APPENDIX 1

SCOTTISH BORDERS COUNCIL

TREASURY MANAGEMENT STRATEGY
(incorporating the Annual Investment Strategy)
2020/21

CONTENTS

1 Purpose and Scope

1.1 The Council is currently required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimated and actual figures.

a) **Treasury Management Strategy 2020/21** (this report).
This report is the most important of the three reports and covers:

- The capital plans of the Council (including prudential indicators);
- A policy for the statutory repayment of debt, (how residual capital expenditure is charged to revenue over time);
- The treasury management strategy (how the investments and borrowings are organised), including treasury indicators, and
- A permitted investment strategy (investment options and limits applied).

b) **Mid Year Treasury Management Report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **Annual Treasury Report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2 **Scrutiny**
These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the **Audit and Srutiny Committee**.

1.3 The treasury management issues covered by this report are:

Capital Issues
- the capital expenditure plans and the associated prudential indicators
- the loan fund repayment policy

Treasury management issues
- the current treasury position
- treasury indicators which will 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

1.4 These elements cover the requirements of the Local Government in Scotland Act 2003, the CIFPA Prudential Code (the Prudential Code), the CIPFA Treasury Management Code (the Code) and Scottish Government loans fund repayment regulations and investment regulations.

1.5 The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council will address this important issue by:

a) **Elected Members**
- Working with members of the Audit and Scrutiny Committee to identify their training needs

- Working with Link Asset Services to identify appropriate training provision for elected members

b) **Officers** dealing with treasury management matters will have the option of various levels of training including:

- Treasury courses run by the Council's advisers
- Attendance at CIPFA treasury management training events
- Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
- On the job training in line with the approved Treasury Management Practices (TMPs).

1.6 Treasury Management Consultants

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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.

1.7 The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations), the cash managed by the Council on behalf of the Scottish Borders Council Pension Fund, the Common Good and Trust Funds.

2 Background

2.1 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.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans and strategy. 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 The Prudential and Treasury Indicators (summarised in **Annex A**) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. These Indicators have been developed in line with both the Prudential and Treasury Codes. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992. The Treasury Management Strategy therefore forms an integral part of the Council's overall Financial Strategy covering both its revenue and capital budgets.

2.4 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

2.5 CIPFA defines treasury management as:

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

2.6 Revised reporting is required for the 2020/21 reporting cycle due to revisions of the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity if that is going to be undertaken. The capital strategy is being reported separately.

3 The Capital Prudential Indicators 2019/20 – 2024/25

The Council's Financial Strategy sets out financial resource and management parameters within which it will deliver its Corporate Vision and Priorities. The Financial Strategy brings together various elements of financial policy and strategy, including the Treasury Management Strategy, and establishes the financial planning framework for the Council in terms of Revenue Expenditure and Capital Investment. The output from this framework is the Council's Financial Plan, approved annually in February, presenting the financial proposals for delivering its services and objectives.

The Financial Strategy establishes that the Financial Principles underpinning the planning for the Council's future service delivery are to:

(i) Raise the funds required by the Council to meet approved service levels in the most effective manner;

(ii) Manage the effective deployment of those funds in line with the Council's corporate objectives and priorities; and

(iii) Provide stability in resource planning and service delivery as expressed through Corporate and Business Plans and the Revenue and Capital Financial Plan.

In order to adhere to these Principles, the Financial Strategy states that the Council will adopt Financial Objectives to:

"ensure capital borrowing is within prudential borrowing limits and sustainable in the longer term. In this regard it is important to recognise the capital investment decisions taken now have long term borrowing implications and these have the potential to place a significant burden on future tax payers".

The draft revenue budget sets loans charges associated with capital borrowing over the next 5 years at £19.1m in 2020/21, rising to £23.7m in 2024/25.

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

3.1 Capital Expenditure (Prudential Indicator PI-1)

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this planning cycle. The Capital Financial Plan for 2020/21 – 2029/30 includes the following capital expenditure forecasts for the first five years. 2019/20 projected outturn figures are also shown:

Capital Expenditure (PI-1) £m	Estimate					
	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Assets & Infrastructure	24.2	41.0	38.4	32.1	16.6	14.8
Other Corporate Services	7.2	1.9	0.4	0.4	0.9	0.3
Children & Young People	8.3	20.5	27.1	41.8	31.9	4.5
Culture & Sport	2.4	1.3	0.5	1.1	0.6	0.7
Economic Regeneration	6.7	15.9	6.3	2.1	2.2	0.2
Housing Strategy & Services	0.1	0.5	0.5	0.4	0.5	0.5
Social Care Infrastructure	0	5.0	12.5	7.8	0.2	0.3
Emergency & Unplanned Schemes	1.7	0.2	0.2	0.2	0.2	0.2
Total	**50.6**	**86.3**	**85.9**	**85.9**	**53.1**	**21.5**

3.2 Capital Financing Assumptions

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 financing need.

