Aberdeenshire COUNCIL Business Services

REPORT TO THE BUSINESS SERVICES COMMITTEE – 26 APRIL, 2019

TREASURY MANAGEMENT STRATEGY

1. Recommendation

The Committee is recommended to:

1.1 Approve the revised Treasury Management Strategy (TMS) for 2019/20, as referenced in paragraph 2.6 and detailed in Appendices A-E to this report;

1.2 Agree the Prudential Indicators for 2019-2022, as referenced in paragraph 2.5 and detailed in Appendix F; and

1.3 Agree that the new Capital Strategy report is presented to this Committee for approval and implementation during financial year 2019-20.

2. Background/Discussion

2.1 Treasury management is fundamental to the operation of all Council services as it ensures that appropriate financial resources are considered, secured and available when required.

2.2 In practical terms, treasury management is the management of the Council's cash. This in turn relates to: banking, investments, borrowing, cash flow and all financial transactions.

2.3 The TMS also sets out the governance arrangements under which all treasury activities are carried out to ensure, where possible, that all risks are known, identified and managed. The mitigation of risk is imperative for the safeguarding of public funds and for the pursuit of optimum performance commensurate with an acceptable level of risk for Aberdeenshire Council.

2.4 Broadly, there are two connected activities under treasury management: short-term and long-term requirements.

- Short-Term: The day-to-day monitoring and management of the Council's cashflows through short-term investment and borrowing;
- Long-Term: managing the requirements of the Capital Plan through long-term borrowing decisions and considerations of debt maturity and repayments

2.5 In terms of governance, the Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and therefore to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2.6 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in the Public Services also requires the Council to set out its treasury management strategy for borrowing and investment.

2.7 The Prudential Code was introduced in 2004 and replaced the capital borrowing limits set by the Scottish Government. Under the Code, Aberdeenshire Council now sets its own borrowing limits but must demonstrate, via a set of Prudential Indicators, that any borrowing is affordable, prudent and sustainable. By undertaking borrowing, or taking loans, Aberdeenshire Council will periodically review the portfolio of loans held to ensure that these are being managed as effectively as possible.

2.8 The Head of Finance has arranged for a review of the Council's Loans Fund to be undertaken during 2019/2,0 in conjunction with our external treasury advisors, LINK Asset Services. The Loans Fund is the central financing account of the Council. It is an accounting arrangement which simplifies expenditure on various capital projects and the borrowing of money to finance projects.

2.9 Effectively, Services borrow from the Loans Fund to finance their capital expenditure and the Loans Fund, in turn, borrows from the Government through the Public Works Loans Board (PWLB) or direct from money markets. At the end of each financial year, the capital expenditure incurred by each Service is added to their prior year's expenditure to reflect the total debt owed by each Service to the Loans Fund.

2.10 The review will cover an assessment of opportunities to optimise the benefits available to the Council, in terms of the profile of internal Loans Fund repayments, whilst maintaining a prudent provision for the repayment of the external debt liability. The outcome of the review will be reported to this Committee during 2019/20.

3 Prudential And Treasury Management Codes of Practice

3.1 CIPFA has revised the Prudential Code and the Treasury Management Code. The most significant change to the Codes requires all local authorities to produce detailed Capital Strategies which are intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services. In addition, an overview of how associated risk is managed and the implications for future financial sustainability is to be included.

3.2 The full implementation of the Capital Strategy is not expected until financial year 2019-20. The Finance Service will continue to work with the Capital Plan Group, Property Service and other local authorities, along with our Treasury Advisors and External Audit, to ensure the required Strategy fully complies with the revised Code.

3.3 The Treasury Management Strategy (TMS) is detailed in **Appendix 1**.

3.4 The Head of Finance and Monitoring Officer within Business Services have been consulted in the preparation of this report and are satisfied that the report complies with the Scheme of Governance and relevant legislation.

4. Scheme of Governance

4.1 The Committee is able to consider and take a decision on this item in terms of Section C.2.7 of the List of Committee Powers in Part 2A of the Scheme of Governance.

5. Implications and Risks

5.1 An Equality Impact Assessment has been carried out as part of the development of this Strategy.

5.2 Inherent within the setting of targets over a 3-year period is an element of risk due to the uncertainty of data available, both in relation to delivering capital activities and external market forces. Minimising these risks has been taken into consideration in developing the proposed Treasury Management Strategy and the Loans Fund budget.

5.3 The following Risk has been identified as relevant to this matter on a Strategic Level: Balancing the Books (*Directorate Risk Registers*).

There are no financial implications at this stage arising from the report. However, the following summarises areas of risk:

(i) Long-term borrowing interest rates are largely dependent on the strength of the UK and global economy. Rates were volatile in 2018, ending the year at lower levels. There continues to be uncertainty as to the European Union exit terms and trading conditions going forward. There are also recession fears in the major world economies of China and the United States and with falling growth in the Eurozone. There is a risk that long-term borrowing rates will rise during 2019.

(ii) The Council is currently maintaining an under-borrowed position. This means that the financing required to fund the Council's capital projects (the Capital Financing Requirement) has not been fully funded by borrowing but is also funded from the Council's reserves, cash balances and cash flow surpluses on a temporary basis.

(iii) The Council's bank, the Clydesdale Bank, is currently owned by CYBG plc, which also owns the Yorkshire Bank. It was previously owned by the National Australia Bank before its divestment of its UK business in 2016. This change in ownership has resulted in the Council's treasury advisors removing the Bank from the list of acceptable financial institutions for investment. The proposed Investment Policy continues to allow the Council to invest with its own bank and accept the risk.

(iv) The stringent criteria applied in relation to investment counterparties, compounded with historically low interest rates, will continue to limit investment income generation in 2019/20.

These issues will continue to be monitored closely during 2019/20 as part of the Treasury Management Strategy.

Ritchie Johnson, Director of Business Services
Report prepared by Chris Smith, Principal Accountant**,** 28 March, 2019

APPENDIX 1

Treasury Management Strategy – Specific Points

Treasury limits	Exposure to variable rate will not exceed 40% of total borrowing. Temporary loans together with long term borrowing maturing in the forthcoming financial year will not exceed 40% of total borrowing. Borrowing for cashflow purposes shall be restricted to 30% of total borrowing at the time the borrowing is undertaken. The minimum average life to maturity of the Council's long-term borrowing shall be 5 years. No more than the greater of 25% of temporary borrowing, callable at short notice or £30 million will be taken from any one lender at any one time.
Annual Investment Strategy including Non-Treasury Investments (Permitted Investment Tables)	The Annual Investment Strategy details permitted investments by category with maximum values and periods. The primary objective of the investment of surplus funds is to minimise risk and maintain the security of funds and liquidity.
Long Term Borrowing Strategy	The objective of the strategy is to arrange borrowing activities in order to minimise the average rate of interest payable on the Council's loan debt, while spreading the maturities of the debt. The long term borrowing at 31 March 2018 was £566 million of which £467 million was from the Public Works Loan Board (PWLB) with the balance being market loans i.e. bonds and mortgages. In 2019/20 the net forecast borrowing requirement is £202 million, based on

	the implementation of the Treasury Strategy in conjunction with the Council’s overall Medium-Term Financial Strategy. The present outlook for interest rates and the shape of the yield curve suggests that the borrowing strategy in terms of debt maturity for 2019/20 should be kept flexible with regular monitoring undertaken to identify favourable opportunities.
Treasury Risk Management Policy	Risk management is the process of identifying risks, evaluating their potential consequences and determining the most effective methods of controlling them and/or responding to them. Within treasury management activities the primary objective is to minimise risk and maintain the security of capital and liquidity of investments.
Prudential Indicators	The Local Government in Scotland Act 2003 and supporting regulations require the Council to ‘have regard to’ the Prudential Code and therefore to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. A particularly important indicator is that of the Council’s authorised limit for external borrowing which is capped at £1,006 million in 2019/20. The authorised limit should not be breached in any circumstances without the prior approval of the Council. The operational limit is set at £956 million in 2019/20, which excludes an allowance for temporary borrowing and reflects the budgeted provision for borrowing. It is however necessary to retain some scope for managing temporary cash shortfalls, hence the requirement to set a higher authorised limit.

