Appendix 1

Prudential Indicators 2013/14 to 2016/17

1. The Capital Expenditure Plans

1.1 The Council's gross capital expenditure plans are summarised below in Table A and this forms the first of the prudential indicators. Total expenditure is partially funded by resources such as capital receipts, capital grants, etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

1.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be funded from the Council's own resources.

1.3 There are two main limiting factors which may impact on the Council's ability to undertake unsupported capital expenditure:

- Whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing costs and running costs; and

- The Government may use a control to limit either the total of all councils' plans nationally, or in the event of an assessment by central government that local plans are unaffordable at a specific council, it may implement a local control. No such control has been implemented since the inception of the prudential code, however, HM Treasury keep this under review.

1.4 The summary of capital expenditure as per the capital plan refresh reported to Council on 6 February 2014 for General Services and HRA is shown in the table below:

Table A

£000	**2013/14 Revised**	**2014/15 Estimated**	**2015/16 Estimated**	**2016/17 Estimated**
General Services	**31,656**	**34,099**	**69,164**	**37,375**
Financed by:				
Capital receipts	162	2,680	3,200	5,125
Capital grants	12,224	9,653	10,333	7,598
Revenue	2,501	1,094	242	242
Net financing need for the year	**16,769**	**20,672**	**55,389**	**24,410**

£000	**2013/14 Revised**	**2014/15 Estimated**	**2015/16 Estimated**	**2016/17 Estimated**
HRA	**36,361**	**35,966**	**27,024**	**17,711**
Financed by:				
Capital receipts	1,037	950	500	452
Capital grants	4,123	1,850	0	0
Revenue	2,031	1,969	0	0
Net financing need for the year	**29,170**	**31,197**	**26,524**	**17,259**

£000	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
General Services	31,656	34,099	69,164	37,375
HRA	36,361	35,966	27,024	17,711
Capital Expenditure	**68,017**	**70,065**	**96,188**	**55,086**
Financed by:				
Capital receipts	1,199	3,630	3,700	5,577
Capital grants	16,347	11,503	10,333	7,598
Revenue	4,532	3,063	242	242
Net financing need for the year	**45,939**	**51,869**	**81,913**	**41,669**

2. The Council's Borrowing Need (the Capital Financing Requirement)

2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. The net capital financing need (as indicated in Table A) impacts directly on the CFR.

2.2 Following accounting changes the CFR includes any other long term liabilities (i.e. PPP schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £91.442m of such schemes within the CFR.

2.3 The CFR projections for both General Services and HRA are shown in table B:

Table B

£000	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
Capital Financing Requirement				
CFR – General Services	217,773	236,793	285,970	304,033
CFR – HRA	135,950	156,761	177,572	188,454
Total CFR	**353,723**	**393,554**	**463,542**	**492,487**
Movement in CFR	28,352	39,831	69,988	28,945

Movement in CFR represented by				
Net financing need for the year (above)	45,939	51,869	81,913	41,669
Less scheduled debt amortisation and other financing movements	(17,587)	(12,038)	(11,925)	(12,724)
Movement in CFR	**28,352**	**39,831**	**69,988**	**28,945**

2.4 The CFR for both General Services and HRA is projected to increase from 2014/15 onwards.

2.5 The expected impact of the capital expenditure decisions above on the Council's debt and investment position are shown in the treasury strategy (Appendix 2).

3. Affordability Prudential Indicators

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

3.1.1 Actual and Estimates of the ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (loan charges) against the net revenue stream (funding sources e.g. AEF and council tax). The estimates of financing costs include current commitments and the impact of capital expenditure as per Table A.

Table C

	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
General Services	6.73%	4.55%	5.03%	5.69%
HRA	36.36%	36.16%	35.00%	36.60%

3.1.2 Estimates of the incremental impact of capital investment decisions on the Council Tax

This indicator identifies the trend in the cost of approved capital expenditure compared to the current expenditure levels. The assumptions are based on the 10 year capital plan, but will invariably include some elements which are estimated over the three year period.

Table D

	Proposed Budget 2014/15	Forward Projection 2015/16	Forward Projection 2016/17
Council Tax - Band D	£12.20	£26.58	£8.85

3.1.3 Estimates of the incremental impact of capital investment decisions on Housing

This indicator identifies the trend in the cost of approved capital expenditure compared to the current expenditure levels, expressed as a discrete impact on weekly rent levels.

