East Lothian Council

Members' Library Service Request Form

Date of Document	17/03/17
Originator	Liz Shaw,
Originator's Ref (if any)	
Document Title	Treasury Management Strategy 2017–18 to 2019–30/172020

Please indicate if access to the document is to be "unrestricted" or "restricted", with regard to the terms of the Local Government (Access to Information) Act 1985.

Unrestricted	☒	Restricted	☐

If the document is "restricted", please state on what grounds (click on grey area for drop-down menu):

For Publication

Additional information:

To be read in conjunction with the report to the meeting of East Lothian Council on 28 March 2017, entitled Treasury Management Strategy 2017-2020.

Authorised By	Jim Lamond
Designation	Head of Council Resources
Date	17/03/17

For Office Use Only:	
Library Reference	30/17
Date Received	20/03/17
Bulletin	Mar17

East Lothian Council

Treasury Management Strategy Statement

2017 - 2020

1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

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

1.2 Reporting requirements

Members of the Council are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

Scrutiny will be provided by the Audit & Governance Committee.

1.3 Treasury Management Strategy for 2017/20

The strategy for 2017/20 covers two main areas:

Capital issues

- the capital plans and the prudential indicators..

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and Scottish Government Investment Regulations.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been provided for members in the past and further training will be provided following the Local Government Elections in May this year.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Capita Asset Services (formerly Sector) as its external treasury management advisors.

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

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2017/18– 2019/20

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Table 1: Capital Expenditure	2015/16 £'000 actual	2016/17 £'000 outturn	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
General Services	31,268	21,379	47,963	51,582	69,090
HRA	22,020	23,779	23,421	28,210	36,033
TOTAL	53,288	45,158	71,384	79,792	105,123

The above financing need excludes other long term liabilities, such as PPP and leasing arrangements which already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 2: Net Financing Need for the Year

	2015/16 £'000 actual	2016/17 £'000 outturn	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
General Services Gross Capital Spend	31,268	21,379	47,963	51,582	69,090
HRA Gross Capital Spend	22,020	23,779	23,421	28,210	36,033
Sub-total	53,288	45,158	71,384	79,792	105,123
Financed by;					
Capital grants	(16,801)	(12,340)	(15,077)	(16,825)	(21,547)
Capital receipts/contributions	(7,679)	(4,881)	(25,688)	(22,082)	(27,303)
Capital Reserves	(122)	-	-	-	-
Revenue Contributions	(90)	(3,382)	(2,683)	(2,183)	(2,683)
Sub-total	(24,692)	(20,603)	(43,448)	(41,090)	(51,533)
Net Financing Need for the Year	28,595	24,556	27,936	38,702	53,590

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as prudent annual repayments from revenue (Scheduled Debt Amortisation)need to be made which reflect the useful life of capital assets financed by borrowing.

As noted above the CFR calculation includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £42.5m of such schemes within the CFR. The figures shown in the table below therefore excludes these liabilities.

The Council is asked to approve the CFR projections below:

Table 3: Capital Financing Requirement (CFR)

	2015/16 £'000 actual	2016/17 £'000 outturn	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
Total CFR at start of year	368,195	383,848	394,325	407,581	430,519
Movement in CFR represented by	15,653	10,476	13,256	22,939	36,764
Total CFR at end of the year	383,848	394,325	407,581	430,519	467,283
Movement in CFR					
Net Financing Need for the year (above)	28,595	24,556	27,936	38,702	53,590
Less: Scheduled Debt Amortisation	(12,942)	(14,079)	(14,680)	(15,763)	(16,826)
Movement in CFR	15,653	10,476	13,256	22,939	36,764

2.3 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.4 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 4: Ratio of financing costs to revenue stream					
	2015/16 % actual	2016/17 % outturn	2017/18 % estimate	2018/19 % estimate	2019/20 % estimate
General Services	8.11%	8.45%	8.57%	8.87%	9.17%
HRA	33.21%	34.36%	33.18%	34.09%	35.39%

The estimates of financing costs include current commitments and the proposals in this budget report.