APPENDIX A
TREASURY MANAGEMENT STRATEGY REVIEW

1. Definition of Treasury Management

1.1 Treasury management is defined as the management of the organisation's investments and cashflows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of the optimum performance consistent with those risks.

1.2 Within the Council, treasury management covers two inter-linked activities:

1.2.1 **The day-to-day monitoring and management of the Council's cashflows undertaking short term investment and borrowing as required**.
Short term relates to activities within treasury management of less than 365 days. The objectives of day-to-day management of cashflows is to maximise investment opportunities through detailed forecasting and monitoring of interest rate trends and risk assessment by optimising investment returns using a list of approved organisations for investment. The average cash balance held for the financial year 2017/18 was £44.7 million. In 2018/19 it is forecast the average cash balance will be £46.9 million.

1.2.2 **Managing the long-term borrowing requirements of the Council**:
Long-term borrowing requirements relates to borrowing that is required to fund the capital programme of the Council. The objective is to arrange borrowing activities in order to minimise the average rate of interest payable on the Council's loan debt, while spreading the maturities of the debt over different timeframes to minimise exposure to interest rate movements. The long term borrowing at 31 March 2018 was £566 million of which £467 million was from the Public Works Loan Board (PWLB) with the balance being market loans i.e. bonds and mortgages.

2. Balanced Budget Requirement on the Council

2.1 It is a statutory requirement under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget and the impact of capital investment decisions must be reflected in the revenue budget over time. It is also illegal to borrow to finance revenue expenditure. All borrowing undertaken by Aberdeenshire Council will be for the purpose of financing capital expenditure, with the exception of borrowing to meet short-term cash flow requirements.

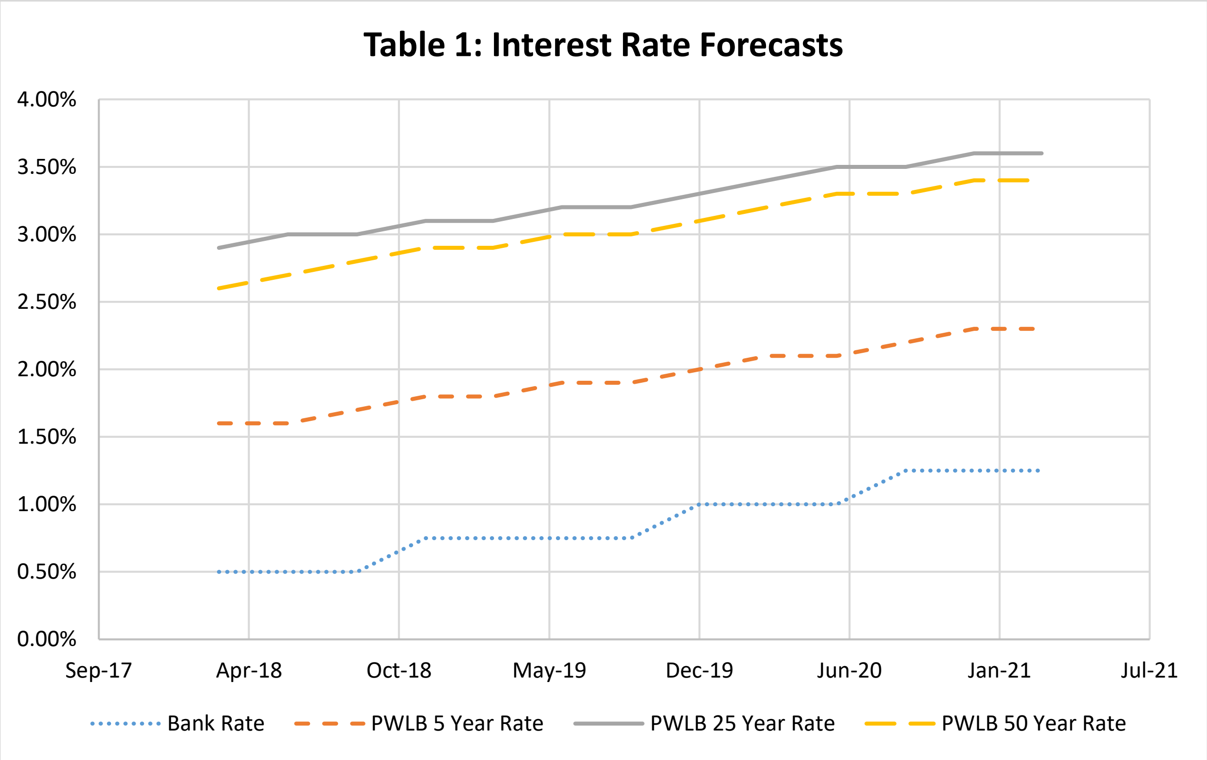
3. Prospects for Interest Rates and the UK Economy

3.1 The Bank Rate (formerly known as Base Rate) is influenced by a range of factors. The two key areas that the Bank of England's Monetary Policy Committee (MPC) considers when setting the Bank Rate are the government inflation targets and the growth in the economy.

3.2 For the period to 29 April 2021 the Council has appointed Link Asset Services (formerly Capita Asset Services) as treasury advisors. Their services include assisting the Council to formulate a view on interest rates to help inform borrowing decisions. Table 1 below reflects their 3-year forecast. Link anticipate growth in the UK economy to continue throughout 2019 and that the

Bank Rates and long term PWLB borrowing rates will increase incrementally through the period 2019-2022.

3.3 The borrowing interest rates have been volatile during 2018 and the Council's policy of avoiding new borrowing by utilising spare cash balances has served well over the last few years and is likely to continue. This policy will be subject to regular review to ensure the avoidance of higher borrowing costs in later years when borrowing will be required to finance new capital expenditure and/or the maturing debt will require refinancing. reviewed to avoid incurring higher borrowing costs in later years, when the authority will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt.



4. Treasury Limits for 2019/20

4.1 It is recommended good practice to have diversified sources of finance and a smooth maturity profile to reduce the risk and impact of adverse interest rate movements as well as refinancing risk, which are managed through the setting of treasury limits.

The limits proposed: -

- **Variable rate loans** - exposure will not exceed 40% of total borrowing
- **Temporary loans** – these loans together with long term borrowing maturing in the forthcoming financial year will not exceed 40% of total borrowing
- **Borrowing for cashflow purposes** - restricted to 30% of total borrowing at the time the borrowing is undertaken
- **Long term borrowing** - minimum average life to maturity 5 years
- **Individual lenders** - no more than the greater of 25% of temporary borrowing, callable at short notice or £30 million will be taken from any one lender at any one time

5. Debt Rescheduling

5.1 Debt Rescheduling is the process of replacing existing higher interest debt with lower interest rate debt resulting in reduced loan repayment costs. Debt Rescheduling is dependent on prevailing rates of interest and will only be undertaken when it is in the Council's interest to do so and following advice from the Treasury Advisers.

5.2 In common with all UK Councils, the Rescheduling of debt is Council policy as part of the treasury management function delegated to the Head of Finance.