Table E

	Proposed Budget 2014/15	Forward Projection 2015/16	Forward Projection 2016/17
Weekly Housing Rent levels	£2.66	£2.26	£1.47

Appendix 2

Treasury Management Strategy 2014/15 – 2016/17

1. Background

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Appendix 1 consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy which need approval.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2011). This Council adopted the revised Code of Practice on Treasury Management on 28 March 2012.

1.3 As a requirement of the Code the Council adopted revised Treasury Management Policy Statement and four Treasury Management clauses on 28 March 2012. These form part of the Council's financial regulations and are also a requirement of one of the prudential indicators.

1.4 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. Further reports are issued as follows:

- Mid year monitoring report on actual activity during the year including revised indicators where appropriate; and
- Year-end report on actual activity for the previous year.

1.5 This strategy covers:

- The Council's debt and investment projections;
- Limits to the Council's borrowing activity;
- The economic climate and expected movement in interest rates;
- The Council's borrowing, debt and investment strategies;
- Treasury performance indicators; and
- Specific limits on treasury activities.

2. The Council's debt and investment projections

2.1 The Council's treasury portfolio position at 31 March 2013, with forward projections are summarised below. Table F shows the gross debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any under or over borrowing.

Table F

£000	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
External Debt				
Debt at 1 April	220,308	243,866	284,989	356,504
Maturing Debt	(31,894)	(27,413)	(8,032)	(7,144)
New Borrowing : Maturing Debt	25,900	27,397	8,025	7,144
New Borrowing : CFR	29,552	41,139	71,521	30,652
Debt at 31 March	**243,866**	**284,989**	**356,504**	**387,156**
Long Term Liabilities at 1 April	91,442	90,242	88,934	87,401
Change in Long Term Liabilities	(1,200)	(1,308)	(1,533)	(1,707)
LTL at 31 March	**90,242**	**88,934**	**87,401**	**85,694**
Gross Debt at 31 March	**334,108**	**373,923**	**443,905**	**472,850**
CFR	**353,723**	**393,554**	**463,542**	**492,487**
Under/(Over) Borrowing	**19,615**	**19,631**	**19,637**	**19,637**

2.2 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. This is illustrated by comparing the estimated gross debt as at 31 March 2014 with the CFR as at 31 March 2017.

2.3 **The Section 95 Officer (Head of Finance & Resources) reports that the Council has complied with this prudential indicator, and no difficulties are envisaged for the current or future years.** This view takes into account current commitments, existing plans, and the approved 10 year capital plan.

3. Limits to Borrowing Activity

3.1 The Operational Boundary is detailed in Table G below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table G

£000	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
External Debt	367,519	411,316	488,295	520,134

3.2 The Authorised Limit for External Borrowing – a further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is not allowed to exceed. This needs to be set or revised by Members. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. 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. The Council is asked to approve the authorised limit detailed in Table H below:

Table H

£000	2013/14 Revised	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated
External Debt	400,930	448,708	532,685	567,419

3.3 **Advance Borrowing -** This Council will not borrow more than or earlier than required purely in order to profit from the investment return of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

3.3.1 Advance borrowing will only be taken for risk management purposes subject to sound justification. The Section 95 Officer (Head of Finance & Resources) may do this 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. A cautious approach to any such borrowing will be adopted, however where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

3.3.2 Full consideration will be given to balancing investment risks, such as the credit and interest risk resulting from the temporary investment of the sums, against the risk of adverse interest rate movements in addition to the existing debt maturity profile over the medium term.

3.3.3 As required by The Investment Regulations (Code on the Investments of Money by Scottish Local Authorities) which came into force on 1 April 2010 the Council will appraise all risks associated with advance borrowing activity. The Council will fully document the justification for the decision prior to the activity being undertaken, with subsequent reporting either within the mid year or annual reporting mechanism.

4. Prospect for Interest Rates

4.1 The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Table I gives the Sector central view.

Table I

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

4.2 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

4.3 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;

- Borrowing interest rates have risen during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

5. Borrowing and Debt Strategy 2014/15 – 2016/17

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

5.2 Against this background and the risk within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Section 95 Officer (Head of Finance & Resources) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

5.3 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 borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

5.4 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 a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

5.5 The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

5.6 Any decisions will be reported to Members via the Members Bulletin at the next available opportunity.

6. Investment Strategy

6.1 The Council's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular). The Council has also adopted both the 2011 revised Treasury Management Code of Practice and the 2013 revised Prudential Code. The day to day investment policies and practices are contained in the Council's Treasury Management Practices, which reflect the requirements of these codes. These practices are regularly reviewed.

6.2 **Key Objectives** – Following the economic background above, the current investment climate has one over-riding risk consideration - counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy. The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.2.1 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, outlooks and watches published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency.

Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

6.2.2 Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of creditworthiness.

6.2.3 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.

6.2.4 The aim of the strategy is to generate a list of highly creditworthy counterparties which will enable diversification, and thus avoidance of concentration, with the prime intention of providing security of investment and minimisation of risk.

6.3 **Investment Strategy** – The process for investment strategy under the regulations covers a wide range of Council investments and will be broadly managed in the following way:

- Short Term Cash – Cash relating to day to day cash flow will be maintained on a shorter term basis in cash type products with consideration to the liquidity requirements outlined above.

- Longer Term Cash – Cash relating to reserves, provisions and balances on the balance sheet may be held for longer periods of time in cash type products or in longer term bonds or funds depending on:

    - Cash flow requirements:
    - The underlying expectation for interest rates; and
    - The economic background of these investments may be held longer term.

- Service Type Investments – These types of investments will predominately be policy driven and approved by Members. Shareholdings, development opportunities, loans to third parties, equity instruments and investment properties held for rental returns) will be regularly reviewed to judge the investment performance.

- Non Service Type Investments – Investments such as Joint venture delivery companies such as Hub West Scotland and investments in regeneration partnerships and development opportunities

6.4 **Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service**
A development for Member reporting is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are additional new requirements to the Member reporting.

6.4.1 These benchmarks are targets (not limits) and so 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 depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

6.4.2 In the context of benchmarking, assessing security is a very subjective area to assess. Security is currently evidenced by the application of minimum quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). 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. Table J shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category.

Table J

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.02%	0.06%	0.10%	0.13%
AA	0.02%	0.04%	0.14%	0.28%	0.40%
A (including A-)	0.09%	0.25%	0.44%	0.62%	0.83%
BBB	0.21%	0.61%	1.07%	1.61%	2.13%

6.4.3 The Council's minimum long term rating criteria is currently "A-", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.09% of the total investment (e.g. for a £1m investment the average loss would be £900). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

6.4.4 As required by the CIPFA Treasury Management Code of Practice The Council will "ensure that it has 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". In respect to liquidity as defined above the Council seeks to maintain:

- Bank overdraft - £1.000m; and
- Liquid short term deposits of at least £5m available on an overnight basis.

6.4.5 Local measures of yield investment benchmarks that will be used to assess returns are:

- Internal returns above the 7 day LIBID rate;
- Internal returns above the 1 month LIBID rate for fixed investments; and
- Internal returns above the Council's instant access account.

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

6.5.1 The permitted investments which may be used in the forthcoming year are noted below. Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in Appendix 3.

- **Cash Type Instruments**
  - Deposits with the Debt Management Account Facility (UK Government);

- Deposits with other local authorities or public bodies;
- Money Market Funds;
- Call accounts, deposit accounts with financial institutions (banks and building societies;
- Term deposits with financial institutions (banks and building societies);
- UK Government Gilts and Treasury Bills;
- Certificates of deposits will financial institutions (banks and building societies); and
- Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates, etc).

- **Other Investments**

  - Investment properties;
  - Loans to third parties, including soft loans;
  - Loans to a local authority company;
  - Shareholding in a local authority company;
  - Non-local authority shareholdings;
  - Joint venture delivery companies such as hub West Scotland;
  - Regeneration partnerships and development opportunities; and
  - Local Authority Mortgage Scheme (LAMS).

6.5.2 Permitted investments related to the Common Good are also shown in Appendix 3, and where applicable the same counterparty selection criteria as noted in 6.6 below will be applied.

6.6 Investment Counterparty Selection Criteria

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.6.1 The Section 95 Officer (Head of Finance & Resources) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criterion selects which counterparties the Council will choose from, rather than defining what its investments are.

6.6.2 The minimum rating criteria to be used uses the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating type and definitions are attached as Appendix 4.

6.6.3 Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to any counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

6.6.4 The criteria for providing a pool of high quality cash type investment counterparties are:

- **Category 1 - Good Credit Quality** – the Council will only use financial institutions (including certificates of deposit and corporate bonds) which:

  - Are UK banks; and/or
  - Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA; The UK will be excluded from any Sovereign rating criteria.
  - And have, as a minimum, the following Fitch, Moody's and Standard and Poors (S&P) credit ratings (where rated):
    - Short Term – F1 (or equivalent from Fitch, Moody's and S&P)
    - Long Term – A- (or equivalent from Fitch, Moody's and S&P)
    - Viability / Financial Strength – bb+ (Fitch) / C (Moody's)
    - Support – 3 (Fitch only)

  The difference between the ratings will be reflected in the money limits as noted in Table L

- **Category 2** – **Part nationalised UK banks** – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Category 1 above.