2.5 Incremental impact of capital investment decisions on council tax and housing rent levels.

These indicators identify the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Similar to the council tax calculation, the housing rent indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table 5: Incremental impact of capital investment decisions				
	2016/17 £'000 estimate	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
Increase in Council Tax (band D) per annum	£10.19	£14.69	£15.75	£16.36
Increase in average housing rent per week	£1.61	£0.76	£1.79	£2.42

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

3 Borrowing

The capital expenditure plans set out in the approved Council budget on 21st February 2017 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 6: Actual Debt and the Capital Financing Requirement (CFR)

	2015/16 £'000 actual	2016/17 £'000 outturn	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
Total External debt at start of year	334,930	337,160	348,212	366,780	388,004
Expected/Actual change in debt	2,230	11,052	18,568	21,224	36,086
Actual/Estimate gross debt at 31 March	337,160	348,212	366,780	388,004	424,090
The Capital Financing Requirement	383,848	394,325	407,581	430,519	467,283
(Under)/Over borrowing	(46,688)	(46,113)	(40,800)	(42,515)	(43,193)

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Council Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: Limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on levels of actual debt.

Table 7: Operational Boundary for External Debt					
	2015/16 £'000 estimate	2016/17 £'000 estimate	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
Borrowing	383,848	394,325	407,581	430,519	467,283
Other long term liabilities	42,506	41,430	39,835	38,357	37,010
Total	426,354	435,755	447,416	468,877	504,293

The authorised limit for external debt: A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35 (1) of the Local Government in Scotland Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Table 8: Authorised Limit for External Debt					
	2015/16 £'000 estimate	2016/17 £'000 estimate	2017/18 £'000 estimate	2018/19 £'000 estimate	2019/20 £'000 estimate
Borrowing	414,000	424,000	438,000	461,000	497,000
Other long term liabilities	43,000	42,000	40,000	39,000	38,000
Total	457,000	466,000	478,000	500,000	535,000

3.3 Prospects for interest rates

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

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
    - Italian constitutional referendum 04.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
    - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
    - Dutch general election 15.3.17;
    - French presidential election April/May 2017;

  - French National Assembly election June 2017;
  - German Federal election August – October 2017.

- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most

likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Head of Council Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was 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 an acceleration in the start date and in the rate of increase in central rates in

the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

£m	**2017/18**	**2018/19**	**2019/20**
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity structure of fixed interest rate borrowing 2017/18			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	30%
2 years to 5 years		0%	40%
5 years to 10 years		0%	40%
10 years and above		0%	75%
Maturity structure of variable interest rate borrowing 2017/18			
		Lower	***Upper***
Under 12 months		*0%*	*100%*
12 months to 2 years		*0%*	*50%*
2 years to 5 years		*0%*	*30%*

5 years to 10 years	*0%*	*20%*
10 years and above	*0%*	*20%*

3.5 Policy on borrowing in advance of need

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported within the regular quarterly Treasury Management reports to the Members Library.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

In accordance with guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendices 5.3 and 5.4. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;

- sovereign ratings to select counterparties from only the most creditworthy countries.

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

- Yellow 5 years
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

	Colour (and long term rating where applicable)	**Money and/or % Limit**	**Time Limit**
Banks *	**yellow**	**£5m**	**5yrs**
Banks	**purple**	**£5m**	**2 yrs**
Banks	**orange**	**£5m**	**1 yr**
Banks – part nationalised	**blue**	**£5m**	**1 yr**
Banks	**red**	**£5m**	**6 mths**
Banks	**green**	**£5m**	**100 days**
Banks	**No colour**	**Not to be used**	
Limit 3 category – Council's banker (not meeting Banks 1)	**Lloyds Bank**	**Unlimited**	**1 day**

DMADF	**UK Sovereign Rating**	**unlimited**	**6 months**
Local authorities	**n/a**	**£5m**	**3yrs**
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money Market Funds	**AAA**	**£5m**	**liquid**

The Capita Asset Services 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-, 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.

