NORTH AYRSHIRE COUNCIL

28 February 2018

North Ayrshire Council

Title:	**Treasury Management and Investment Strategy 2018/19**
Purpose:	To seek approval for the proposed Strategy for Treasury Management and Investment activities within the Council for the financial year 2018/19
Recommendation:	That the Council (i) approves the Treasury Management and Investment Strategy for 2018/19 as attached at Appendix 1.

1. Executive Summary

1.1 The Council is required by regulations issued under the Local Government in Scotland Act 2003 and the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) to approve a Treasury Management Strategy before the start of each financial year. The Council is also required by regulation to have regard to CIPFA's Prudential Code (revised 2017) under Part 7 of the Local Government in Scotland Act 2003. In addition, the Consent by Scottish Ministers for the Investment of Money by Scottish Local Authorities Regulation (April 2010) requires the Council to approve an Investment Strategy before the start of each financial year.

1.2 The Treasury Management and Investment Strategy attached to this report complies fully with these requirements and provides;

- a summary of the Council's capital plans;
- outlines the Treasury Management Strategy in relation to borrowing and the impact of council plans on borrowing;
- outlines the Investment Strategy including the instruments available for investments and permitted counterparties.

1.3 The strategy provides key prudential and treasury indicators to 2027/28 which clearly articulate the operational parameters associated with Treasury Management and Investment as well as offering assurance in relation to the affordability and sustainability of capital investment plans.

1.4 Significant changes in the updated Strategy include;

- the expectation that the Council’s historic “under borrowed” position will end in 2018/19;
- financial commentators predicting that the UK Bank Rate will rise from 0.50% to 1.00% during 2018-19;
- regulatory changes classifying the Local authorities as “Retail Clients” with the Council opting up to a “Professional Client” ensuring continued access to lower fees and a greater range of investment products and firms;
- from 1 January 2019 UK banks will separate their activity into retail and investment, with the retail sector being ring fenced offering more protection to customers, the impact of this on the Council is not clear;
- bail in risk exposure via the Council’s operational bank account, mitigated by minimising deposits;
- inclusion of information on Material investments, Guarantees and Liabilities for the first time, in line with new requirements.

2. Background

2.1 CIPFA defines treasury management as:

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

2.2 The Local Government Scotland Act 2003 and the Prudential Code requires the Council to approve an annual Treasury Management and Investment Strategy which outlines the Council's strategy in relation to borrowing and the Council's strategy for managing investments giving priority to the security and liquidity of those investments.

2.3 The Treasury Management and Investment Strategy 2018/19 is attached at Appendix 1. The overall objectives of the strategy are as follows:

Borrowing

- to minimise the revenue cost of borrowings;
- to manage the Council’s cash flow;
- to manage the borrowing repayment profile;
- to assess interest rates’ movements and borrow/invest accordingly;
- to monitor and review the level of variable rate loans held in order to take advantage of interest rate movements; and
- to identify and evaluate opportunities for debt rescheduling.

Investments

- to protect capital security of the invested funds;
- to obtain the best market return whilst recognising that security and liquidity are key priorities;
- to specify criteria for identifying creditworthy counterparties; and
- to specify the types of investments permitted and appropriate limits for each.

2.4 The strategy provides detailed key prudential and treasury indicators over a 10 year period which clearly articulate the operational parameters associated with Treasury Management and Investment as well as offering assurances in relation to the affordability and sustainability of capital investment plans;

- the General Services capital plan to 2027/28 and
- the one-year programme for the Housing Revenue Account, with investment requirements for future years outlined within the HRA 30-year Business Plan.

and links with the key objectives of the Prudential Code that capital investment programmes should be set at a level that delivers the Council’s strategic priorities and is affordable in terms of the impact of the resultant debt repayments on revenue budgets.

2.5 The Treasury Management and Investment Strategy includes prudential indicators which are critical in assessing the affordability of capital investment plans and their impact on the Council's overall finances. The indicator used to demonstrate affordability is the ratio of financing costs to the net revenue stream (for both General Fund and Housing Revenue Account).

2.6 There are a number of other key indicators designed to ensure that the Council operates within well-defined limits. The strategy, therefore, specifies :-

- limits we do not expect external debt to exceed;
- appropriate levels of fixed rate borrowing versus variable rate borrowing;
- upper and lower limits on the maturity of the debt portfolio, which reduces the Council's exposure to large sums falling due for refinancing at any one time;
- limits on investments placed for more than 365 days.