- **Category 3**- **The Council's own banker** for transactional purposes if the bank falls below the above criteria specified in category 1, although in this case balances will be minimised in both monetary size and time.

- **Category 4 - Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined in category 1.

- **Category 5 - Building Societies** – the Council will use all Societies which meet the ratings for banks outlined in category 1.

- **Category 6 - Money Market Funds** – the Council will use money market funds that are AAA rated (by at least one of the 3 rating agencies).

- **Category 7 - UK Government** (including gilts, treasury bills and the DMADF)

- **Category 8 - Local Authorities, etc**

6.6.5 Due to the uncertainty in the financial markets it is recommended that the Investment Strategy is approved which will provide officers with the flexibility to deal with any unexpected occurrences. Officers can restrict the pool of available counterparties from these criteria to safer instruments and institutions.

6.6.6 The time limits for institutions on the Council's cash type counterparty list are as noted in Table K:

Table K

Investment Category	Fitch (or equivalent)	Money Limit	Time Limit
1	F1+ / AA-	£10million	364 days
	F1 / A-	£5 million	
2	F1/A-	£10 million (per group)	364 days
3		£5 million	Overnight
4		£5 million	364 days
5	As in 1 above	£10 m and £5m	364 days
6	Sector Limit	£20 million	Very liquid no time limit applies
	Fund Limit	£5 million	
7		No limit	6 months
8	Sector Limit Fund Limit	£20 million £5 million	364 days

6.6.7 The Council's bankers are currently the Clydesdale Bank Plc which falls within Category 3. It is recognised that the money limit of £5million may be breached for purely operational purposes on a temporary overnight basis only. The Head of Finance & Resources will endeavour to avoid this scenario but this allows for circumstances that are outwith the Council's control where funds may be deposited unexpectedly or at short notice into the Council's accounts after the dealing deadline for the day has passed. In such a circumstance the funds will require to be kept on an overnight basis in the Council's bank account until appropriate arrangements can be made for investment.

6.6.8 Table K does not include a monetary limit for category 7 which are funds deposited with the UK Government namely the Debt Management Account Deposit Facility (DMADF). This facility allows local authorities to deposit surplus cash on flexible terms and receive a market related rate of interest. Funds are held by the Bank of England and the scheme carried the Government's own sovereign credit rating offering the highest available security and therefore no maximum monetary limit has been set.

6.6.9 Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above and the list of approved countries for investments are detailed in Appendix 5. In addition:

- No more than 25% will be placed with any country outside of the UK at any time;
- Limits in place above will apply to Group companies; and
- Sector limits will be monitored regularly for appropriateness.

6.6.10Use of additional information other than credit ratings – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

6.6.11 Economic Investment Considerations - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in March 2015. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

6.6.12 There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

6.6.13 The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Section 95 Officer (Head of Finance & Resources) may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

6.6.14 Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds and strongly rated. The credit criteria have been amended to reflect these facilities.

6.7 Sensitivity to Interest Rate Movements - Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. Table L highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table L

Loan Type	2014/15 Estimate	2014/15 Estimated + 1%	2014/15 Estimated - 1%
Revenue Budgets			
Variable Rate Debt Payments	£0.004m	+£0.005m	-£0.004m
Variable Rate Investment income	-£0.040m	-£0.080m	£0.040m

7. Treasury Management Limits on Activity

7.1 There are four further treasury activity limits, which were previously prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs.

- *Upper limits on variable interest rate exposure* – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments

- *Upper limits on fixed interest rate exposure* – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- *Maturity structures of borrowing* – These 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.

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

The proposed indicators are shown within Table M:

Table M

	2014/15 Upper		2015/16 Upper		2016/17 Upper	
Limits on fixed interest Rates	100%		100%		100%	
Limits on variable interest rates	50%		50%		50%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	50%	0%	50%	0%	50%
12 months to 2 years	0%	50%	0%	50%	0%	50%
2 years to 5 years	0%	50%	0%	50%	0%	50%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years to 20 years	0%	50%	0%	50%	0%	50%
20 years to 30 years	0%	50%	0%	50%	0%	50%
30 years to 40 years	0%	50%	0%	50%	0%	50%
40 years to 50 years	0%	100%	0%	100%	0%	100%
50 years to 60 years	0%	100%	0%	100%	0%	100%
60 years to 70 years	0%	100%	0%	100%	0%	100%
Principal sums invested > 364 days	£nil	£1m	£nil	£1m	£nil	£1m

7.2 The upper limit applies to the maturity structure of fixed interest rate borrowing in the table above. The level has been set to take account of the way that local authorities have to record certain market loans where the maturity date is deemed to be the next call date rather than the eventual repayment date.