6. Annual Investment Strategy

6.1 Aberdeenshire Council maintains only temporary, short term investments which are made with reference to cash flow requirements. To maximise the value that the Council derives from its cash position, the closing bank balance will be as close to zero each day. The Council's bank account pays 0% interest.

6.2 The average cash balance held for financial year 2017/18 was £44.7 million. This reflects the underlying cash balance net of the decision to defer borrowing. This practise of using internal balances has been adopted to minimise credit risk and avoid the cost of holding cash in the current climate of low investment returns. A breakdown of the underlying cash balance at 31 March 2018 is provided in **Appendix B**.

6.3 The proposed Annual Investment Strategy for 2019/20 governing these activities is detailed in **Appendix C** and incorporates:

- All shareholding, unit holding and bond holding, including those in a local authority owned company,
- Loans to a local authority company or other entity formed by a local authority to deliver services,
- Loans made to third parties,
- Investment property.

6.4 Whilst the policy focuses on credit ratings these are only the starting point when considering investment risk and wide-ranging market data and information is reviewed regularly by the Finance function. This Policy has been reviewed in light of current economic climate and the recommendation within the Treasury Management Code that Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits

6.5 Ultra Short-Dated Bond Funds have been introduced as a permitted investment. They aim to achieve a higher yield and to do this either take slightly more credit risk or invest out for longer periods of time, which means they may be more volatile. These funds are similar to MMFs, can still be AAA rated but have Variable Net Asset Values (VNAV) as opposed to a traditional MMF which are currently a Constant Net Asset Value (CNAV). However, from 21 July 2018 they now have 3 different structures, CNAV, Low Volatility Net Asset Value (LVNAV) or Variable Net Asset Value (VNAV).

7. Borrowing Strategy

7.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) encourages authorities to take a three-year view of capital financing requirements. It is for councils to decide for themselves how much they should borrow, based upon prudent assessments of expected capital financing requirements. **Appendix D** details the Strategy proposed to govern borrowing activities in 2019/20.

7.2 The long term borrowing at 31 March 2018 was £566 million of which £467 million was from the Public Works Loan Board (PWLB) with the balance being market loans i.e. bonds and mortgages. In 2019/20 the net expected borrowing requirement is £202.3 million, (2018/19 £212.9 million) comprising of the following elements:

2019/20 Net Borrowing Requirement General Fund and HRA	**Amount (£'million)**
Capital Expenditure	112.8
Amortisation of existing capital advances	(14.9)
Repayment of maturing debt	22.2
Deferred borrowing from previous years	82.2
Total	**202.3**

7.3 **Table 1** in 3.3 indicates the forecast for PWLB interest rates and presents a range of options available for 2019/20 to minimise the average rate of interest payable on the Council's loan debt, while spreading the maturity of the debt. The forecast indicates an upwards pressure on interest rates throughout the year, with rates lower on loans maturing within 20 years.

7.4 Banks and other financial institutions continue to develop alternative lending products and where appropriate these will be evaluated in consultation with our Treasury Advisors.

7.5 Borrowing interest rates are expected to be on a rising trend in 2019. 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. Over the next three years, investment rates are expected to be below long-term borrowing rates and so value for money considerations would indicate that cost minimisation is obtained by deferring new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt as far as possible. This practise was adopted in January 2009 and its use continues to be monitored considering investment returns and the potential for incurring additional long-term extra costs by delaying unavoidable new external borrowing until later years, when PWLB long term rates are forecast to be significantly higher.

7.6 Against this background the Head of Finance will monitor the interest rates and adopt a practical approach to any changing circumstances. Actual borrowing decisions will, of course, depend upon market conditions at the time.

7.7 The Council continues to explore and utilise as appropriate alternative methods of financing capital investment.

8. Risk Management

8.1 The revised CIPFA Code of Practice on Treasury Management in Local Authorities advocated that the Council's appetite for risk must be clearly identified within the strategy report. The role of risk management was further codified within the Local Government Investments (Scotland) Regulations 2010 (the Investment Regulations) and the associated consent to invest issued by Scottish Ministers.

8.2 Sound Corporate Governance requires appropriate regulation, monitoring and control of these activities to minimise risk exposure, by instilling risk awareness in the policy and procedures of the Council. Risk associated with treasury management practices and policies are considered throughout this report and the Risk Management Policy together with the Operational Framework for the Management of Risk in the Investment Strategy adopted in 2011/12 will continue to be proactively maintained and used. This is detailed in **Appendix E.**

9. Prudential Indicators

9.1 The Prudential Code requires the Council to demonstrate that its Capital and Revenue Plans are: -

- Affordable
- Prudent
- Sustainable
- Understanding risks

9.2 In order to demonstrate these three criteria a range of Prudential Indicators are proposed. A detailed explanation of each indicator is attached in **Appendix F**.

10. Reporting and Formal Monitoring

10.1 The Code of Practice for Treasury Management by Local Authorities (the Code) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), which forms part of the Council's Financial Regulations, states that the performance of the treasury management function should be reviewed at least twice per annum. This requirement will continue to be met in the form of an information bulletin to the Policy Committee responsible for Finance. In addition to these performance reports a summarised version of the performance reports will continue to be produced quarterly for this Committee.

10.2 The Scrutiny Role is undertaken by the Policy Committee responsible for Finance.

10.3 Formal quarterly strategy review meetings are held between officers and our Treasury Advisors. In addition, regular internal meetings are held to review performance and market changes with onwards reporting as appropriate.

11. Use of Treasury Advisors

11.1 Responsibility for risk management and control in relation to treasury management lies with Aberdeenshire Council and cannot be delegated to any outside organisation, however the Council appoints treasury advisors to assist in the undertaking of treasury management activities. The Council's current advisors are Link Asset Services (formerly Capita Asset Services), the services provided are:

- Pro-active capital financing and treasury management advice and performance monitoring,
- Economic review and interest rate forecasting,
- Addressing key issues arising from the Prudential Code,
- Debt rescheduling advice and evaluation,
- Providing treasury management training and
- Quarterly strategy meetings

The contract to provide treasury advice is award tri-annually, with the current contract awarded from 30 April 2018 and due to expire on 29 April 2021. Link Asset Services were successful in retaining the contract.

APPENDIX B

UNDERLYING CASH BALANCE BREAKDOWN

The cash position of the Council changes throughout the year, but the underlying surplus (detailed below) is made up of the reserves and other balances. There are clear strategies for the use of all revenue reserves except Devolved Education Management, which, is a consolidation of balances held by schools that are retained for the specific purpose of investing in services delivered at each school. The value of reserves and balances at 31 March 2018 was £58.999 m (£64.654m 31 March 2017), as shown below:

Reserves and Balances at 31 March 2018

	£m	£m
General Fund		
Working balance	11.392	
Earmarked reserves	21.827	33.219
Housing Revenue Account		
Working balance		2.000
Other Reserves		
Renewals and repairs funds	1.855	
Insurance fund	1.316	
Capital fund	0.299	3.470
Common Good, Trusts and Endowment Funds		4.353
Planning Gain & Roads Bonds		15.957
Total		**58.999**

APPENDIX C

ANNUAL INVESTMENT STRATEGY 2019/20

1. Purpose of Policy

1.1 The Annual Investment Strategy defines the parameters by which investment activities are permitted to be undertaken. The policy is approved annually by Policy Committee responsible for Finance.

2. Background

2.1 Objectives of Investment Activities

2.1.1 The primary objective of investment of surplus funds is to minimise risk and maintain the security of funds and liquidity. Investment opportunities are identified through detailed forecasting and monitoring of interest rate trends and returns optimised using a list of approved organisations.