2.7 The Council expects to hold an 'under-borrowed' position at 31 March 2018. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded by debt, due to the level of the Council's internal funds. The use of internal funds instead of borrowing will continue due to the low level of investment rates in the market and the saving which can be made in borrowing costs. This under-borrowed position is expected to end in 2018/19.

3. Proposals

3.1 That the Council agrees to approve the Treasury Management and Investment Strategy for 2018/19 as attached at Appendix 1.

4. Implications

Financial:	Financial implications are detailed in the report attached at Appendix 1.
Human Resources:	None
Legal:	The Local Government in Scotland Act 2003 and supporting regulations require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016 require the Council to set a policy for the repayment of loans fund advances.
Equality: **Children and Young People:**	None None
Environmental & Sustainability:	None
Key Priorities:	The Treasury Management Strategy aligns with the Council Plan by contributing to “a sound financial position” and “making the best use of all resources” as referred to under the banner of Underpinning our Priorities.
Community Benefits:	None

5. Consultation

5.1 The Council's treasury advisors, Arlingclose Ltd, were consulted in the preparation of the Strategy.

Laura Friel
Executive Director (Finance and Corporate Support)

For further information please contact **Alan Dunsmore, Team Manager (Business Partnering)** on **01294 324596**.

Background Papers
None

Appendix 1

North Ayrshire Council
Comhairle Siorrachd Àir a Tuath

Treasury Management and Investment Strategy

2018/19

PublicFinance INNOVATION AWARDS 2017 FINALIST

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1 Purpose

The Council is required by regulations issued under the Local Government in Scotland Act 2003 and the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) to approve a Treasury Management Strategy before the start of each financial year. The Council is also required by regulation to have regard to CIPFA's Prudential Code (revised 2017) under Part 7 of the Local Government in Scotland Act 2003.

In addition, the Consent by Scottish Ministers for the Investment of Money by Scottish Local Authorities, which came into force in April 2010, requires the Authority to approve an Investment Strategy before the start of each financial year.

This strategy meets these requirements fully.

Three main reports on Treasury Management activity are presented to Members each year, incorporating a variety of policies, estimates and actuals. These are:

- **Annual Treasury Management and Investment Strategy** (this report), which is submitted to full Council before the start of each financial year.
- **Mid-Year Treasury Management and Investment Report**, submitted to Cabinet as soon as possible following 30 September each year.
- **Annual Treasury Management and Investment Report**, submitted to full Council annually by the 30 June following the end of each financial year.

Responsibilities

Regulations place responsibility on Members for the review and scrutiny of treasury management policy and activities. The following Scheme of Delegation has been adopted by the Council:

Full Council
- to receive and review reports on treasury management policies, practices and activities;
- to approve annual Treasury Strategy.

Cabinet
- to approve amendments to the treasury management policy statement and treasury management practices;
- to approve the division of responsibilities;
- to receive and review regular monitoring reports and act on recommendations.

Section 95 Officer

The Executive Director (Finance & Corporate Support) is the Council's S95 officer and is required:

- to recommend treasury management policies / practices, review these regularly and monitor compliance;
- to submit regular treasury management updates;
- to receive and review management information;
- to review the performance of the treasury management function;
- to ensure the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function; and
- to approve the appointment of external service providers.

External Treasury Advisers

The Council recognises that there is value in employing external providers of treasury management services, in order to access specialist skills and resources.

However it recognises that the responsibility for treasury management decisions remains with the Council at all times and officers will ensure that undue reliance is not placed upon external advice.

The Council's current external treasury management advisors are Arlingclose Limited. The contract started on 1 January 2016 and is in place for an initial 3-year period. The Council will ensure that the terms of their appointment and the methods by which their value is assessed are properly agreed, documented and subject to regular review.

2 Executive Summary

The treasury management function ensures that the Council's funds are managed in accordance with the the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cashflow and where capital plans require, the organisation of approporiate borrowing facilities.

CIPFA defines treasury management as:

"The management of the local authority'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 optimum performance consistent with those risks."

This document outlines the Council's Annual Treasury Management Strategy and Annual Investment Strategy providing:-

- a summary of the Council's capital plans
- an outline of the treasury management strategy in relation to borrowing and the impact of capital plans on this borrowing
- an outline of the investment strategy including the type of instruments available for investment and our permitted counterparties

Key prudential and treasury indicators are provided throughout this strategy which clearly articulate the operational parameters in relation to Treasury Management and Investment, as well as provide assurances in relation to the affordability and sustainability of capital investment plans. Table 1 below contains the key prudential and treasury indicators within the report.