Capital Expenditure £m	Estimate					
	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Capital Expenditure – per plan	50.6	86.3	85.9	85.9	53.1	21.5
Other Relevant Expenditure	-	-	-	-	-	-
Total Expenditure	**50.6**	**86.3**	**85.9**	**85.9**	**53.1**	**21.5**
Financed by:						
Capital receipts	3.3	2.4	0.3	0.4	-	-
CFCR	0.8	-	-	-	-	-
Developer Contributions	0.2	0.2	0.1	0.1	0.1	0.2
Govt. General Capital Grants	16.8	11.1	15.4	15.4	15.4	15.4
Govt. Specific Capital Grants	8.2	21.1	15.9	8.3	0.8	0.7
Other Grants & Contributions	8.9	13.0	16.5	2.5	1.9	-
Plant & Vehicle / Infrastructure Fund	2.0	2.0	2.0	2.0	2.0	2.0
Synthetic Pitch Replacement Fund	-	0.4	0.1	0.3	0.3	0.4
Element of Net financing need for the year met by borrowing	**10.4**	**36.1**	**35.6**	**56.9**	**32.6**	**2.8**

3.3 The Council's Borrowing Need (the Capital Financing Requirement – Prudential Indicator PI-2)

a) 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 indebtedness and so its underlying borrowing need. Any capital expenditure identified above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing.

b) The CFR includes any other long term liabilities (e.g. PPP schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council has £67.3m of liabilities relating to such schemes within the 2019/20 long term liabilities figure. The CFR increases by a further £34.0m in 2020/21 as a result of the Jedburgh campus.

c) The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £m	Actual	Estimate					
	18/19	19/20	20/21	21/22	22/23	23/24	24/25
Total CFR (PI-2) *	**315.2**	**314.9**	**374.6**	**398.9**	**444.8**	**466.3**	**452.2**
Movement in CFR represented by:							
Net financing need for the year (above)		**10.3**	**70.2**	**35.4**	**56.9**	**32.6**	**(2.8)**
Less scheduled debt amortisation and other financing movements		(10.6)	(10.5)	(11.1)	(11.0)	(11.1)	(11.3)
Movement in CFR		**(0.3)**	**59.7**	**24.3**	**45.9**	**21.5**	**(14.1)**

* *The CFR for this calculation includes capital expenditure to 31 March of each financial year.*

The figures for 2020/21 include £34m for Jedburgh Campus which is funded via PPP scheme and not capital borrowing requirement.

d) A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 3.1, 3.2 and 3.3, and the details above, demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

3.4 Statutory Repayment of Loans Fund Advances

a) 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.

b) A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

For loans fund advances made before 1 April 2007, the policy will be to maintain the practice of previous years and apply the **Statutory Method (option 1)**, with all loans fund advances being repaid in equal instalments of principal/ by the annuity method

For loans fund advances made after 1 April 2007, the policy for the repayment of loans advances will be the:-

1. **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method (option 3);

The annuity rate applied to the loans fund repayments was based on historic interest rates and is currently 4.07%. 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.

4 Treasury Management Strategy

The capital expenditure plans set out in Section 3 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 relevant professional Codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

a) The overall treasury management portfolio as at 31 March 2019 and for the position as at 31 December 2019 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual **31.3.19** £000	actual **31.3.19** %	current **31.12.19** £000	current **31.12.19** %
Treasury investments				
banks	3,295	62%	6,365	23%
DMADF (H.M.Treasury)	2,000	38%	0	0%
money market funds	0	0%	21,625	77%
Total managed in house	**5,295**	**100%**	**27,990**	**100%**
Total managed externally	**0**	**0%**	**0**	**0%**
Total treasury investments	**5,295**	**100%**	**27,990**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
third party loans	600	0%	600	0%
PWLB	159,631	82%	167,131	83%
LOBOs	35,000	18%	35,000	17%
Total external borrowing	**195,231**	**100%**	**202,731**	**100%**
Net treasury investments / (borrowing)	**(189,936)**	**0**	**(174,741)**	**0**

b) The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing position, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

as at 31 March £m	**Estimate**				
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**
Borrowing	202.7	224.9	251.1	291.9	313.9
Other Long Term Liabilities	67.3	97.8	93.6	89.6	85.5
Total Gross Borrowing (Prudential Indicator PI-5)	**270.0**	**322.7**	**344.7**	**381.5**	**399.4**
Capital Financing Requirement*	**398.9**	**444.8**	**466.3**	**452.2**	**462.1**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(128.9)**	**(122.1)**	**(121.6)**	**(70.7)**	**(62.7)**

** The CFR for this calculation includes the current and two future years projected capital expenditure see 3.3c)*

c) Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-6) is that the Council needs to ensure that its gross debt figure (shown above) 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 2020/21 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 or speculative purposes.

d) The Council has complied with this prudential indicator in the current year and no difficulties are currently envisaged for the long term future. This view takes into account current commitments, existing plans, and the proposals in the Financial Plans for 2020/21.