All credit ratings will be monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services 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 the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Servcies. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA-* from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Council Permitted Investments

The Investment Regulations (Code on the Investment of Money by Local Authorities) requires the Council approval of all the types of investments to be used and set appropriate limits for the amount that can be held in each investment type. These types of investments are termed permitted investments and any investments used which has not been approved as a permitted investment will be considered ultra vires.

The permitted investments which may be used in the forthcoming year are:

Cash type instruments

- Deposits with the Debt Management Account Facility (UK Government);
- Deposits with other local authorities or public bodies;
- Money Market Funds;
- Call account deposit accounts with financial institutions (banks and building societies);
- Term deposits with financial institutions (banks and building societies);
- UK Government Gilts and Treasury Bills;
- Supranational Bonds (e.g. World Bank)
- Certificates of deposits with financial institutions (banks and building societies)
- Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.);
- Corporate bonds;
- Bond funds;
- Property funds;

Other investments

- Investment properties;

- Loans to third parties, including soft loans and loans made for service policy reasons
- Loans to a local authority company including loans made for service policy reasons
- Shareholdings in a local authority company;
- Non-local authority shareholdings.

Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in Appendix 5.4.

For those permitted cash type investments the Head of Council Resources will maintain a counterparty list in compliance with the counterparty selection criteria as stated above. These criteria will be reviewed and revised as considered necessary and submitted to Council for approval as necessary. These criteria select which counterparties the Council will choose from, rather than defining what its investments are.

4.5 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

2016/17 0.25%
2017/18 0.25%
2018/19 0.25%
2019/20 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

	Now
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	£m 10	£m 10	£m 10

4.6 End of year investment report

In addition to the regular activity reports, the Council will report on its investment activity as part of its Annual Treasury Report at the end of the financial year.

4.7 Common Good & Charitable Trusts Investments

East Lothian Common Good funds and Charitable Trust funds are managed in two separate portfolios by an external investment management company, Investec. At 31st December 2016, the East Lothian Charitable Trust portfolio was valued at £3.178m while the Common Good portfolio was valued at £3.247m. The Council has set the objective for these funds to achieve growth in income and capital over the long term.

Both of the Council's portfolios are classified as medium/high risk and are structured as follows:

- **Quality**: the aim is to hold at least 25% of the UK equity content in a combination of individual stocks within the FTSE100 Index and of 'generalist' collective funds
- **Concentration**: no individual stock should account for more than 10% of the equity content of the portfolio. No individual bond should account for more than 10% of the total portfolio.
- **Diversification**: any holdings valued at over 5% of the portfolio may not, in aggregate, represent more than 40% of the portfolio. There is no restriction on the percentage of the overseas equity content in generalist

collective funds. Portfolios of a value of less than £100,000 should be substantially invested in collective funds.

Reporting

- Investec produce performance reports on a quarterly basis comparing performance to set investment benchmarks. These reports are reviewed by the Head of Council Resources.

- A summary report will be submitted to the full Council at least once a year on the performance of the portfolio.

- Ad hoc reports will be submitted to the Council should any significant events occur which in the opinion of the Head of Council Resources might affect the performance of the portfolio or the security of the investments.

- Reports will be submitted to individual Common Good committees or Trust boards as requested.

5 APPENDICES

- o Statutory repayment of loans fund advances
- o Economic background – Capital Asset Services
- o Treasury management practice 1 – permitted investments
- o Treasury management practice 1 – credit and counterparty risk management
- o Approved countries for investments
- o Treasury management reporting and scheme of delegation
- o The treasury management role of the section 95 officer

5.1Statutory repayment of loans fund advances

1. The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016, which came into force on 1 April 2016 set out the powers of local authorities to borrow money and enter into credit arrangements together with providing updated guidance for the operation of the loans fund.

2. All capital expenditure incurred, including any loans given to third parties, which the Council has determined should be financed from borrowing must be the subject of a loans fund advance. In this respect the loans fund operates as the internal bank for the Council as it provides Services with the funding to support the purchase and creation of assets, arranges appropriate external borrowing to finance these advances, and pays interest and expenses to the provider of these loans and thereafter recovers these costs from the Services through the annual repayments (debt charges) similar in many ways to the operation of a domestic mortgage account.