Table 1

Prudential and Treasury Indicators	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital Expenditure:				
General Services	45.586	37.674	42.206	35.863
HRA	27.246	35.809	24.557	71.001
Total	**72.832**	**73.483**	**66.763**	**106.864**
Loans Capital Financing Requirement (CFR):				
General Services	174.870	190.114	199.351	207.652
HRA	120.244	132.574	130.908	151.472
Total	**295.114**	**322.689**	**330.260**	**359.124**
Gross Borrowing	285.112	322.687	330.258	359.122
Operational Boundary for Borrowing	319.407	344.670	347.182	375.537
Authorised Limit for Borrowing	351.348	379.137	381.900	413.090
Total Operational Boundary (Including PPP/NPD)	429.558	452.203	452.155	478.274
Total Authorised Limit (Including PPP/NPD)	461.499	486.670	486.873	515.827
Investments:				
Longer than 1 year	-	-	-	-
Under 1 year	10.000	15.000	15.000	15.000
Total	**10.000**	**15.000**	**15.000**	**15.000**

A summary of this is provided below with more detailed information provided in the body of the report.

Capital Expenditure for the General Fund (GF) reflects the capital investment programme for 2018/19 to 2027/28 and Housing Revenue Account (HRA) reflects the capital investment programme for 2018/19 and the capital investment included in the latest Business Plan. To ensure the financial consequences of the new programme are fully transparent, all relevant indicators have been projected to 2027/28 and these can be found in Appendix 1.

The **Capital Financing Requirement (CFR)** is the underlying borrowing requirements of the Council.

Gross Borrowing reflects the actual borrowing which has been undertaken. This is projected to be lower than the CFR as the Council continues with its strategy to use internal funds, however, this is forecast to end in 2018-19.

The **Operational Boundary** is the maximum borrowing and other long-term liabilities to fund previous years' and the current year capital programme, building in flexibility for the timing of the different funding streams and principal repayments. The operational boundary includes any other long-term liabilities (e.g. PPP schemes, finance leases) however no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

The **Authorised Limits** is set at 10% above the Operational Boundary to give some flexibility around raising funds for future year capital investment.

Affordability of borrowing is measured by the percentage of financial costs relative to the net revenue stream of the GF and HRA.

Full details of these can be found on page 8.

The **average investment** rate set for 2018/19 is 0.35% and is reflective of the Council's appetite for risk, the short term nature of investments and the permitted instruments and counterparties selected.

Other prudential and treasury indicators and supporting information can be found in the main body of this report.

Regulatory Change

The introduction of the second Market in Financial Instruments Directive (MiFID II) in January 2018, classifies Local Authorities as "retail clients" unless it chooses opt-up to "professional client". Professional client status has the advantages of lower fees and access to a greater range of products and investment firms. The Council has therefore chosen to opt-up to professional client status. In order to meet the professional client criteria, the Council must hold a £10m investment portfolio at all times and have at least one officer with the necessary level of experience and knowledge to understand the risks involved in the management of the investments.

From 1 January 2019, Ring Fencing Legislation will come into place and large UK banks will have to separate their essential banking services (Retail Bank, which will be the ring-fenced bank) from the rest of their banking group (Investment Bank). This ringfencing means that customers investing in the retail bank are less likely to be affected by a failure in the riskier parts of the business such as investment banking. The Council will closely monitor the position of the UK banks and how local authority deposits are treated.

3 Capital and Prudential Indicators 2018/19 – 2020/21

In exercising its power to borrow, the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 require the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The Prudential Code is a framework to ensure Councils demonstrate effective control over levels of, and decisions relating to, capital investment activity, including borrowing. The Treasury indicators are used to ensure that risk is managed and controlled effectively. Together the Prudential and Treasury Indicators consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework.

(a) Capital Expenditure and Financing

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of the 2018/19 budget setting.

The estimated capital expenditure aligns with the proposed revised 10-year Capital investment programme for General Services and updated investment plans for the HRA for 2018/19 and outlined in the latest Business Plan. All projects within the Capital programme are linked to the Council's key strategic priorities. To ensure the financial consequences of the new programme are fully transparent, all relevant indicators have been projected to 2027/28 and these can be found in Appendix 1. The table 2 below show the capital expenditure plans and how they are being financed by capital or revenue resources over the next three years. Borrowing is the difference between the total capital programme and other funding sources.