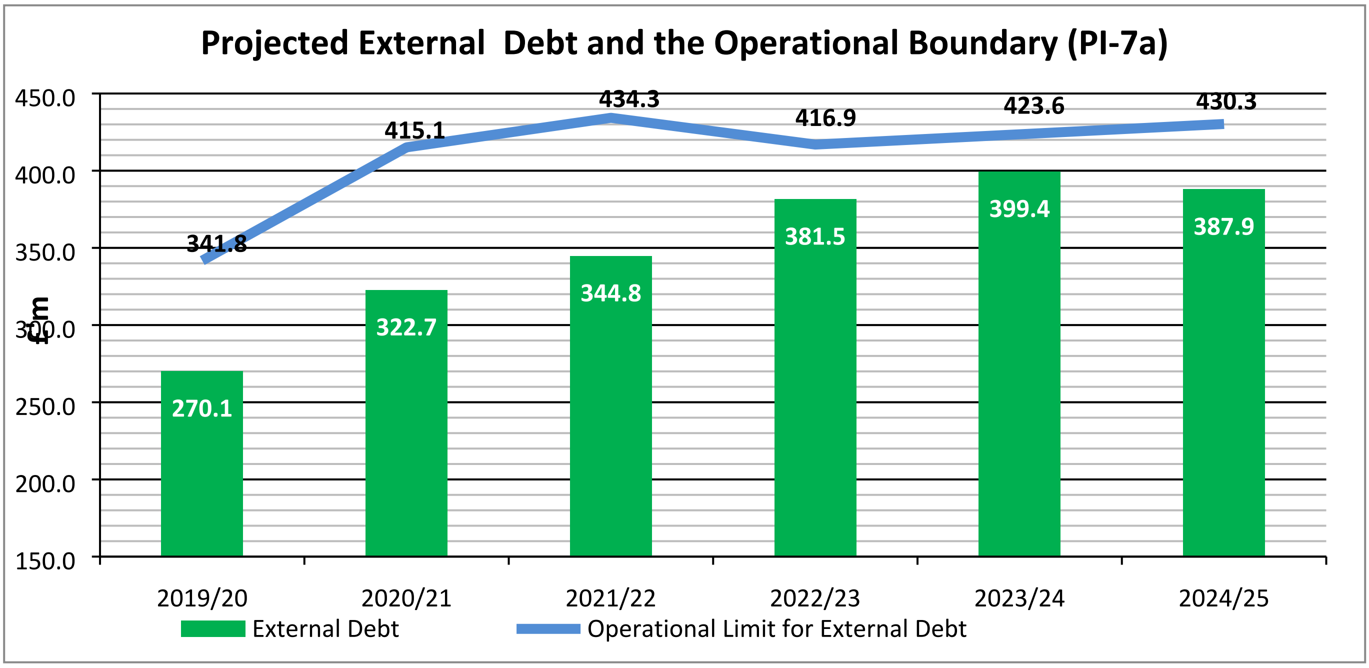
4.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary (Prudential Indicator PI-7)

a) This is the limit which external borrowing 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 the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	Estimate					
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Total Operational Boundary (PI-7a)	**341.7**	**415.1**	**434.3**	**416.9**	**423.6**	**430.3**
Less: Other long term liabilities	(67.3)	(97.8)	(93.6)	(89.6)	(85.5)	(81.4)
Operational Boundary exc. Other Long Term Liabilities (PI-7b)	**274.4**	**317.3**	**340.7**	**327.3**	**338.1**	**348.9**

b) The following chart shows how the current and projected Operational Borrowing limit compare with the anticipated levels of actual debt.



The Authorised Limit for External Debt (Prudential Indicator PI-8)

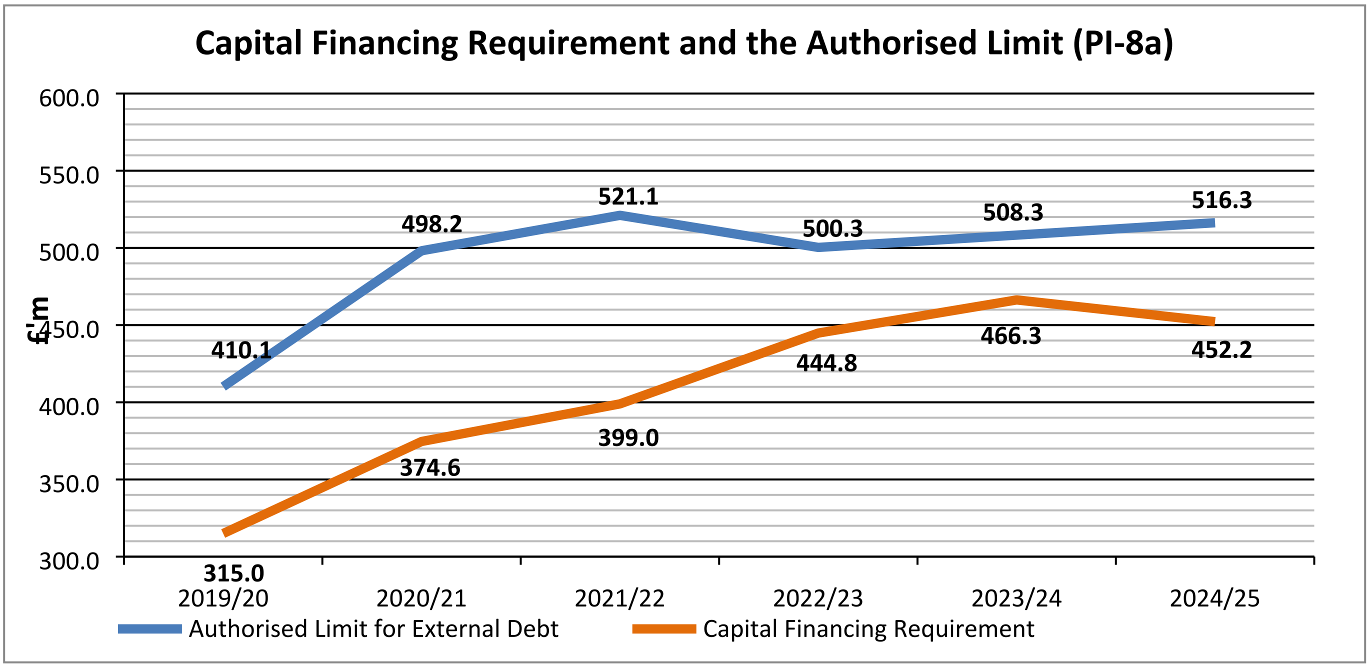
c) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could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