3. The 2016 Regulations places an additional disclosure requirement on the Council in respect of the loans fund and the liability to make future repayment of advances. This is summarised in the following table.

Years	Opening	Additions	Repayments	Closing
	£K	£K	£K	£K
1	393,115	27,936	14,672	406,380
2-5	406,380	160,974	70,581	496,773
6-10	496,773	0	107,843	388,930
11-15	388,930	0	94,232	294,698
16-20	294,698	0	80,892	213,806
20-25	213,806	0	77,040	136,766
26-30	136,766	0	77,745	59,021
30+	59,021	0	59,021	0

4. The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

5. A variety of options are provided to Councils so long as a prudent provision is made each year. The statutory guidance identifies 4 options that are considered prudent: (1) Statutory Method; (2) Depreciation Method; (3) Asset Life Method and (4) Funding/Income

Profile Method. What represents prudent repayment will be a decision for each local authority: an authority need not select a single option and can apply different options for different capital schemes / projects, but should be consistent in applying options. The Regulations also allow a local authority to vary the period of any advance, or the repayment amount, or both, where it considers it prudent to do so. This provision enables an authority to make additional voluntary repayments of loans fund advances.

6. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

7. For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the Statutory Method with all loans fund advances being repaid by the annuity method

8. For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances will be the:- are there plans to review this for 2016/17 charge and future years?

9. Statutory method – loans fund advances will be repaid by the annuity method

10. The Council is permitted to use this option for a transitional period only, of five years until 31st March 2021, at which time it must review its policy to use one of the methods outlined above

11. The annuity rate applied to the loans fund repayments was based on historic interest rates and is currently 4%. However, under regulation 14 (2) of SSI 2016 No 123, the Council has reviewed and re-assessed the historic annuity rate to ensure that it is a prudent application. The result of this review suggests that an annuity rate of 4% provides a fair and prudent approach and provide principal repayments more closely associated with the use of the assets.

.

5.2Economic Background (as reported by Capita Asset Services

UK. **GDP growth rates** in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.6%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in quarter 4 grew reasonably strongly, increasing by 1.2% and added 0.1% to GDP growth. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, by December it had fallen back to -7 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do 'whatever is needed' i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.6% in December. However, prices paid by factories for inputs are rising very strongly although producer output prices are still lagging well behind.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

USA. The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.5% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

EZ. In the Eurozone, the ECB commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- Greece continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- Spain has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.
- The under capitalisation of Italian banks poses a major risk. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to

borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- 4 December Italian constitutional referendum on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- Dutch general election 15.3.17; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- French presidential election; first round 13 April; second round 7 May 2017.
- French National Assembly election June 2017.
- German Federal election August – 22 October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Asia. Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries. There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.
.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.

- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

5.3 TREASURY MANAGEMENT PRACTICE (TMP1): PERMITTED INVESTMENTS

This Council approves the following forms of investment instrument for use as permitted investments as set out in table 1

Treasury risks
All the investment instruments in tables 1 are subject to the following risks: -

- **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 organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.

- **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in table 1 headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get cash, or term i.e. money is locked in until an agreed maturity date.