Table 2

Estimates of Capital Expenditure and Income	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
General Services Capital expenditure	45.586	37.674	42.206	35.863
Funded by:				
Borrowing	-	24.050	18.469	14.533
Receipts / Grants	43.061	8.722	23.737	21.330
Funded from Revenue	0.809	1.112	-	-
Funded from Reserves	1.716	3.790	-	-
Total	**45.586**	**37.674**	**42.206**	**35.863**
HRA Capital expenditure	27.246	35.809	24.557	71.001
Funded by:				
Borrowing	5.324	14.770	1.119	23.822
Receipts / Grants	5.236	8.155	5.133	25.783
Funded from Revenue	15.080	12.766	15.201	16.644
Funded from Reserves	1.606	0.118	3.104	4.752
Total	**27.246**	**35.809**	**24.557**	**71.001**

(b) The Council's Overall Borrowing Need (the Capital Financing Requirement)

This indicator outlines the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure, which has not been paid from either a capital or a revenue resource and therefore needs to be funded from borrowing. It is essentially a measure of the Council's underlying borrowing need.

Part of the Council's treasury activity is to meet the funding requirements for this borrowing need. The treasury management section organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. The Council is required to make an annual revenue charge, called the Loan Fund Principal Repayment. This is effectively a repayment of the borrowing need and it is charged to revenue over the life of the asset. This charge reduces the CFR each year. This differs from the treasury management arrangements, which ensure that cash is available to meet the payment of capital commitments on an ongoing basis. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- increasing the annual revenue charge

The Council's CFR is shown below, and is a key prudential indicator. The opening balances include the PPP/NPD scheme on the balance sheet, which increases the Council's borrowing need, this is shown to give a complete picture of the Council's debt, however no borrowing is actually required against these schemes as a borrowing facility is included in the contract and as such, this is removed from the bottom line. The CFR is forecast to rise over the next few years, as capital expenditure financed by borrowing increases.

Table 3

Capital Financing Requirement (CFR)	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
General Services	285.021	297.647	304.324	310.389
HRA	120.244	132.574	130.908	151.472
Sub-total	**405.265**	**430.222**	**435.233**	**461.861**
Less PPP/NPD long-term liability	(110.151)	(107.533)	(104.973)	(102.737)
Sub-total	**295.114**	**322.689**	**330.260**	**359.124**
Movement in CFR				
General Services	(8.930)	15.244	9.237	8.301
HRA	3.128	12.331	(1.666)	20.563
Annual Change	**(5.802)**	**27.575**	**7.571**	**28.864**

(c) Limits to borrowing activity

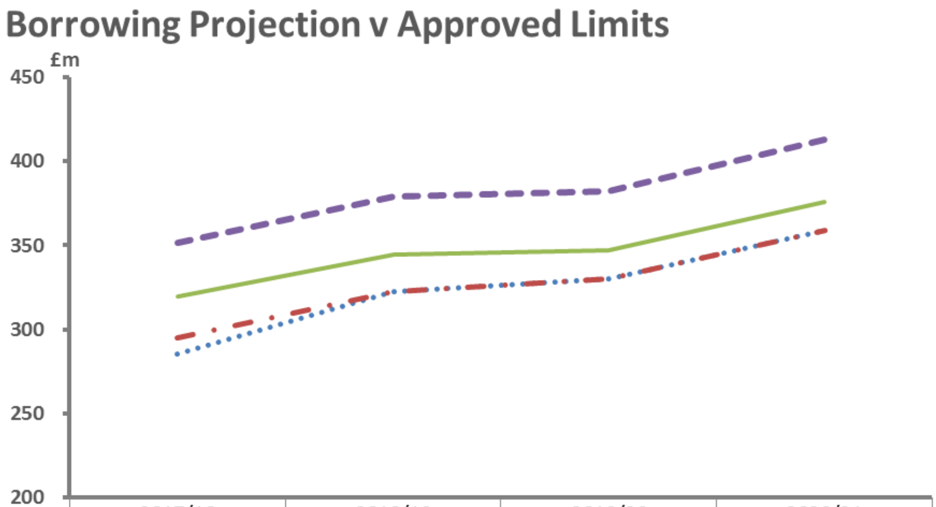
The Operational Boundary

The operational boundary is the expected maximum borrowing position of the Council during the year, taking account of the timing of various funding streams and the recharge of principal repayments from the revenue account. Periods where the actual position varies from the boundary are acceptable, subject to the authorised limit not being breached.

The Authorised Limit

The authorised limit represents a limit beyond which external debt is prohibited. This limit is set by Council and can only be revised by Council approval. It reflects the level of external borrowing which, while not desirable, could be afforded in the short term, but is not sustainable in the longer. The current limit is set at 10% above the Operational Boundary.