d) 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.

e) The Council is asked to approve the following authorised limit:

Authorised Limit £m	Estimate					
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Total Authorised Limit (PI-8a)	**410.1**	**498.1**	**521.1**	**500.3**	**508.3**	**516.3**
Less: Other long term liabilities	(67.3)	(97.7)	(93.6)	(89.6)	(85.5)	(81.4)
Authorised Limit exc. Other Long-Term Liabilities (PI-8b)	**342.8**	**400.4**	**427.5**	**410.7**	**422.8**	**434.9**

f) The chart on the below shows how the current and projected Capital Financing Requirement compares the Authorised Limit for External Debt



4.3 Prospects for Interest Rates

a) The Council has appointed Link 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 our central view.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

b) The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

c) It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

d) There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

e) During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. *(See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.)* There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

f) One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

g) Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

h) The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

i) In addition, PWLB rates are subject to ad hoc decisions by **H.M. Treasury** to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

j) Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. 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.

k) Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings;

- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.

l) **Annex C** contains a more comprehensive Economic Background narrative from Link Asset Services.

4.4 Borrowing Strategy

a) 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 still an issue to be considered.

b) Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Chief Financial Officer 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 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.

c) Any decisions will be reported to Members at the next available opportunity.

4.5 Policy on borrowing in advance of need

a) Borrowing in advance of need is defined as any borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the capital financing requirement (CFR) of the local authority for the following twelve month period. This twelve month period is on a rolling twelve month basis.

b) The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

c) 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.

d) The Chief Financial Officer has the authority to borrow in advance of need under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. The Chief Financial Officer will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:

- the benefits of borrowing in advance,
- the risks created by additional levels of borrowing and investment, and
- how far in advance it is reasonable to borrow considering the risks identified

e) Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

4.6 Debt Rescheduling

a) Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

b) All rescheduling will be reported to the **Executive** at the earliest meeting following its action.

5 Investment Strategy

5.1 Investment Objectives and Policy

a) The Council's investment policy implements the requirements of the Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010), and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017, ("the CIPFA TM Code").

b) The Council's primary investment objectives are as follows, in order of importance:
   (i) The safeguarding or **security** of the re-payment of principal and interest of investments on a timely basis;
   (ii) The **liquidity** of its investments;
   (iii) The **returns on investments** that can be realised.

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

c) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

d) Other information: 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 achieve this consideration 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.

e) 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.

f) This authority has defined the list of types of investment instruments that are permitted investments authorised for use in appendix D. Appendix F expands on the risks involved in each type of investment and the mitigating controls.

g) All investments will be denominated in **sterling.**

h) As a result of the change in accounting standards for 2019/20 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (This area is currently under review by LASAAC and the Scottish Government. Members will be updated when there is further news.)

i) This authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 5.6). Regular monitoring of investment performance will be carried out during the year.

j) The above criteria are unchanged from last year.

5.2 Council Permitted Investments

The proposed criteria for permitted investments are shown in annex D approval.

5.3 Creditworthiness Policy

a) This Council applies the creditworthiness service provided by Link 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
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

b) 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:

Creditworthiness Colour Banding	Maximum Investment Duration
Yellow	5 years
Dark pink	5 years for Ultra short dated bond funds with a credit score of 1.25
Light pink	5 years for Ultra short dated bond funds 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 (ie don't invest)

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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

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

e) All credit ratings will be monitored on a real time basis. The Council is alerted to changes to ratings of all three agencies through its use of a creditworthiness service provided by Link Asset Services.

- 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 Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

f) 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 sovereign support for banks and the credit ratings of that supporting government.

g) The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

h) Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

i) While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

5.4 Country and Sector Considerations

a) Due care will be taken to consider the country and sector exposure of the Council’s investments.

Country Limits

b) If the institution is non-UK, then the country in which it is domiciled must have a minimum Sovereign long term rating of AAA.

c) No more than **10%** will be placed with any non-UK country at any time.

Institutional Sector Limits

d) These institutions must either be UK Local Authorities or UK Incorporated Institutions, UK Banks and Building Societies incorporated in the European Economic Area entitled to accept deposits through a branch in the UK. The Council may also use the UK Government including in the form of gilts and the Debt Management Account Deposit Facility (DMADF).

e) Limits will be applied to the overall amount lent out to any one sector at any one time in order to limit sector specific exposure risk, as follows:

UK Building Societies	**£25 m**
Banks	**£35 m**
UK Local Authorities	**£40 m**
UK Government Debt Management Office	**£unlimited**
UK Gilts and Treasury Bills	**£20 m**
Institutions covered by Government Guarantee	**£10 m**
Part Nationalised Banks	**£35 m**
Money Market Funds (AAA)	**£25 m**

These limits will be monitored regularly for appropriateness.