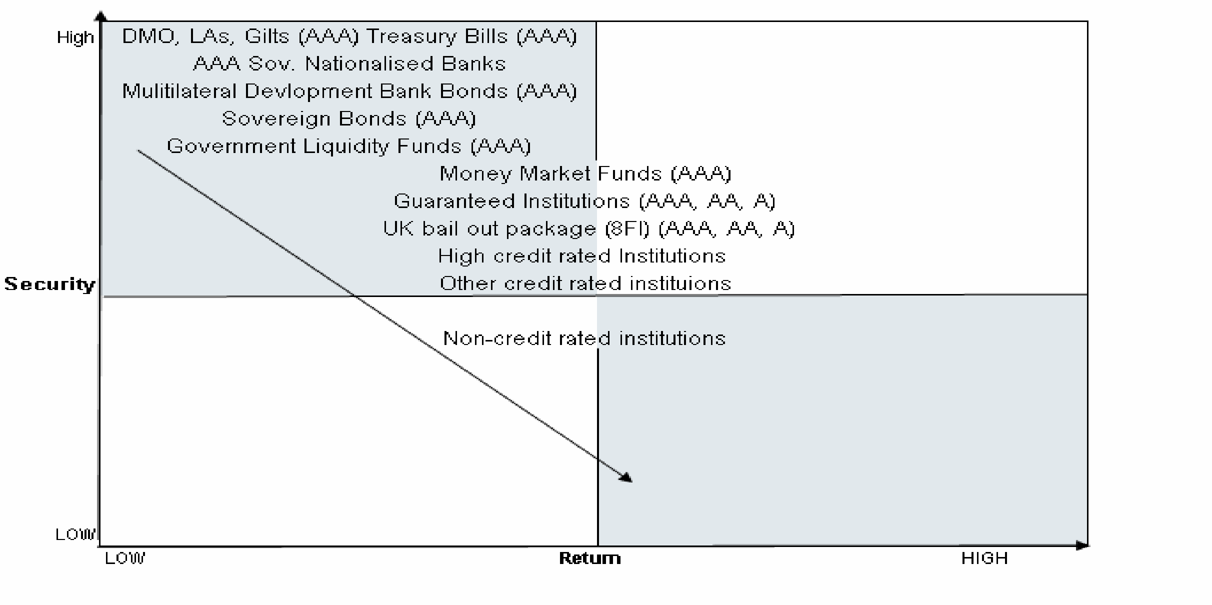
- **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some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

- **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report. All types of investment instrument have interest rate risk

- **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

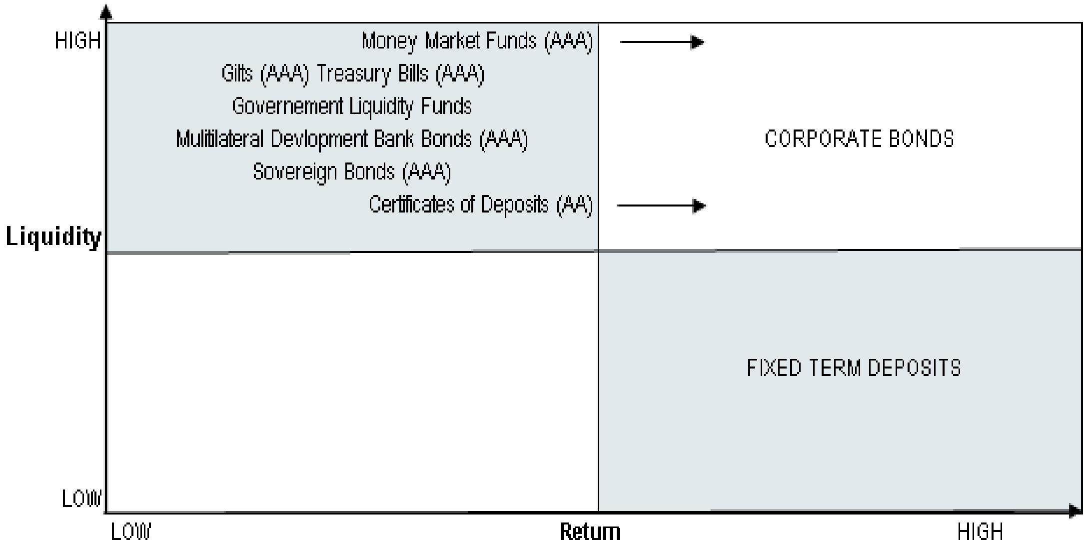
The graph below summarises the risk exposure of various types of investment instrument. It shows that as you move from top to bottom, so the level of credit risk increases. However, moving from top to bottom also results in moving towards the right i.e. returns increase. The overall message is: -

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



The next graph shows the other message: -

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



Controls on treasury risks

- **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of high creditworthiness to enable investments to be made safely. See paragraphs 4.2 and 4.3.