The graph below shows the projected levels of the Operational Boundary and Authorised Limit, compared with the Council's CFR and gross debt position. CIPFA's Prudential Code for Capital Finance in Local Authority's recommends that the Council's total debt should not exceed the highest forecast CFR over the next three year. This provides Councils with some flexibility to borrow to meet future capital investment requirements but provides a balance to ensure debt is not held for long periods of time without an underlying need to fund capital investment. The graph below confirms that the Council expects to comply with this recommendation.



NB: Figures exclude PPP

	2017/18	2018/19	2019/20	2020/21
Gross Debt at 31 March	285.112	322.687	330.258	359.122
CFR (Borrowing need)	295.114	322.689	330.260	359.124
Operational Boundary	319.407	344.670	347.182	375.537
Authorised Limit	351.348	379.137	381.900	413.090

Affordability Prudential Indicators

These Prudential Indicators assess the affordability of capital investment plans and provide an indication of the impact of capital investment plans on the Council's overall finances. The cost impact of borrowing decisions are reflected in the Council's budget as loan charges. These have been projected over the next 10 years in line with the capital plan and will be used to update the Council's Long Term Financial Outlook.

Actual and estimates of the ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long-term liabilities net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and those arising from the capital programme. The HRA costs are aligned with the 30-year business plan.

Ratio of financing costs to net revenue stream	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
General Services	5.0%	5.2%	5.6%	4.8%
HRA	15.9%	16.9%	17.4%	18.3%

The previously reported prudential indicators showing the incremental impact of capital investment decisions on both Council Tax and Housing rents are no longer required under the 2017 Prudential Code. As a result these are no longer reported.

4 Treasury Management Strategy

The treasury management function ensures that the Council's funds are managed in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cashflow and where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

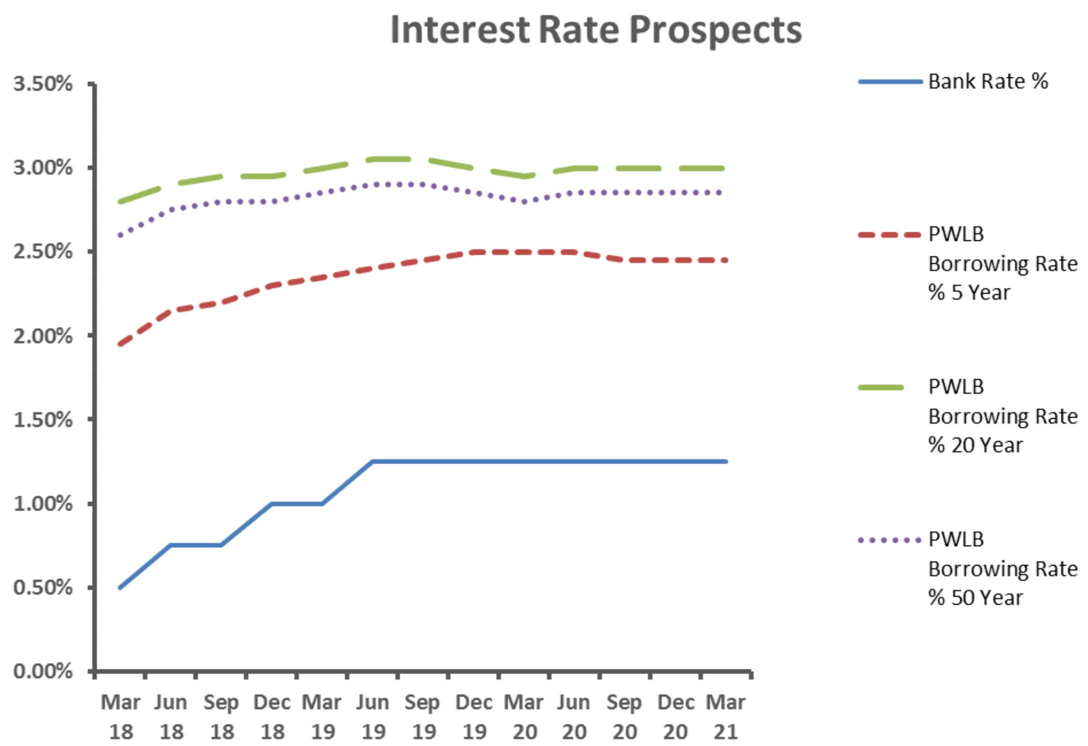
The primary objectives of the Council's borrowing strategy is to minimise the revenue impact of borrowing and to effectively manage the repayment profile of the debt.

The treasury strategy aligns with the Council Plan by contributing to "a sound financial position" and "making the best use of all resources" as referred to under the banner of "Underpinning our Priorities". The Council Plan can be found on the Council's website at: www.north-ayrshire.gov.uk.