2.1.2 The Council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

2.2 The objective of loans to third parties are to provide support to organisations who are contributing to the delivery of the Strategic Priorities of the Council and have difficulty securing funds from other sources at an affordable interest rate.

2.3 The objective of investments in properties is to support/provide premises to third parties to deliver the economic development objectives of the Council and to optimise the return on the estates portfolio.

2.2 The Nature and Scope of Investments

2.2.1 The Local Government Investments (Scotland) Regulations 2010 permits local authorities to make investments subject to them gaining the consent of Scottish Ministers. The Consent defines Investments as:

(a) All share holding, unit holding and bond holding, including those in a local authority owned company, is an investment.
(b) Loans to a local authority company or other entity formed by a local authority to deliver services, is an investment.
(c) Loans made to third parties are investments.
(d) Investment property is an investment.

2.2.2 The need to invest funds can arise as a consequence of the day-to-day management of the Council's Loans Fund. The cash balances of the Council means it is often necessary for the Council to invest what can be very substantial sums of money in the money markets.

2.2.3 Other investments area in which the Council will be active are: the investment of the capital sums of the various minor trusts and common good funds. These investments tend to be of relatively small amounts for long periods of time. In addition to the investment of surplus funds the Council may enter in to loan agreements for the purpose of meeting service delivery obligations. The

Council also maintains a property portfolio for both service delivery and investment returns.

2.3 The security of the investment will always be the main criteria in investment decisions with the returns being of secondary importance. Investments will be reviewed on a regular basis by Treasury Management and should the security of the investment be at risk the disinvestment will be reported through the performance reporting to Committee

2.4 Regulation

2.4.1 The Local Government Investments (Scotland) Regulations 2010 permits local authorities to make investments subject to them gaining the consent of Scottish Ministers, consent has been issued subject to compliance with the terms of the consent.

2.4.2 The Financial Regulations of Aberdeenshire Council state 'All investments of money under the control of the Council shall be managed by the Head of Finance in accordance with the Council's Annual Investment Strategy and shall be in the name of the Council or in the name of nominees approved by the Head of Finance who will report the need for such nominees to the Policy Committee responsible for Finance.'

2.4.3 The Council will have regard to CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA Treasury Management Code).

2.4.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

3. Annual Investment Strategy

3.1 The Annual Investment Strategy formulated for consideration by Committee is as follows:

(a) Investments of funds of the Council shall, in individual cases, be subject to the observance of any legal restrictions pertaining to the particular investment, in Sterling and as set out in the Permitted Investment Schedule appended to this policy.

(b) Actions undertaken in the investments of funds shall comply with the 'Investment Governance – Operational Framework for Managing Risk' approved by Policy and Resources Committee on 16 September 2010.

(c) **Surplus money in the Council's Loans Fund** may only be advanced to any other UK local authority or government guaranteed institution. In addition to:

1. any bank, financial institution, insurance company or utility company which meets the following criteria: -

(i) It is UK, EU, Australian or Canadian based.

(ii) It falls into one of the groups of banks, financial institutions or insurance companies and the institution have a credit rating of P-1 (or better) from Moody's <u>or</u> a rating of F-1 (or better) from Fitch. Or where the organisations are deemed UK government backed.

(iii) Whilst the above criteria rely 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.

(iv) The Council's own bankers.

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

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

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

A list of approved counterparties will be maintained by the Head of Finance and reviewed on at least a monthly basis.

(d) **Fund Balances on Trust Funds and Common Goods** may be invested: -

(i) as in (ii) of (c) above; and
(ii) in the Council's Loans Fund; and
(iii) in companies which meet the same criteria as set out in (ii) of (c) above, but not in companies known to deal to a significant extent directly or indirectly in arms, alcohol, tobacco, gambling, animal testing or activities resulting in environmental damage.

(e) No more than £15m will be lent to and be outstanding with any one borrower at one time, with the exception of (i) the Debt Management Office where the limit will not be capped and (ii) UK government backed institutions and the Councils bankers, where the limit will be £20 million. The borrower group limit is also £20m.

(f) The maximum country exposure limit of £30 million with the exception of the UK where the limit will not be capped.

(g) **Investment Properties** - All future investments will be subject to investigation and scrutiny by relevant officials of the Council on a case by case basis to ensure that they are prudent and thereafter if considered that the investment will meet investment criteria as agreed by the relevant committees of the Council will be reported to the required committees of the Council for approval.

Table 1: Annual Investment Strategy: - Permitted Investments Schedule – Treasury and Common Good Funds

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
Deposits	Call Accounts	Yes	Instant access	none	£15m (£20m*)	n/a	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Deposits	Business Reserve Accounts – Notice Accounts	Yes	Notice	none	£15m (£20m*)	24 mths	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Securities Issued or guaranteed by governments	DMO (Debt Management Office)	Yes	Term deposit	none	unlimited	12 mths	Annual Investment Strategy as approved by Policy and Resources Committee on

Investment Category	**Name**	**Applicable to Treasury and Common Good Investments**	**Liquidity Risk**	**Market Risk**	**Limit Per Counterparty/ Investee £'s**	**Maximum Period**	**Governance Policy**
							16 September 2010.
Deposits	Fixed Term Deposits	Yes	Term deposit	none	£15m (Treasury investments only - £20m*)	24 mths	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Collective Investment Schemes structures as open-ended investment companies	Money Market Funds	Yes	Instant access	none	£10m	12 mths	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Collective Investment Schemes structures as open-ended investment companies	Ultra Short-Dated Bonds	Treasury investments only	Today + 2 Days	Minimal - Pooled cash investment vehicle which provides very	£5m	12 mths	Annual Investment Strategy as approved by Policy and

Investment Category	**Name**	**Applicable to Treasury and Common Good Investments**	**Liquidity Risk**	**Market Risk**	**Limit Per Counterparty/ Investee £'s**	**Maximum Period**	**Governance Policy**
				low market risk. These will primarily be used as liquidity instruments.			Resources Committee on 5 March 2015
Securities Issued or guaranteed by governments	Treasury Bills	Yes	Term Deposit / Secondary Market	Yes if not held to term	Treasury investments- unlimited Common Good Fund investments - £10m	24 mths	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Deposit	Certificate of Deposits	Yes	Term Deposit / Secondary Market	Yes if not held to term	£10m	24 mths	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
Securities Issued or guaranteed by governments	Trust Funds: Heritable Property	Treasury investments only	notice	Yes	unlimited	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Securities Issued or guaranteed by governments	Common Good Funds: Heritable Property	Common Good investments only	notice	Yes	unlimited	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
Securities Issued or guaranteed by governments	Trust Funds: Government Stocks	Treasury investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
Securities Issued or guaranteed by governments	Common Good Funds: Government Stocks	Common Good investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
All shareholding, unit holding and bond holding	Trust Funds Shareholdings: Investment Trusts	Treasury investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
All shareholding, unit holding and bond holding	Common Good Funds Shareholdings: Investment Trusts	Common Good investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
All shareholding, unit holding and bond holding	Trust Funds Shareholdings: Unit Trusts	Treasury investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.
All shareholding, unit holding and bond holding	Common Good Funds Shareholdings: Unit Trusts	Common Good investments only	notice	Yes	£1m	unlimited	Annual Investment Strategy as approved by Policy and Resources Committee on 16 September 2010.