Group Limits

g) Limits will be applied to the overall amount lent out to institutions within the same group at any one time in order to limit group specific exposure risk, as follows, and subject to the parent company appearing on Link Asset Services’ creditworthiness list:

Group of Banks **£10m**

Council's Own Banker

h) The Council's own banker (currently Bank of Scotland, in the process of transferring to Royal Bank of Scotland) will be maintained on the Council's counterparty list in situations where rating changes may mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities and overnight and short-term investment facilities. However, in the event that the rating does change below the criteria, officers will review the situation carefully and identify any appropriate action required to manage the risk that this change creates for the Council.

5.5 Individual Institution Monetary Limits

a) The monetary limits for institutions on the Council's Counterparty List are as follows:

	Money Limit
UK Building Societies	£5m
Banks	£5m
UK Local Authorities (i)	£40m
UK Government Debt Management Office	Unlimited
UK Gilts & Treasury Bills	£20m
Government Guaranteed Institutions	£2m
AAA rated Money Market Funds	£5m
Council's Own Banker (ii)	£5m

(i) No individual limit will be applied on lending to a UK local authority, other than it must not exceed the relevant sector limit of £40m.

(ii) Further to Sections 5.4 and 5.5, in the event that the rating of the Council's own banker falls below the criteria, the time limit on money deposited with the bank will be reduced to an overnight basis.

b) As mentioned earlier, the treasury function manages the funds of the Council, any subsidiary organisations, the Pension Fund and the Common Good and Trust Funds. When applying the limits set out in the table above, these limits will apply to the cumulative investment with an institution from the Council, the Pension Fund and the Common Good Funds and Trust Funds.

5.6 Types of Investments

a) For institutions on the approved counterparty list, investments will be restricted to safer instruments (such as deposits). Currently this involves the use of money market funds, the DMADF and institutions with higher credit ratings than the minimum permissible rating outlined in the investment strategy, as well as the Council's own bank.

b) Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:

- ICAP Securities Limited
- Sterling International Brokers Limited

- Tradition (UK) Limited

5.7 Investment Strategy and bank rate projections

In-house funds

a) 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

b) On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

Q1 2021	0.75%
Q1 2022	1.00%
Q1 2023	1.25%

c) The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows

2019/2020	0.75%
2020/2021	0.75%
2021/2022	1.00%
2022/2023	1.25%
2023/2024	1.50%
2024/2025	1.75%
Later years	2.25%

d) The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the remaining uncertainties over Brexit and its impact, as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are broadly similarly to the downside. The final impact of the Brexit the final deal with the EU and its impact is still unclear, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

Investment Treasury Indicator and Limit (Treasury Indicator TI-5)

e) Total principal funds invested for greater than 365 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 for longer than 365 days (TI-5)					
£m	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Principal sums invested for longer than 365 days	20%	20%	20%	20%	20%

f) For positive cash balances and in order to maintain liquidity, the Council will seek to use overnight investment accounts, short term (< 1 month) notice accounts, money market funds and short-dated deposits (overnight to three months).

5.8 Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

a) Security

The Council's **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

0.04% historic risk of default when compared to the whole portfolio.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £250,000
- Liquid short term deposits of at least £1,500,000 available with a week's notice.
- Weighted Average Life benchmark is **expected to be 0.5 years** (equivalent to an weighted average life of 6 months), with a **maximum of 1.00 years**

c) Yield

Local measures of yield benchmarks are:

Investments – **Internal returns above the 7 day LIBID rate**

d) At the end of the financial year, the Chief Financial Officer will report on its investment activity as part of the Annual Treasury Report.

6 Performance Indicators

6.1 The CIPFA Code requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

6.2 Debt Performance Indicators

(i) Average "Pool Rate" charged by the Loans Fund compared to Scottish Local Authority average Pool Rate.

Target is to be at or below the Scottish Average for 2019/20.

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2019/20.

6.3 **Investment Risk Benchmark Indicators** for Security, Liquidity and Yield, as set out in paragraph 5.8.

6.4 Loan Charges

a) Loan Charges for 2020/21 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in March 2020, which are estimated as follows:

£m	2020/21	2021/22	2022/23	2023/24	2024/25
Interest on Borrowing	11.7	11.2	12.0	13.8	13.9
Investment income	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)
Capital Repayments	7.6	8.4	8.9	9.4	9.7
Total Loan Charges *	**19.1**	**19.4**	**20.7**	**23.0**	**23.7**

**The Loan Charges exclude the capital element of PPP repayments.*

b) The above budget excludes the revenue impact of funding the cost of the NHT and the lending to RSLs and lending in respect of the Council-led house building programme with the Scottish Futures Trust, as these are assumed to be revenue neutral overall.

6.5 The indicators, based on actual performance for the year, will be included in the Treasury Management Annual Report for 2020/21.