Economic Outlook

Interest rate forecast

Interest rate forecasts are key to estimating the costs of future borrowing. The Council's treasury advisor, Arlingclose, projects that the Bank of England will raise interest rates this calendar year and in 2019 following the Bank's strong intent conveyed in its February 2018 Inflation Report, taking Bank Rate from 0.5% to 1.25% in 2019. Although Bank Rate will be higher than witnessed in recent years, it will still be low when viewed against historic levels. The projected rates are shown in the graph below alongside an assessment of PWLB borrowing rates to March 2021:



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Current portfolio position

The Council's treasury portfolio position at 31 March 2018, with forward projections, are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing. Both the external debt and CFR exclude the Council's liabilities in respect of the PPP/NPD schemes.

Current Portfolio Position (excluding PPP/NPD)	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Gross Debt at 31 March	285.112	322.687	330.258	359.122
CFR	295.114	322.689	330.260	359.124
(Under)/Over Borrowed Position	**(10.002)**	**(0.002)**	**(0.002)**	**(0.002)**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council's gross debt should not, except in the short term, exceed the total of the CFR. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council is currently under-borrowed. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt because the cash supporting the Council's internal balances and cashflow is being used as a temporary measure. This strategy is currently prudent, as investment returns are low and counterparty risk is high. Where possible, the Council will continue to use internal funds, but will balance this strategy against movements in interest rates as outlined above.

Against this background and the risks within the economic forecast, caution will be adopted within 2018/19 treasury operations. The Executive Director of Finance and Corporate Support will monitor interest rates and adopt a pragmatic approach to changing circumstances. For example:

- if it is felt that there is a significant risk of a sharp fall in long and short-term rates, then long-term borrowings will be postponed and potential rescheduling from fixed rate funding into short-term borrowing will be considered.

- if it is felt that there is a significant risk of a sharp rise in long and short-term rates than that currently forecast, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they are expected to be in the next few years.

Any such decisions will be reported to the Cabinet as part of the mid-year report. A summary of treasury risks and mitigating controls can be found at Appendix 2.

Controls on borrowing activity

The purpose of these controls is to manage the risk and impact of any adverse movement in interest rates. However, if they are set to be too restrictive they will impair any opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates.

	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Limits on fixed interest rates based on net debt	298.248	319.14	321.900	353.090
Limits on variable interest rates based on net debt	53.100	60.000	60.000	60.000

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing; both upper and lower limits are required.

Maturity Profile of Borrowing	2017/18 Probable Outturn £m	2017/18 Probable Outturn %	Lower Limit %	Upper Limit %
Under 12 months	75.517	31%	0%	40%
12 months and within 24 months	11.867	5%	0%	25%
24 months and within 5 years	15.166	6%	0%	50%
5 years and within 10 years	1.350	1%	0%	75%
10 years and above	140.512	57%	25%	90%
Total Borrowing	**244.412**	**100%**		

*Note the Under 12 months figure in the above table includes £38.950m LOBOs which have call options in year.

LOBOs

The Council holds £53.1m of Lender's Option Borrower's Option (LOBO) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Policy on borrowing in advance of need

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

Risks associated with any advance borrowing activity will be subject to appraisal and subsequent reporting in either the mid-year or annual treasury report.

Debt rescheduling

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

Potential reasons for debt rescheduling include:

- the generation of cash savings and / or discounted cashflow savings;
- the enhancement of the portfolio balance (amend the maturity profile and / or risk).

All debt rescheduling proposals will be reported to Cabinet / full Council as part of the annual or mid-year report.

Borrowing Sources

Approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- Any institution approved for investments (see Appendix 3)
- Any other bank or buiding society authorised to operate in the UK
- UK public and private sector pension fund (except Strathclyde Pension Fund)
- Capital market bond investors
- Special purpose companies created to enable local authority bond issues

In addition, capital finance can be raised by the following methods that are not borrowing, but are classed as other debt liabilities:

- Operating and finance leases
- Hire purchase
- Private Finance Initiatives
- Sale and leaseback arrangements

North Ayrshire Council raises the majority of its long-term borrowing from the PWLB, but continues to investigate other sources of finance that may be available with terms that are more favourable.

Policy on Use of Financial Derivatives

A financial derivative is a contract, which derives its value from the performance of an underlying entity. They are used for a number of purposes, including insuring against price movements. In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, future and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Policy on Repayment of Loans Fund Advances

In July 2016, the Scottish Government confirmed new Loans Fund accounting arrangements, under the provisions of The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016, which apply retrospectively from 1 April 2016.

