still give the UK a AAA sovereign rating but are reviewing this rating. All of the agencies are carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

3. **Sector's Forward View**
    a. Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

        - The potential for the Eurozone to withdraw support for Greece at some point if the Greek government was unable to eliminate the annual budget deficit and the costs of further support were to be viewed as being prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself. The same considerations could also apply to Spain;
        - Inter-government agreement on how to deal with the overall Eurozone debt crisis could fragment;
        - The impact of the Eurozone crisis on financial markets and the banking sector;
        - The impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;
        - The under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;

- The risk of the UK's main trading partners, in particular the EU and US, falling into recession;
- Stimulus packages failing to stimulate growth;
- Elections in Italy and Germany in 2013;
- Potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China;
- The potential for action to curtail the Iranian nuclear programme;
- The situation in Syria deteriorating and impacting other countries in the Middle East.

b. The focus of so many consumers, corporates and banks on reducing their borrowings, rather than spending, will continue to act as a major headwind to a return to robust growth in Western economies.

c. Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

d. 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. The interest rate forecast in this report represents a balance of downside and upside risks. The downside risks have already been commented on. However, there are specific identifiable upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields:
   - UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields;
   - Reversal of QE; this could initially be allowing gilts held by the Bank of England to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held;
   - Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone;
   - Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth.

Appendix 2

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	95%	2 Years
Securities					
Certificates of Deposit – Banks and Building Societies	Sector Colour Category GREEN	See Note Below	See Note Below	80%	2 Years

Note: 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.

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.

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%	---
(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%	---
(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 category (a), will have a loan under category (b) (for the BPRA), 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.

<u>Permitted Investments – Common Good</u>

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	95%	---

<u>Treasury Risks Arising From Permitted Instruments</u>

All of the investment instruments in the above tables are subject to the following risks:

1. **<u>Credit and counter-party risk</u>**
   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. <u>There are no counterparties where this risk is zero</u> although AAA-rated organisations have a very high level of creditworthiness.

2. **<u>Liquidity risk</u>**
   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. **<u>Market risk</u>**
   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. **<u>Interest rate risk</u>**
   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. **<u>Legal and regulatory risk</u>**
   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 <u>risk exposure</u> of various types of investment instrument can be summarised as:

- low risk = low rate of return
- higher risk = higher rate of return.

For <u>liquidity</u>, the position can be summarised as:

- high liquidity = low return
- low liquidity = higher returns.

<u>Controls on Treasury Risks</u>

1. <u>Credit and counter-party risk</u>
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. <u>Liquidity risk</u>
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. <u>Market risk</u>
The only instruments that the Council may purchase which 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. <u>Interest rate risk</u>
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. <u>Legal and regulatory risk</u>
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 high 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 5.31-5.36 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): £70m (or as approved by the Council or Committee)
   - Limit for any one group of counterparties: £30m (£70m 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 5.31-5.36 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 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 securities 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. 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.

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 our capital investment programme. These forecasts are as follows:

INVESTMENT FORECASTS	**2013/14**	**2014/15**	**2015/16**
	Estimate	**Estimate**	**Estimate**
	£000	£000	£000
Cash balances managed in house			
1st April	74,579	48,949	19,378
31st March	48,949	19,378	21,254
Change in year	(25,630)	(29,571)	1,876
Average daily cash balances	61,764	34,164	20,316
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	74,579	48,949	19,378
31st March	48,949	19,378	21,254
Change in year	(25,630)	(29,571)	1,876
Average daily cash balances	61,764	34,164	20,316
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	2,200	2,200	2,200
Advances	0	0	0
Repayments	0	0	0
31st March	2,200	2,200	2,200
Loans made to third parties			
1st April	377	317	275
Advances	14	10	10
Repayments	74	52	36
31st March	317	275	249
Investment properties			
1st April	0	0	0
Purchases	0	0	0
Sales	0	0	0
31st March	0	0	0

INVESTMENT FORECASTS (Continued)	2013/14	2014/15	2015/16
	Estimate	Estimate	Estimate
	£'000	£'000	£'000
TOTAL OF ALL INVESTMENTS			
1st April	77,158	51,468	21,855
31st March	51,468	21,855	23,705
Change in year	(25,690)	(29,613)	1,850

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 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.

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.

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.

The highest credit rating is AAA.

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

Fed Rate
This is 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
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).

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.

G7/G8/G20
These are forums for discussions by the governments of large world economies.

The G7 is comprised of Canada, France, Germany, Italy, Japan, the UK, and the USA. The G8 is the G7 plus Russia (with the European Union also attending). The G20 is comprised of 19 countries (including the G7 and Russia) plus the European Union.

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.

IMF
The International Monetary Fund oversees the world financial system and seeks to stabilise international exchange rates, facilitate development, and provide resources to countries in balance of payments difficulties or to assist with poverty reduction.

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 came 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 last revised in November 2011.

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 Rate
In the Budget in March 2012, the Chancellor of the Exchequer announced that local authorities that provide information on their long-term borrowing and capital spending plans would be eligible for a 0.20% discount rate for new PWLB borrowing. This PWLB Certainty Rate 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.

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 advisers.

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 last revised in November 2011.

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.

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
March 2013.