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Ref.	Indicator	Page Ref.	2019/20	2020/21	2021/22	2022/23	2023/24
PRUDENTIAL INDICATORS							
Capital Expenditure Indicator							
PI-1	Capital Expenditure Limits (£m)	6	50.6	86.3	85.9	85.9	53.1
PI-2	Capital Financing Requirement (CFR) (£m)	8	314.9	374.6	398.9	444.8	466.3
Affordability Indicator							
PI-3	Ratio of Financing Costs to Net Revenue (inc. PPP repayment costs)	24	9.6%	8.9%	9.0%	9.4%	10.0%
PI-4	Incremental Saving/(Cost) Impact of Capital Investment Decisions on Council Tax	24	£(0.01)	£(0.03)	£(0.03)	£(0.01)	£0.00
External Debt Indicators							
PI-5	Actual Debt (£m)	9	270.0	322.7	344.7	381.5	399.4
PI-7a	Operational Boundary (inc. Other Long Term Liabilities) (£m)	10	341.7	415.1	434.3	416.9	423.6
PI-7b	Operational Boundary (exc. Other Long Term Liabilities) (£m)	10	274.4	317.3	340.7	327.3	338.0
PI-8a	Authorised Limit (inc. Other Long Term Liabilities) (£m)	11	410.1	498.1	521.1	500.3	508.3
PI-8b	Authorised Limit (exc. Other Long Term Liabilities) (£m)	11	342.8	400.4	427.5	410.7	422.8
Indicators of Prudence							
PI-6	(Under)/Over Gross Borrowing against the CFR (£m)	9	(128.9)	(122.1)	(121.6)	(70.7)	(62.7)
TREASURY INDICATORS							
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt (£m)	25	341.8	415.1	434.3	416.9	423.6
TI-2	Upper Limit to Variable Interest Rates based on Net Debt (£m)	25	119.6	145.3	152.0	145.9	148.3
TI-3	Maturity Structure of Fixed Interest Rate Borrowing 2019/20	25	**Lower**		**Upper**		
	Under 12 months		0%		20%		
	12 months to 2 years		0%		20%		
	2 years to 5 years		0%		20%		
	5 years to 10 years		0%		20%		
	10 years and above		20%		100%		
TI-5	Maximum Principal Sum invested greater than 365 days	20	20%	20%	20%	20%	20%

Further 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 updated indicators are as follows:

Ratio of financing costs to net revenue stream (Prudential Indicator PI-3)

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.

%	Actual	Estimate				
	18/19	19/20	20/21	21/22	22/23	23/24
Ratio of Financing Costs to Net Revenue Stream (PI-3) *(inc. PPP repayment costs)*	9.3%	9.6%	8.9%	9.0%	9.4%	10.0

The estimates of financing costs include current commitments and the proposals in the Financial Plans for 2020/21. The movements in the above ratio from 2019/20 onwards reflect a real-time reduction in overall financial resources available to the Council.

Incremental impact of capital investment decisions on council tax (Prudential Indicator PI-4)

This indicator identifies the revenue costs associated with the operational three year capital programme detailed 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.

£	Estimate				
	2020/21	2021/22	2022/23	2023/24	2024/25
Incremental Saving/(Cost) Impact of Capital Investment Decisions on the Band D Council Tax (PI-4)	(£0.03)	(£0.03)	(£0.01)	(£0.01)	£0.00

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:

(i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)

This identifies a maximum limit for borrowing exposure to fixed interest rates, based on the debt position net of investments.

(ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)

This identifies a maximum limit for borrowing exposure to variable interest rates based upon the debt position net of investments.

(iii) Maturity structure of borrowing (Treasury Indicator TI-3)

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.

(iv) The following table highlights the proposed treasury indicators and limits:

£m	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
Interest rate exposures					
	Upper	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt (TI-1)	341.7	415.1	434.3	416.9	423.6
Limits on variable interest rates based on net debt (TI-2)	119.6	145.3	152.0	145.9	148.3
Maturity Structure of fixed interest rate borrowing 2019/20 (TI-3)					
		Lower		**Upper**	
Under 12 months		0%		20%	
12 months to 2 years		0%		20%	
2 years to 5 years		0%		20%	
5 years to 10 years		0%		20%	
10 years and above		20%		100%	

ANNEX B: INTEREST RATE FORECASTS 2020-23

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

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00
Bank Rate													
Link Asset Services	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	2.40%	2.50%	2.50%	2.60%	2.60%	2.80%	2.80%	2.90%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	3.10%	3.10%	3.20%	3.20%	3.20%	3.30%	3.30%	3.40%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	-	-	-	-	-

Source: Link Asset Services, January 2020

ANNEX C
Economic Background

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report,** (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%.. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.
However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. **Growth** has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by ‘growth friendly’ fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates**.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Annex D

TREASURY MANAGEMENT PRACTICE: PERMITTED INVESTMENTS, ASSOCIATED CONTROLS AND LIMITS

This Council approves the following forms of investment instrument for use as permitted investments

Treasury risks

All the investment instruments are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the 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 the highest, relative, level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. 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.

3. **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.

4. **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 except for the following forms of instrument which are at variable rate of interest

5. **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.

Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 5.3 and 5.4.