Treasury and Common Good Investment Minimum Credit Criteria – see Annual Investment Strategy above

* UK government backed institutions and the Councils bankers limit will be £20 million

Table 2: Annual Investment Strategy: - Permitted Investments Schedule – Non-Treasury

Investment Category	Name	Minimum Credit Criteria	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
Loans made to third parties are investments	Adhoc loans including existing long-term debtors	Service Delivery Objectives	Term	Appropriate Due diligence undertaken before loans made	Unlimited	Unlimited	Scheme of Governance - Individual Reports to Policy Committee responsible for Finance
Loans made to third parties are investments	Support for Aberdeenshire Business Scheme	Service Delivery Objectives*	Term	Appropriate Due diligence undertaken before loans made	£25,000 unless heritable security obtained	60 months	Support For Aberdeenshire Business Scheme report to ISC on 17 February 1998
Loans made to third parties are investments	Assistance for Aberdeenshire Business - Significant Financial Support	Service Delivery Objectives*	Term	Appropriate Due diligence undertaken before loans made	unlimited	unlimited	Support For Aberdeenshire Business a Framework For Significant Financial Support - Report To Industrial Cases

Investment Category	Name	Minimum Credit Criteria	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
							Committee – 22 November 2004
Investment Property	Investment Land and Buildings held for economic development purposes	Service Delivery Objectives*	notice	Appropriate Due diligence undertaken before loans made	unlimited	unlimited	Scheme of Governance
Investment Property	Investment Land and Buildings held for income generation purposes.	Development Appraisal Criteria (per Estates)	notice	managed	unlimited	unlimited	Scheme of Governance
Investment Property	Purchase and lease back arrangements.	Development Appraisal Criteria (per Estates)	notice	managed	unlimited	unlimited	Scheme of Governance
Deposit	Hub-Co DBFM – Subordinated Debt (Own)	n/a – Council Shareholder	Term (25 Years)	Service delivery - managed	£1.5 million	25 year	Subject to Report to Policy Committee responsible for Finance
Deposit	Hub-Co DBFM – Subordinated Debt (Other)	n/a – Council Shareholder	Term (25 Years)	Service delivery - managed	£1.5 million	25 year	Subject to Report to Policy Committee

Investment Category	Name	Minimum Credit Criteria	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period	Governance Policy
							responsible for Finance
All shareholding, unit holding, and bond holding/ Loans made to third parties are investments	Limited Liability Partnership – NHT Variant	n/a – Council Shareholder	Term (10 years)	House price market	£25 million	15 years	Subject to Report to Policy Committee responsible for Finance
Loans made to third parties are investments	LAMS – Council as Guarantor	Security over property/ Service Delivery Objectives	Repayment Term	managed	£100,000	30 years	Subject to Report to Policy Committee responsible for Finance
Loans made to third parties are investments	Empty Homes Initiative	Security over property/ Service Delivery Objectives	On receipt of rental.	Service delivery - managed	£50,000	10 years	Policy and Resources Committee 10 January 2013 Report - Local Housing Strategy
Loans made to third parties are investments	Housing Equity Release Loans	Security over property/ Service Delivery Objectives	On sale of property	Housing market - managed	£50,000	unlimited	Policy and Resources Committee 10 January 2013 Report

Investment Category	**Name**	**Minimum Credit Criteria**	**Liquidity Risk**	**Market Risk**	**Limit Per Counterparty/ Investee £'s**	**Maximum Period**	**Governance Policy**
							- Local Housing Strategy
Loans made to third parties are investments	Credit Unions	Authorised by the Prudential Regulation Authority as Category 5 Credit Union meeting capital financing requirements and Security over property	Repayment Term	Monitored	£150,000	12 months rolling	Policy and Resources Committee 27 February 2014 - Minutes
All shareholding, unit holding and bond holding	Shareholdings General	Service Delivery Objectives	notice	Yes	£1m	unlimited	Subject to Report to Policy Committee responsible for Finance

* 1994 Local Government Scotland Act 1994 s171 - Power to Carry Out Economic Development activities

APPENDIX D

LONG-TERM BORROWING STRATEGY

1. Purpose of Strategy

1.1 The borrowing strategy outlines the intended approach to borrowing activity and defines the parameters in which those activities will be undertaken. The strategy is reviewed annually by the Policy Committee responsible for Finance.

2. Background

2.1 Objectives of Borrowing Strategy

2.1.1 The objective of the strategy is to arrange borrowing activities in order to minimise the average rate of interest payable on the Council's loan debt, while spreading the maturities of the debt.

2.2 The Nature of Long-Term Borrowing

2.2.1 Borrowing is undertaken to fund the HRA and non-HRA capital program as appropriate. In 2019/20 the net expected borrowing requirement is £202.3 million (2018/19 £212.9 million) as detailed below:

2019/20 Net Borrowing Requirement General Fund and HRA	**Amount (£'million**)
Capital Expenditure	112.8
Amortisation of existing capital advances	(14.9)
Repayment of maturing debt	22.2
Deferred borrowing from previous years	82.2
Total	**202.3**

The balance of the capital plan is funded from CFCR, grants and capital receipts.

2.2.2 Borrowing instruments can be PWLB (Public Works Loans Board) loans, Bonds and Mortgages (LOBO and other market instruments).

2.3 Regulation

2.3.1 Section 4.8 of the Financial Regulations of Aberdeenshire Council details the requirements in terms of treasury management that must be adhered to.

2.3.2 The Council must have regard to CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code).

2.3.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

2.4 Rescheduling Debt

2.4.1 Debt Rescheduling is an accepted tool of effective treasury management. It involves a constant monitoring of the Council's loan debt in order that existing debt at high rates of interest may be replaced with debt at lower rates of interest, thus generating savings for the Council.

2.4.2 Short term borrowing rates are forecast to be cheaper than longer term rates during 2019/20 and there may be opportunities to generate savings by switching from long term debt to short term debt. Opportunities of this nature need to be considered in the light of their short-term nature and the likely higher cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

2.4.3 If debt Rescheduling opportunities arise, they will be discussed and agreed with the Council's Treasury Advisers, with options identified and actioned, in line with Aberdeenshire Council's Treasury policy.

3. Borrowing Strategy

3.1.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) requires indicators to be set for three years. These include what is a prudent and affordable assessment of capital financing requirements.

3.1.2 The present outlook for interest rates and the shape of the yield curve suggests that the borrowing strategy in terms of debt maturity for 2019/20 should be kept flexible with regular monitoring undertaken to identify favourable opportunities.

3.1.3 Using internal balances to fund capital activity minimises interest rate and credit risk and this strategy will be adopted when appropriate.