  - **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

  - **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.

  - **Interest rate risk**: this authority 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. See paragraph 4.5.

  - **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited investments

Regulation 24 states that an investment can be shown in tables1 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: -

3. **Debt Management Agency Deposit Facility.** 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.

4. **High credit worthiness banks and building societies.** See paragraph 4.2 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 ensure diversification of its portfolio ensuring that no more than £5m can be placed with any one institution or group. The Council's own banker (Lloyds Banking Group) may have sums greater than this held overnight only until they are placed elsewhere.

Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted'.

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 is held at call.

- **Debt Management Agency Deposit Facility.** 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. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest term deposit that can be made with the DMADF is 6 months.

- **Term deposits with high credit worthiness banks and building societies.** See paragraph 4.2 for an explanation of this authority's definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term) The authority will ensure diversification of its portfolio of deposits ensuring that no more than £5m can be placed with any one institution or group. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high 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.

- **Call accounts with high credit worthiness banks and building societies.** The objectives are as for above. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

- **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.

- **Collateralised deposits.** These are deposits placed with a bank which offers collateral backing based on LOBOs borrowed by local authorities. Such deposits are effectively lending to a local authority as that is the ultimate security.

2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either direct (partial or full) ownership. The view of this authority 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.

i. **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for above but Government ownership partial or full 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 authority considers this indicates a low and acceptable level of residual risk.

ii. **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available.

In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently covered under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.

3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

- **Government liquidity funds.** These are very similar to money market funds (see below) but only invest in government debt issuance with highly rated governments. They offer a lower rate of return than MMFs but slightly higher than the returns from the DMADF.

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

4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

a. **Treasury bills.** These are short term bills (up to 12 months) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** e.g. National Rail. This is similar to a gilt due to the explicit Government guarantee.

d. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. AAA rated issues are just as secure as UK Government gilts but the advantage of these securities is they offer a slightly higher yield.

e. **Bonds issued by Multi Lateral Development Banks (MLDBs).** These are similar to c. and e. above but are issued by MLDBs which are guaranteed by sovereign states with a high sovereign rating e.g. European Investment Bank. The advantages of these securities is they are more secure than UK Government gilts, as they are guaranteed by more than one AAA rated government, and offer a slightly higher yield.

6. OTHER

a. **Property fund.** This is a collective investment fund specialising in property. Rather than owning a single property with all the risk exposure that means to one property in one location rising or falling in value, maintenance costs, tenants actually paying their rent / lease etc, a collective fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the potential for the property sector to rise in value. However, timing is critical to entering or leaving this sector at the optimum times of the property cycle of rising and falling values unless a long term commitment is made to retain exposure to the property market.

b. **Investment Properties.** These are non-service properties which are being held pending disposal or for a longer term rental income stream.

c. **Loans to third parties, including soft loans**. These are service investments either at market rates of interest or below market rates (soft loans).

d. **Loans to a local authority company.** These are service investments either at market rates of interest or below market rates (soft loans).

e. Shareholdings in a local authority company. These are service investments.

f. Non-local authority shareholdings. These are non-service investments.

Counterparty criteria

Surplus money in the Council's Loans Fund may only be advanced to another UK local authority, government guaranteed institution and third parties and local authority companies as included within the permitted investments. In addition to:

1. any bank or financial institution which meets the following criteria:-

(i) It falls into one of the groups of banks or financial institutions and appears in our treasury advisors CAS) credit rating matrix as approved, specifically a rating of P-1 (or better) from Moodys or a rating of F-1 (or better) from Fitch

(ii) The Council's own bankers.

2. any money market fund that meets the following criteria:-

(i) It is a Sterling denominated fund domiciled within the EU as regulated by the Institutional Money Market Funds Association (IMMFA)

(ii) It falls into one of the groups of banks, financial institutions or insurance companies and the institution concerned has a rating of Aaa from Moody's or a rating of AAAmmf from Fitch or a rating of AAAm with Standard & Poor.