2. **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.

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

4. **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.

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. All types of investment instruments

Unlimited investments

Regulation 24 states that an investment can be shown as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category. The authority has given the following types of investment an unlimited category: -

1. **Debt Management Agency Deposit Facility.** 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 sovereign 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.

Annex E
SCHEME OF DELEGATION

(i) Full board/council

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

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 95 OFFICER

The S95 (responsible) officer

- Take and/or authorise all operational decisions regarding the Council's investments and borrowing, in accordance with approved Treasury Management Policy and Strategy.
- Responsible for execution and administration of treasury management decisions in accordance with the Council's Treasury Management policy statement and Treasury Management Practice, and if (s)he is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- In terms of Treasury Management, from time to time, formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and construct a lending list defining appropriate limits.
- Borrow, in advance of need, where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Adopt a cautious approach to any such borrowing, and a business case to support the decision-making process must consider:
  - the benefits of borrowing in advance,
  - the investment risks created by the existence of investments at the same time as additional borrowing being outstanding; and
  - how far in advance it is reasonable to borrow, considering the risks identified. Any such advance borrowing shall be reported through the mid-year or annual Treasury Management reporting mechanism.
- Take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast contained in the Treasury Management Strategy.
- Maintain a counterparty list consistent with the Investment Counterparty Selection Criteria and revise the criteria and submit them to Committee for approval as necessary, and in addition, set out the types of investment to be made (Permitted Investments).

Annex F

Credit and Counterparty Risk Management

Permitted Investments, Associated Controls and Limits for Scottish Borders Council, Common Good and Trust Funds and In-house Managed Pension Fund

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
Cash type instruments					
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	£40m, maximum 1 year.	£5m, maximum 1 year.	£40m, maximum 1 year.
c. Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has a "AAA" rated status from either Fitch, Moody's or Standard and Poor's.	£5m per fund/£25m overall	£5m per fund/£25m overall	£5m per fund/£25m overall

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
d. Ultra short dated bond funds **(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 have a "AAA" rated status from either Fitch, Moody's or Standard and Poor's.	N/A	N/A	N/A
e. 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 Poor'sDay to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
f. 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 Poor's. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	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 & Trust Fund Limits	Pension Fund In-House Limits
g. 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.	£20m, maximum 1 year.	£5m, maximum 1 year	£20m, maximum 1 year.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
Other types of investments					
a. 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.	£30m	£25m	N/A
b. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25m	£1m	N/A
c. Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25M	N/A	N/A
d. National Housing Trust **(Very Low Risk due to Scottish Government Underwriting)**	These are loans to a Special Purpose Vehicle to allow it to purchase new homes under the NHT umbrella. These loans represent either 65% or 70% of the purchase price, the remainder being funded by the developer. The loan is redeemed after a 5 to	Loan redemption arises when the homes are sold. Interest payments are made to the Council by the SPV from rental payments in the intervening period. Both the loan amount and associated interest payments are underwritten by Scottish Government.	£8m	N/A	N/A

	10 year period when the properties are sold.				
e. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	£1m	N/A	N/A
f. Investment in the Subordinated Debt of projects delivered via the 'HubCo' model **(Very Low Risk)**	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term. These projects are based on robust business cases with a cashflow from public sector organisations (i.e. low credit risk)	£600,000	N/A	N/A

The Monitoring of Investment Counterparties

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

Use of External Fund Managers

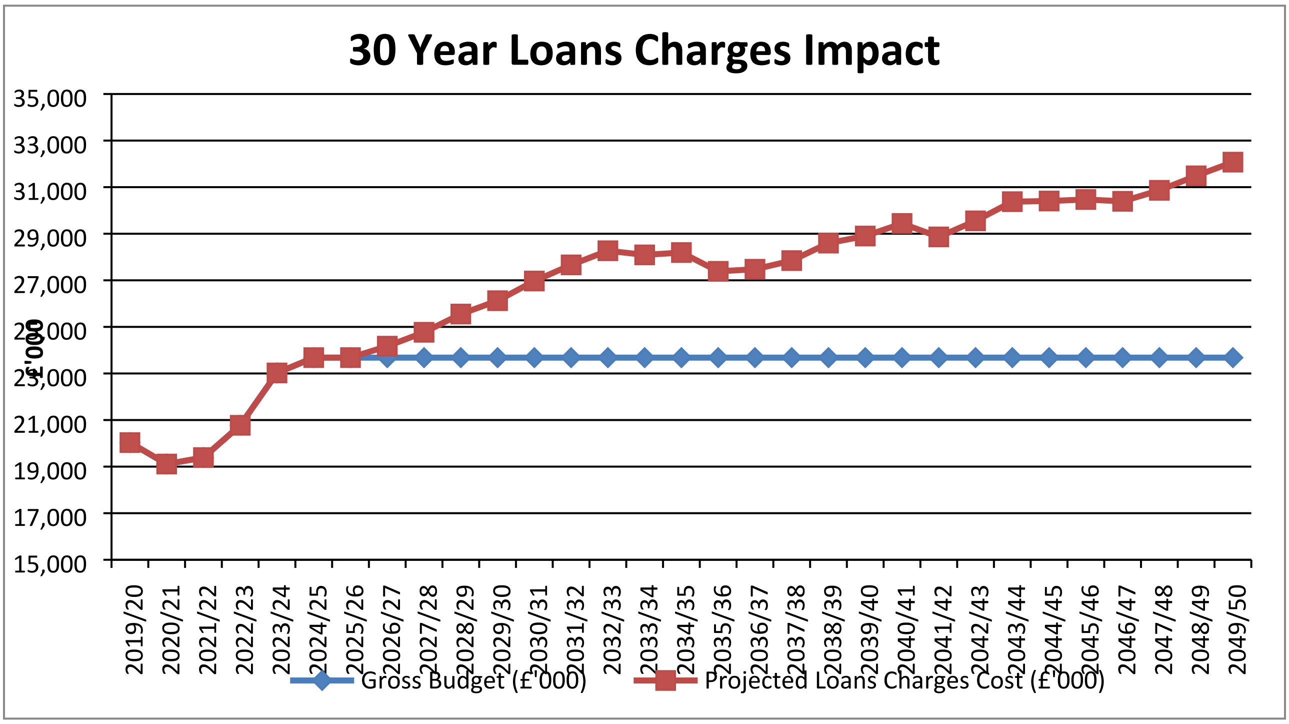
It is the Council's policy to use external fund managers to manage the investment portfolios of the Scottish Borders Council Pension Fund and the pooled investment fund of the Common Good and Trust Funds. This Annex reflects the approved policies around the Common Good and Trust Fund Investment Strategy but specifically excludes, as allowed by regulations, the work undertaken by External Fund Managers in relation to the Scottish Borders Council Pension Fund.