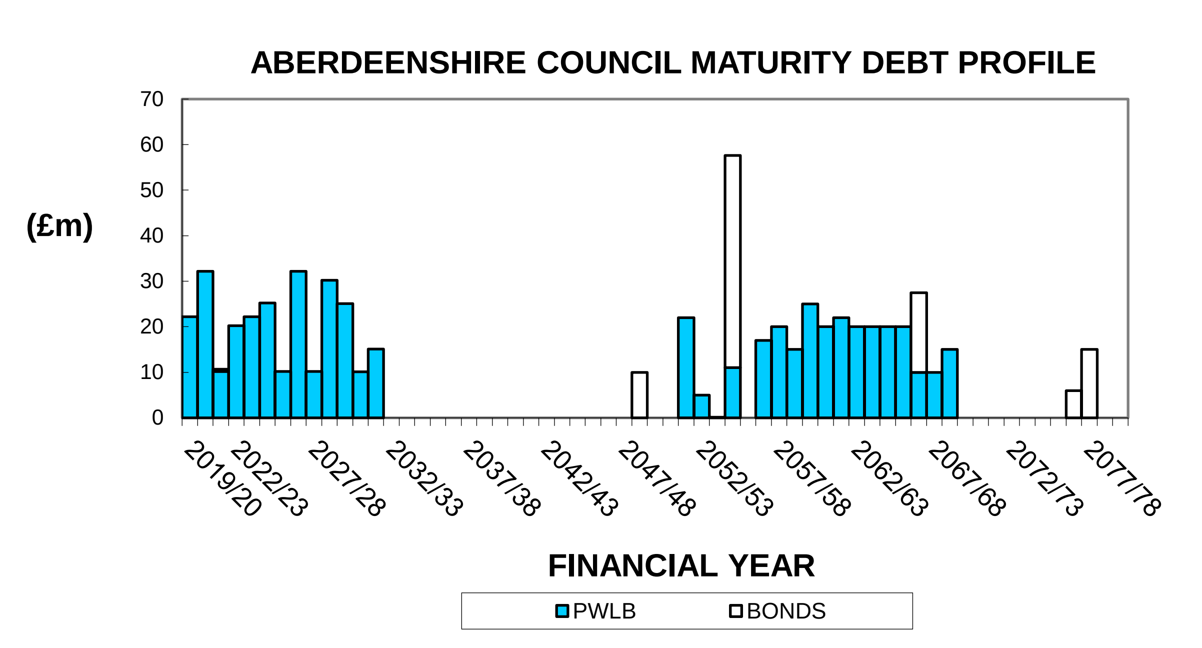
3.1.4 Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it is felt that there is a significant risk of a rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively low.

- If it is felt that there is a significant risk of a fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from long dated fixed rate funding into short term funding will be considered.

3.1.5 The Council's Loans Fund may borrow from any other UK local authority or government guaranteed institution which includes the PWLB or successors. In addition to it may borrow from any bank, financial institution, insurance company or utility company which is governed by MiFID, the EU Markets in Financial Instruments Directive (2004/39/EC).

3.1.6 When taking new borrowing the debt maturity profile will be considered to ensure that an acceptable level of debt matures in any one year. This is in order to manage the refinancing risk of replacing maturing debt at unfavourable borrowing rates.



3.1.7 Against this background, caution will be adopted with the 2019/20 treasury operations. The Head of Finance will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances. Actual borrowing decisions will, of course, depend upon market conditions at the time.

4. Policy on borrowing in advance of need

4.1 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. In accordance with the revised Treasury Management Code, any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

4.2 In determining whether borrowing will be undertaken in advance of need the Council will:

- consider the proposed definition of such within the Code on the Investment of Money By Scottish Local Authorities (Investment Regulations),
- ensure that there is a clear link between the capital plan and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need,
- ensure the cost of holding cash and its budgetary implications have been considered,
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

APPENDIX E

Treasury Risk Management Policy

1. Purpose of Policy

1.1 The Treasury Risk Management Policy codifies in a formal framework the risks associated with treasury management activities and defines the organisation's appetite for risk and how it will be managed. The policy is reviewed annually by the Policy Committee responsible for Finance.

2. Background

2.1 Objectives of Treasury Risk Management Policy

2.1.1 The objective of the policy is to provide a framework that insures risks are managed and minimised in the pursuit of Treasury Management activities.

2.2 The Nature of Treasury Risk Management

2.2.1 Risk management is the process of identifying risks, evaluating their potential consequences and determining the most effective methods of controlling them and/or responding to them.

2.2.2 Within treasury management activities the primary objective is to minimise risk and maintain the security of capital and liquidity of investments.

2.2.3 Whilst the Council uses Treasury Advisors, responsibility for risk management and control lies with Aberdeenshire Council and cannot be delegated to any outside organisation.

2.3 Regulation

2.3.1 Over recent years Aberdeenshire Council has embedded a risk management culture within the organisation and has created risk registers.

2.3.2 The risk register process is used by the Council to identify, assess, manage, monitor and report on its strategic and operational risks. It captures information on the risks arising from key processes, systems and service activities. It enables the Council to assess both its inherent and residual risk exposure and determine its approach to managing risk. The Council requires that Risk Registers be maintained at both a Corporate and Service level and that these are updated on a biannual basis. Risk Registers are subject to review and challenge by the Risk Manager prior to acceptance by the appropriate Director.

2.3.3 The revised CIPFA Code of Practice on Treasury Management in Local Authorities advocated that (i) the Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out and (ii) responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.

2.3.4 The role of risk management was further codified within the Local Government Investments (Scotland) Regulations 2010 (the Investment Regulations) and the associated consent to invest issued by Scottish Ministers. The Investment Regulations provided a more flexible legal framework for Local Authorities to determine how they invest funds. However, with this additional flexibility there are a series of controls, which places the onus on Councils to risk assess and report on all investments within a single Annual Investment Strategy.

3. Risk Management Policy

3.1 Recognition - Types of Risk

3.1.1 The following are the types of treasury management risks formally recognised by this organisation:

Credit and Counter-party Risk	This is the risk of failure by a counterparty (bank or building society or organisation) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness.
Liquidity Risk	This is the risk that cash will not be available when it is required.
Market Risk	Is defined as 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.
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.
Legal and Regulatory Risk	This is the risk that the organisation itself, or an organisation with which it is dealing in its activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.
Exchange Rate Risk	The risk that the organisations operations or investment will be affected by changes in exchange rates. For example, if money must be converted into a different currency for cashflow reasons, changes in the value of the currency relative to the pound will affect the total loss or gain on conversion of money back.

Inflation Risk	The possibility that the value of assets or income will decrease as inflation shrinks the purchasing power of funds. Inflation causes money to decrease in value at some rate, and does so whether the money is invested or not.
Refinancing Risk	Is the risk that the organisation will be unable to refinance maturing debt when they come due at maturity, at acceptable prices and terms.
Fraud and Error Risk	Is the risk of loss resulting from inadequate or failed internal processes, people and systems.

3.2 Identification – The Risk Register

3.2.1 The Risk Register for Business Services which incorporates Finance is maintained at a service level and updated on a biannual basis.

3.3 Management and Control – Treasury Management Practices

3.3.1 The approach to management and control of risk is defined within the Treasury Management Practices document, timely maintenance of this document is undertaken by the Treasury Management Officer.

3.4 Decision Making Process

3.4.1 Decisions in relation to the treasury management strategy, policies and activities are identified, assessed and evaluated, considering stakeholder's expectations, the organisation attitude to risk and the economic environmental risk it faces.

3.4.2 **Explicitly in relation to investments**

The Council's investment priorities are to achieve optimum return only after ensuring:

(a) the security of capital and
(b) the liquidity of its investments

3.4.3 **In relation to borrowing**:

The Council's borrowing priorities are to achieve optimum borrowing rate whilst:

(a) matching borrowing to identified need and
(b) spreading maturity dates of the debt

3.5 Reporting and Scrutiny

3.5.1 The following reporting and scrutiny framework is in place to ensure control and risk minimisation of treasury management activities:

3.5.2 The Treasury Management Strategy is approved annually by the Policy Committee responsible for Finance. It codifies the Annual Investment Strategy, borrowing strategy and prudential indicators that treasury management activities must comply with.

3.5.3 Compliance with the Treasury Management Strategy is reported on a biannual basis to Policy Committee responsible for Finance.

3.5.4 As part of its role of reviewing the treasury management policy and procedures and making recommendations the Policy Committee responsible for Finance will review the Risk Management Policy and Risk Register annually.

3.5.5 Responsibility for recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance rests with the Head of Finance.

3.5.6 In common with all activities of the Council, treasury management is subject to review by both external and internal audit.