This Regulation requires the Council to outline its policy on the repayment of loans fund advances. The Loans Fund Advance is effectively the repayment of the ‘principal’ linked to the capital expenditure which is required to be funded from borrowing.

The broad aim of prudent repayment is to ensure that the Authority’s unfinanced capital expenditure, is financed over the period of years which, that expenditure is expected to provide a benefit and that each year’s repayment amount, is reasonably commensurate with the period and pattern of the benefits.

For the majority of projects undertaken by the Council the policy is to repay loans fund advances on an annuity basis which is similar to the repayment of a mortgage where principal payments are lower at the start of the mortgage and build up to deliver full repayment over the term of the mortgage. However, there are some projects, such as the Ayrshire Growth Deal, where income streams are attached to the project, can be reasonably associated with the borrowing which will be undertaken. In these circumstances it is more appropriate for the advances to be repaid on a profile which matches this income. Therefore for these unique projects, loans fund advances are profiled for repayment to match the income and not on the annuity basis. This complies with the options available under the statutory guidance. The policy is outlined in full in Appendix 4 of the strategy.

5 Investment Strategy

The Council's investment strategy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and of receiving unacceptably low investment income. Where balances are expected to be invested for more than one year, the Authority will maximise returns, without increasing additional risk, in order to maintain the spending power of the sum investment.

The aim of the Investment Strategy is to provide security of investment and minimisation of risk by generating a list of high creditworthy counterparties which will enable diversification. Investment instruments identified for use in the financial year along with their associated risks and controls can be found in Appendix 3.

Counterparty limits are set through the Council's Treasury Management Practices. The maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership, will be treated as a single organisation for limit purposes.

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's revenue budget and cash flow forecast.

Given the risk of bail-in (which is defined below) and continued low returns from short-term unsecured bank investments, the Council will take opportunities, as cash flows permit, to further diversify into more secure asset classes during 2018/19. This is especially the case for longer-term investment. This diversification will mitigate further risks associated with investments.

Current Portfolio Position

Current Portfolio Position	2017/18 Probable Outturn £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Investments at 31 March	10.000	15.000	15.000	15.000
Net Debt at 31 March	**275.112**	**307.687**	**315.258**	**344.122**

Creditworthiness policy

In accordance with the above and in order to minimise risk, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on its lending list. The Council uses Arlingclose's Approved Counterparties List (see Appendix 5) which takes full account of the ratings, outlooks and watches published by all three ratings agencies, with ratings monitored on a real time basis and knowledge of any changes notified electronically, once published by the agencies.

Investment decisions are made by reference to the lowest published long-term credit rating from Standard & Poor's, Fitch and Moody's. The Council considers high credit quality organisations and investments as those having a credit rating of A- or higher that are domiciled in the UK, or in a foreign country with a sovereign rating of AA+ or higher. For money market funds that are more diversified, "high credit quality" is defined as those having a credit rating of A- or higher.

All credit ratings are monitored on a weekly basis by the Treasury Team who are alerted to changes in ratings of all three agencies through Arlingclose's weekly updates and following credit developments. Where a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, any investment will be withdrawn immediately, where breakage costs are not excessive.

It should be noted that where deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In such circumstances, the Council will restrict its investment activity to those organisations of higher credit quality and will reduce the maximum duration of its investments to maintain the required level of security. If this leads to a restricted number of organisations, funds will be placed with the UK government, via the Debt Management Office, treasury bills, or investment in other local authorities.

The Council recognises that credit ratings are good, but not comprehensive, indicators of investment default. Full regard is therefore given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on government support and reports in the financial press. No investment will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

Bail-in Risk

Since the financial crisis, global authorities have embarked on a wide ranging review of the banking sector to ensure that the cost to the public purse of any future crises is contained. One of the most significant changes has arisen from the Financial Services (Banking Reform) Act 2013 which added the bail-in of certain unsecured creditors to the Special Resolution Regime (SRR) granted to the Bank of England under the Banking Act 2009. Bail-in is the opposite of bail-out and requires certain creditors to bail-in funds from existing investments if a bank requires it to remain financial sustainable.

Local authority deposits in banks are unsecured and because other previously unsecure creditors have become preferred under EU Directives it means that the risks associated with local authority unsecured investments in banks have risen. Bail-in risk does not discriminate and applies to RBS and Lloyds Banks even where they retain an albeit reducing level of UK Government ownership.