8. Performance Indicators

8.1 The Code of Practice on Treasury Management 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. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available;
- Debt – Average rate movement year on year; and
- Investments – Internal returns above the 7 day LIBID rate.

8.2 The results of these indicators will be reported in the Treasury Annual Report for 2013/14.

9. Treasury Management Advisers

9.1 The Council uses Sector as its treasury management advisors. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and
- Credit ratings/market information service comprising the three main credit rating agencies.

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

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

9.4 Whilst the advisers provide support to the internal treasury function the final decision on treasury matters remains with the Council.

10. The Monitoring of Investment Counterparties

10.1 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and 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 Executive Director of Corporate Services and, if required, new counterparties which meet the criteria will be added to the list.

11. Impact of the Independence Referendum

11.1 The potential impact of the Independence Referendum has been discussed with the Treasury Management Advisors and members will be advised of any impact as appropriate.

Appendix 3

West Dunbartonshire Council and Common Good Funds Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Cash Type Instruments			
Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	As shown in the counterparty section criteria 6.6.6 above.
Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	As shown in the counterparty section criteria 6.6.6 above.
Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	As shown in the counterparty section criteria 6.6.6 above
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 the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
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 the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	As shown in the counterparty section criteria 6.6.6 above.
Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than the first three categories above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period & credit rating)**	These tend to be medium to low risk investments, but will exhibit higher risks than the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Corporate Bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Other Types of Investments			
Investment properties	These are properties that are not used to facilitate service delivery but are held solely to earn rentals or for capital appreciation or both. 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.	Services will determine monetary and time limits managing risk accordingly.
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.	Services will determine monetary and time limits managing risk accordingly.
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.	Services will determine monetary and time limits managing risk accordingly.
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.	Services will determine monetary and time limits managing risk accordingly.

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by rational behind the service the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.
Joint venture delivery companies such as hub West Scotland	Public sector organisations across a hub territory will work in partnership with each other, and a private sector delivery partner, in a joint venture delivery company called hub West Scotland. The hub company will take a strategic, long-term planning approach of its infrastructure requirements to support the delivery of community services. Hub will provide a mechanism for delivering and managing assets more effectively, with continuous improvement leading to better value for money, which will be measured through detailed key performance indicators.	Any investment in hub West Scotland requires approval from the Section 95 Officer (Head of Finance & Resources) and the Chief Executive in consultation with the Leader of the Council and the Leader of the Opposition and each application will be supported by the service rational behind the investment and the likelihood of loss.	The Section 95 Officer (Head of Finance & Resources) will determine monetary and time limits managing risk accordingly.
Regeneration partnerships and development opportunities	Investments undertaken with the prime intention of local area regeneration.	Any investment in a regeneration partnership / development opportunity requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.
Local Authority Mortgage Scheme (LAMS)	These are service investments at market rates of interest. Under this scheme the Council is required to place funds for a number of years with the bank which is participating in this scheme	Any investment in the LAMS requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Sector, including rating changes, 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

Executive Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.

Appendix 4

Type of Rating	Rating	Explanation
Fitch -Short Term	F1+	Indicates exceptionally strong capacity for timely payment of financial commitments
	F1	Indicates strong capacity for timely payment of financial commitments
Fitch - Long Term	AA-	Indicates very strong capacity for timely payment of financial commitments and this capacity is not significantly vulnerable to foreseeable events
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings
Moody's - Short Term	P-1	Banks based Prime-1 for deposits offer superior credit quality and a very strong capacity for timely payment of short term deposit obligations
Moody's - Long Term	Aa	Offer excellent credit quality, with susceptibility to long term risks with a vulnerability to greater fluctuations within protective elements
	A	Offer excellent credit quality, but elements suggest a Susceptibility to impairment over the long term
Standard & Poors - Short Term	A-1	Indicates a strong capacity to meet institutions financial commitments. Within this category, certain obligors are design with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG
Standard & Poors - Long Term	AA-	Indicates strong capacity for timely payment of financial commitments
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more susceptible to the adverse effects of changes in circumstances or in economic conditions than is the case for higher rated category

Appendix 5

West Dunbartonshire Council and Common Good Funds Permitted Investments, Approved Countries for Investments

Based on lowest available rating

AAA

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

AA+

- United Kingdom
- Hong Kong
- Netherlands
- U.S.A.

AA

- Abu Dhabi
- France
- Qatar

AA-

- Belgium
- Saudi Arabia