APPENDIX F

PRUDENTIAL INDICATORS

1. Purpose of Prudential Indicators

1.1 The Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and therefore to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. In order to demonstrate these three criteria a range of Prudential Indicators are proposed.

2. Prudential Regime for Capital Finance

2.1 The Prudential Regime for Capital Finance has applied to all councils from 1 April 2004. The Prudential Code has offered new opportunities for the Council to take a more strategic approach to capital investment, provided the Council can demonstrate that its Capital and Revenue Plans are affordable, sustainable and prudent.

3. Government Funding

3.1 The Scottish Government will continue to support the costs of borrowing through the Revenue Support Grant mechanism to an indicative level of supported borrowing. However, provided the Council can satisfy investment over and above this level is sustainable, additional borrowing can be undertaken.

4. Prudential Indicators

4.1 The following indicators are extracts from the approved capital plan and revenue budget.

4.1.1 **Estimated capital expenditure**

Purpose: - This indicator simply shows the value of the capital budget proposals

Indicator: -

	2018/19 £'m	**2019/20 £'m**	**2020/21 £'m**	**2021/22 £'m**
General Fund	107.90	114.11	110.95	63.31
Housing Revenue Account	43.84	77.42	67.41	67.41
Total	**151.74**	**191.53**	**178.36**	**130.72**

4.1.2 Estimated ratio of financing cost to net revenue stream

Purpose: - This ratio indicates the percentage of the revenue budget that is required to meet the cost of external borrowing. A separate ratio is shown for the General Fund (GF) and Housing Revenue Account (HRA) and indicates the affordability of the Council's capital expenditure proposals.

Indicator: -

	2018/19	**2019/20**	**2020/21**	**2021/22**
General Fund	6.68%	6.70%	7.28%	7.35%
Housing Revenue Account	11.54%	12.29%	20.86%	21.95%

4.1.3 Net borrowing and the capital financing requirement

Purpose: - These indicators show the estimated total borrowing required to fund existing and additional capital expenditure proposals and the estimated level of net external borrowing. In order to demonstrate over the medium-term net borrowing is only for a capital purpose, except in the short term, this should not exceed the capital financing requirement. The indicators are only required for the Council's overall position and are not divided between the General Fund and HRA.

Indicator: -

	2018/19 £'m	**2019/20 £'m**	**2020/21 £'m**	**2021/22 £'m**
Net Borrowing	751	846	927	971
Capital Financing Requirement	834	929	1,009	1,053

4.1.4 Estimated incremental impact of investment decisions on council tax/rents

Purpose: - This ratio links with the previous ratio and indicates the impact of capital expenditure plans on the revenue budget.

Indicator: -

	2018/19	**2019/20**	**2020/21**	**2021/22**
General Fund	zero	zero	zero	zero
Housing Revenue Account	zero	zero	zero	zero

This indicates that, because any proposed change to the existing capital plans which impacts on borrowing will be funded by efficiencies, there is no incremental effect on the revenue budget.

4.2 **Treasury Management Prudential Indicators**

4.2.1 **Authorised limited and operational limit for external debt**

Purpose: - The authorised limit sets an absolute limit for the Council's total external borrowing. It is set to reflect current and proposed borrowing and contains an allowance for the estimated maximum temporary borrowing during the year to meet cash flow requirements. The operational limit excludes the allowance for temporary borrowing and reflects the budgeted provision for borrowing. It is however necessary to retain some scope for managing temporary cash shortfalls, hence the requirement to set a higher authorised limit. The authorised limit should not be breached in any circumstances without the prior approval of the Council.

Indicator: -

	2018/19 £'m	**2019/20 £'m**	**2020/21 £'m**	**2021/22 £'m**
Authorised Limit	911	1,006	1,086	1,131
Operational Limit	861	956	1,036	1,081

4.2.2 **Upper limits on fixed and variable interest rate exposures**

Purpose: - The Treasury Management Policy requires the Council to minimise risk rather than to maximise return. Exposure to variable interest rates means that the Council is exposed to higher borrowing costs in the event of a sudden increase in interest rates.

Indicator: -

	2019/20	**2020/21**	**2021/22**
Fixed rate exposure upper limit	100%	100%	100%
Variable rate exposure upper limit	40%	40%	40%

This proposal ensures that no more than 40% of the overall debt portfolio is exposed to fluctuations in interest rates at any time.

4.2.3 **Has the authority adopted the CIPFA Code of Practice for Treasury Management in the Public Services?**

Purpose: - Prudential indicators require a close link to existing good practice in Treasury Management. Adoption of the CIPFA Code reflects best practice in this area.

Indicator: - Yes

4.2.4 **Upper limit for the maturity structure of fixed rate borrowing**

Purpose: **-** In order to avoid exposure to fluctuating or higher interest rates it is important to manage debt maturity to limit any requirement to re-borrow funds in any given period. This indicator sets maximum and minimum limits for the value of debt maturing in different time periods.

Indicator: -

	Maximum proportion of fixed rate borrowing maturing	**Minimum proportion of fixed rate borrowing maturing**
Under 12 months	30%	0%
1 year to 2 years	30%	0%
2 years to 5 years	50%	0%
5 years to 10 years	75%	0%
10 years and above	90%	25%

4.2.5 Total Principal Funds invested for Greater than 365 days

Purpose: –There is continuing uncertainty over the timing of likely upward movements in investment rates as well as credit risk uncertainty and hence the Council will limit its exposure to investments beyond 365 days to £20 million.

Indicator: - a maximum of £20 million outstanding for greater than 365 days.

APPENDIX G

GLOSSARY OF TREASURY MANAGEMENT TERMS

Authorised Limit - This represents the limit beyond which borrowing is prohibited and needs to be set and revised by the Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate - the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Counterparty – the other party involved in a borrowing or investment transaction.

Credit Rating – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

Liquidity – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO – Lender Option Borrower Option. Long-term borrowing deals structured in a such a way that a low rate of interest is usually offered for a short, initial period (anything from 1 year to 10 years), followed by a "step up" to a higher rate of interest (the "back end" interest rate), which is to be charged for the remainder of the loan period. The overall length of LOBOs is usually 50 or 60 years but can be for shorter or longer periods. After the "step up" date, and at set intervals thereafter, the lender (the bank) has the option of increasing the "back end" interest rate. Whenever this option is exercised, if the proposed new interest rate is unacceptable, the borrower (the Council) can redeem the loan without penalty.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

MiFID - is the EU Markets in Financial Instruments Directive (2004/39/EC). MiFID aims to create a true single market in financial services across the 27 EU and 3 EEA member states. MiFID sets out a framework of key regulations which is implemented into the domestic law of each EU member state. This is intended to harmonise the key regulatory requirements applicable to financial services businesses across the EU.

Monetary Policy Committee (MPC) – the independent body, which determines Bank Rate.

Operational Limit – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an early warning indicator to ensure the Authorised Limit is not breached.

Prudential Code - The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. An institution managed by the Government to provide loans to public bodies at rates, which reflect the rates at which the government is able to sell Gilts.

Sovereign Credit Rating - is the credit rating of a sovereign entity, i.e. a country. The sovereign credit rating indicates the risk level of the investing environment of a country and is used by investors looking to invest abroad. It takes political risk into account.

Variable Rate Funding - The rate of interest either continually moves to reflect interest rates of the day or can be tied to specific dates during the loan period. Rates may change on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt that matures in the year and needs replacing and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short term loans compared to long term loans. An inverted Yield Curve is the opposite of this.