ANNEX G

Long Term (30 Yr) Loans Charges Analysis

Current capital and revenue plans have been extrapolated over a 30 year period in order to assess the impact on the revenue Loans Charges budget. In line with assumptions made when assessing external debt and associated limits as described in paragraph 4.5 of the covering report, long term capital planning will cause a pressure on the loans charges budget from financial year 2025/26, as detailed in the chart below. Movements in notional loans charges associated with internal borrowing also impact on these figures.

It should be noted that from 2030-31, the first year outwith the current 10 year Capital Plan, a 5 year average capital expenditure and borrowing requirement has been assumed.



ANNEX H

Credit Ratings

Long and Short Term Credit Ratings

Audit Commission Grading#	**Fitch**		**Moody's**		**Standard and Poor's**	
	Long Term	**Short Term**	**Long Term**	**Short Term**	**Long Term**	**Short Term**
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+ AA AA-	F1+ F1+ F1+	Aa1 Aa2 Aa3	P-1 P-1 P-1	AA+ AA AA-	A-1+ A-1+ A-1+
Strong grade But susceptible to adverse conditions	A+ A A-	F1+ / F1 F1 F1	A1 A2 A3	P-1 P-1 / P-2 P-1 / P-2	A+ A A	A-1+ / A-1 A-1 A-1 / A-2
Adequate Grade	BBB+ BBB BBB-	F2 F2 / F3 F3	Baa1 Baa2 Baa3	P-2 P-2 / P-3 P-3	BBB+ BBB BBB-	A-2 A-2 / A-3 A-2
Speculative Grade	BB+ BB BB-	B B B	Ba1 Ba2 Ba3	NP * NP NP	BB+ BB BB-	B-1 B-2 B-3
Very Speculative Grade	B+ B B-	B B B	Ba1 Ba2 Ba3	NP NP NP	B+ B B-	- - -
Vulnerable Grade	CCC CCC CCC CC C	C C C C C	Caa1 Caa2 Caa3 - Ca	NP NP NP NP NP	CCC+ CCC CCC- CC C	C C C C C
Defaulting Grade	D	D	C	NP	D	D

for the purpose of standardisation based on Standard and Poor's credit rating definitions.
* NP – Not Prime

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard & Poor's

Benchmarking and Monitoring Security, Liquidity and Yield

The consideration and approval of security and liquidity benchmarks are also part of Member reporting. These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons, in the annual treasury report.

Yield
These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – **Internal returns above the 7 day LIBID rate**

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. Benchmarks for the cash type investments are below. In the other investment categories, appropriate benchmarks will be used where available.

Liquidity
This is defined as an organisation "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of liquidity, the Council seeks to maintain:

- Bank overdraft - £250,000
- Liquid short term deposits of at least £1,500,000 available with a week's notice.

The availability of liquidity in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect, the proposed benchmark to be used is:

- **WAL benchmark is expected to be 0.5 years, with a maximum of 1.00 years**.

Security of the investments
In the context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of the Creditworthiness service provided by Capita Asset Services. Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.04% historic risk of default when compared to the whole portfolio.**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Annual Treasury Management Report. As this data is collated, trends and analysis will be collected and reported.

GLOSSARY OF TERMS

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
Gilts	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
LIBID	London Interbank Bid Rate The rate at which banks bid on Eurocurrency Deposits, being the rate at which a bank is willing to borrow from other banks.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
Treasury Indicators	These consist of a number of Treasury Management Indicators that local authorities are expected to ‘have regard’ to, to demonstrate compliance with the Treasury Management Code of Practice.

You can get this document on tape, in Braille, large print and various computer formats by contacting the address below.

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