(iii) Investments will be made in Constant Net Asset Value (CNAV) Money Market Funds which offer instant access to funds with same day settlement.

A list of approved counterparties will be maintained by the S95 officer and reviewed in line with the CAS counterparty rating service.

Table 1: permitted investments in house – Treasury
1.1 Deposits

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	term	no	**100%**	**6 mths**
Term deposits – local authorities	--	term	no	**100%**	**3 years**
Call accounts – banks and building societies **	as counterparty criteria above	instant	no	**100%**	**n/a**
Term deposits – banks and building societies **	as counterparty criteria above	term	no	**100%**	**5 Years**
Fixed term deposits with variable rate and variable maturities: -Structured deposits.	as counterparty criteria above	term	no	**20%**	**12mnths**

1.2 Deposits with counterparties currently in receipt of government support / ownership

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
UK nationalised banks	as counterparty criteria above	term	No	**100%**	**12 mnths**
Banks nationalised by high credit rated (sovereign rating) countries – non UK	as counterparty criteria above	term	no	**20%**	**3mnths**
Government guarantee (explicit) on ALL deposits by high credit rated (sovereign rating) countries**	as counterparty criteria above	term	no	**20%**	**3mnths**
UK Government support to the banking sector (implicit guarantee) ***	as counterparty criteria above	term	no	**20%**	**3mths**
Fixed term deposits with variable rate and variable maturities: -Structured deposits	as counterparty criteria above	term	no	20%	**3mnths**

1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
1. Government Liquidity Funds	as counterparty criteria above	instant	No	**0%**	**n/a**
2. Money Market Funds	as counterparty criteria above	instant	No	**20%**	**n/a**

1.4 Securities issued or guaranteed by governments

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	yes	**20%**	**5 yrs**
UK Government Gilts	UK sovereign rating	Sale T+1	yes	**20%**	**5 yrs**
Bonds issued by multilateral development banks Sovereign bond issues (other than the UK govt)	AAA	Sale T+1 Sale T+1	yes yes	**20%**	**5yrs**
Bonds issued by multilateral development banks	AAA	Sale T+1	yes	**20%**	**5yrs**

1. 5

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

1.6 Other

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Property funds	--	T+4	yes	0%	

Appendix 5.4 - Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management **East Lothian Council Permitted Investments, Associated Controls and Limits**

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
Cash type instruments				
Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 6 months.	As shown in the counterparty section criteria above.
Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	£unlimited and maximum 3 yrs.	As shown in the counterparty section criteria above.
Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	££5m per fund	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
Term deposits with financial institutions (banks and building societies) **(Low to medium risk** **depending on period & credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	As shown in the counterparty section criteria above..	As shown in the counterparty section criteria above..

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

local authority company	service policy reasons which may exhibit market risk and are likely to be highly illiquid.	authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	the counterparty section criteria above.	the counterparty section criteria above.
Type of Investment	**Treasury Risks**	**Mitigating Controls**	**Council Limits**	**Common Good Limits**
Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Sector, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the S95 officer, and if required new counterparties which meet the criteria will be added to the list.

Use of External Fund Managers – It is the Council’s current policy to use external fund managers for the Common Good Funds and Charitable Trust funds. The investment policy for these funds is outlined in paragraph 4.7 of this strategy.

5.5 Approved countries for investments

AAA

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

AA+

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

AA

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.

AA-

- Belgium

5.6 Treasury management reporting and scheme of delegation

The following reporting arrangements will apply to Treasury Management activity:

(i) Full council

- Annual strategy

(ii) Audit & Governance Committee

- Scrutiny of Annual strategy
- Annual Treasury report

(iii) Members Library

- Reports on Treasury Management activity including a mid-year review at the end of quarter 2.

- The Council has delegated authority to the Head of Council Resources to effect movement between borrowing and long-term liabilities within the total authorised limits and operational boundaries approved. Any such movement would be reported to Cabinet via the Members Library as part of Treasury Management update reports.

5.7 The treasury management role of the section 95 officer

The S95 (responsible) officer

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