CREDIT RATINGS

Credit ratings assess the credit worthiness of an individual, corporation, or even a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. A poor credit rating indicates a high risk of defaulting on a loan, and thus leads to high interest rates, or the refusal of a loan by the creditor.

A Moody’s - Short-Term Credit Ratings

Moody's short-term ratings for taxable securities are opinions of the ability of issuers to honour short-term financial obligations. Ratings may be assigned to issuers, short-term programs or to individual short-term debt instruments. Such obligations generally have an original maturity not exceeding thirteen months, unless explicitly noted.

Definitions
Moody's employs the following designations to indicate the relative repayment ability of rated issuers:

- P-1 Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations.
- P-2 Issuers (or supporting institutions) rated Prime-2 have a strong ability to repay short-term debt obligations.
- P-3 Issuers (or supporting institutions) rated Prime-3 have an acceptable ability to repay short-term obligations.
- NP Issuers (or supporting institutions) rated Not Prime do not fall within any of the categories.

B Moody's - Bank Financial Strength Ratings

An opinion of a bank's intrinsic safety and soundness. Bank Financial Strength Ratings is a measure of the likelihood that a bank will require assistance from third parties such as its owners, its industry group, or official institutions. Bank Financial Strength Ratings do not consider the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do consider other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Definitions
- A Banks rated A possess exceptional intrinsic financial strength. Typically, they will be major institutions with highly valuable and defensible business franchises, strong financial fundamentals, and a very attractive and stable operating environment.

B Banks rated B possess strong intrinsic financial strength. Typically, they will be important institutions with valuable and defensible business franchises, good financial fundamentals, and an attractive and stable operating environment.

C Banks rated C possess good intrinsic financial strength. Typically, they will be institutions with valuable and defensible business franchises. These banks will demonstrate either acceptable financial fundamentals within a stable operating environment, or better than average financial fundamentals within an unstable operating environment.

D Banks rated D possess adequate financial strength but may be limited by one or more of the following factors: a vulnerable or developing business franchise; weak financial fundamentals; or an unstable operating environment.

E Banks rated E possess very weak intrinsic financial strength, requiring periodic outside support or suggesting an eventual need for outside assistance. Such institutions may be limited by one or more of the following factors: a business franchise of questionable value; financial fundamentals that are seriously deficient in one or more respects; or a highly unstable operating environment.

Intermediate Categories: Where appropriate, a "+" may be appended to ratings below the "A" category to distinguish those banks that fall into intermediate categories.

C Fitch - Short-term Issue Credit Ratings

Fitch's credit ratings provide an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. Credit ratings are used by investors as indications of the likelihood of receiving their money back in accordance with the terms on which they invested

F1+ best quality grade, indicating exceptionally strong capacity of obligor to meet its financial commitment

F1 best quality grade, indicating strong capacity of obligor to meet its financial commitment

F2 good quality grade with satisfactory capacity of obligor to meet its financial commitment

F3 fair quality grade with adequate capacity of obligor to meet its financial commitment but near term adverse conditions could impact the obligor's commitments

B of speculative nature and obligor has minimal capacity to meet its commitment and vulnerability to short term adverse changes in financial and economic conditions

C possibility of default is high and the financial commitment of the obligor is dependent upon sustained, favourable business and economic conditions

D the obligor is in default as it has failed on its financial commitments.

INVESTMENT INSTRUMENTS

A. Debt Management Agency Deposit Facility (DMADF)

Known to date in the Annual Investment Strategy as DMO (Debt Management Office). This offers the lowest risk form of investment available to councils as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account. As it is low risk it also earns low rates of interest. It is very useful where the overriding priority is the avoidance of risk e.g. the banking crisis of 2008-2010.

B. Term deposits with high credit worthiness banks and building societies.

These are deposits with financial institutions for a fixed term. Risks associated with these form of deposits are evaluated applying the criteria set out in the Annual Investment Strategy. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

C. Business Reserve and Call accounts with high credit worthiness banks and building societies.

These are interest bearing bank accounts which can be instant access or notice. Risks associated with these form of deposits are evaluated applying the criteria set out in the Annual Investment Strategy. With these facilities there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. However, the Council has 3 call accounts where the rate of return is higher than term deposits. Use of call accounts is highly desirable to ensure that the council has ready access to cash when needed to pay bills.

D. Money Market Funds (MMFs)

By definition, Money Market Funds are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. MMFs will also help the council to diversify its own portfolio as e.g. a £2m investment placed directly with RBS is a 100% risk exposure to RBS whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF.

E. Ultra Short-Dated Bond Funds

These funds are similar to MMFs, can still be AAA rated but have Variable Net Asset Values (VNAV) as opposed to a traditional MMF which are currently a Constant Net Asset Value (CNAV). However, from 21 July 2018 they will have 3 different structures, CNAV, Low Volatility Net Asset Value (LVNAV) or Variable Net Asset Value (VNAV).

F. Treasury bills

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

G. Certificates of deposit (CDs)

These are shorter term securities issued by deposit taking institutions (mainly banks) so they can be sold if there is a need for access to cash at any point in time. However, that liquidity comes at a price so the yield is less than placing a deposit with the same bank as the issuing bank.

APPENDIX H
LOCAL AUTHORITY (CAPITAL FINANCE AND ACCOUNTING) (SCOTLAND) REGULATIONS 2016

The implications of the main changes the 2016 Regulations made to Schedule 3 of the Local Government Act 1975 are as follows:

Regulations 2016 new Legislation	Implications
The 2016 Regulations allows borrowing for 'treasury management activities' and for local authorities to determine the source and types of borrowing.	Provides local authorities with a wider borrowing power reflecting treasury needs for an authority to refinance existing borrowing, use cash reserves, borrow in advance or after capital expenditure is incurred and for general liquidity purposes.
The authorised limit of external debt under the 2016 Regulations Requirement includes long and short term borrowing and credit arrangements whereas the CIPFA Prudential Code only included long term borrowing and credit arrangements in the authorised limit of external debt.	The 2016 regulations require local authorities to determine and keep under review how much external debt they can afford (the authorised limit) whereas previously this was only recommended by the CIPFA Prudential Code. The authorised limit of external debt prudential Indicator must now include short term debt as well as long term debt.
The 2016 Regulations no longer require consent to borrow out-with the UK in sterling.	This is an additional borrowing power not allowed under the previous legislation. Consent from Scottish Ministers is still required however to borrow in foreign currency.
The 2016 regulations clarify the organisations a local authority can lend to with and without Scottish Minister consent.	This simplifies the decision making process when lending to external organisations.
The 2016 Regulations allow a local authority to borrow to lend to its common good fund for capital expenditure.	This is an additional statutory lending power as the previous legislation did not state that the local authority may borrow to lend to its common good fund.
The 2016 Regulations allow a local authority to determine the period and annual repayments for loans fund advances due to capital expenditure incurred by borrowing provided the method is prudent.	This replaces the prescriptive methodology of loans fund advance repayment under the 1975 Act. 'Prudent' repayment under the new regulations is to ensure the advance is repaid over the period the asset provides a service and the annual payment bears some relation to the consumption of the asset. Recognising authorities have forward capital expenditure plans the existing methodology

	under current legislation can continue to be used until 31 March 2021.
The loans fund is no longer required to manage money borrowed or the interest on money borrowed. The loans fund is now focussed on the statutory recognition of loans fund advances and the statutory repayment of money borrowed.	Going forward the loans fund will only record new advances due to borrowing and the repayment of advances charged to the general fund and HRA. This has no implications as local authorities may continue with full loans fund accounting for their own internal management purposes.