There are a number of steps that can be taken to mitigate against bail-in risk. Clearly, investing with high quality and credit worthy institutions continues to be the best solution and the identification of these institutions remains a key objective of the investment strategy. Ensuring diversification of investment counterparties is also an effective risk management approach and needs to be reflected in investment counterparty limits. But the best way to manage the onset of bail-in risk is to invest in ways that avoid it altogether and this can be achieved by not investing in banks and building societies on an unsecured basis but on a secured basis where any exposure to a bank is specifically exempt from bail-in risk altogether; the Council is working with our advisers to progress this route, as cash flows permit.

Investment Strategy and Permitted Investments

The Investment Regulations (Code on the Investment of Money by Local Authorities) require the Council to approve all types of investments to be used and to set appropriate limits for the amount that can be held in each investment type. In determining its permitted investments, the Council must identify the treasury risks associated with each type of instrument and the controls put in place to limit risk on each investment type. Full details can be found in Appendix 3.

Investment returns expectations

Bank Rate is forecast to increase from 0.5% to 1.25% between March 2018 and March 2021. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 1.00%
- 2019/20 1.25%
- 2020/21 1.25%

Estimated budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

- 2018/19 0.35%
- 2019/20 0.35%
- 2020/21 0.35%

These are lower than previous levels and are reflective of the current rates available within the financial market.

Investment treasury indicator and limit

This is a control on the total principal funds invested for greater than 365 days. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and is based on the availability of funds after each year-end.

Maximum principal sums invested for more than 365 days	2017/18 Probable Outturn	2018/19 Limit	2019/20 Limit	2020/21 Limit
Principal sums invested for more than 365 days	0%	40%	40%	40%

For cashflow management, the Council will seek to utilise its 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Summary of Material Investments, Guarantees and Liabilities

In line with the new requirements in respect of the Council's Capital Investment Strategy information is provided on material Investments, Guarantees and Liabilities. Reporting of this fits better within the TMIS. Information is provided in the table below;

The Council has the current historic investments on the balance sheet as at 31st March 2017:

	Value as at 31 March 2017 £m
Long-term Debtors	1.205
Long-term Investments	0.350
Total	1.555

The long-term debtors represent loan finance provided by the Council to other parties, and include the loans to North Ayrshire Ventures Trust Ltd (£0.996m) and Advances for House Rents (£0.147m).

The long-term investment relates to a joint venture to develop land at North Shore, Ardrossan.

Monitoring of Investment Strategy

An update on the investment position of the Council will be reported to Cabinet in the 2018/19 Mid-Year Treasury report and the Annual Treasury Report will be submitted to the Council after the end of the financial year.

Appendix 1: Prudential Indicators 2022 to 2028

Estimates of Capital Expenditure and Income	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
General Services Capital expenditure	23.832	15.357	19.393	19.247	19.914	15.713	14.129
Funded by:							
Borrowing	6.768	0.737	4.204	3.926	5.122	1.319	-
Receipts / Grants	16.173	14.620	15.189	15.321	14.792	14.394	14.129
Funded from Revenue	-	-	-	-	-	-	-
Funded from Reserves	0.891	-	-	-	-	-	-
Total	**23.832**	**15.357**	**19.393**	**19.247**	**19.914**	**15.713**	**14.129**
HRA Capital expenditure	36.534	9.781	10.172	10.498	10.820	11.168	11.528
Funded by:							
Borrowing	6.256	-	-	-	-	-	-
Receipts / Grants	9.735	-	-	-	-	-	-
Funded from Revenue	17.071	9.781	10.172	10.498	10.820	11.168	11.528
Funded from Reserves	3.471	-	-	-	-	-	-
Total	**36.533**	**9.781**	**10.172**	**10.498**	**10.820**	**11.168**	**11.528**

Capital Financing Requirement (CFR)	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
General Services	309.153	300.762	295.609	290.015	284.841	277.387	267.950
HRA	153.314	148.070	142.320	135.829	128.562	121.022	115.797
Sub-total	**462.467**	**448.832**	**437.930**	**425.844**	**413.403**	**398.409**	**383.747**
Less PPP/NPD long-term liability	(100.793)	(98.614)	(96.019)	(93.548)	(90.880)	(87.857)	(84.324)
Sub-total	**361.674**	**350.218**	**341.911**	**332.296**	**322.523**	**310.552**	**299.423**
Movement in CFR							
General Services	0.708	(6.212)	(2.558)	(3.123)	(2.506)	(4.431)	(5.904)
HRA	1.842	(5.243)	(5.750)	(6.492)	(7.267)	(7.540)	(5.225)
Annual Change	**2.550**	**(11.455)**	**(8.308)**	**(9.614)**	**(9.773)**	**(11.971)**	**(11.129)**

A negative annual change in CFR reflects a reduction in the need to finance capital investment from borrowing.

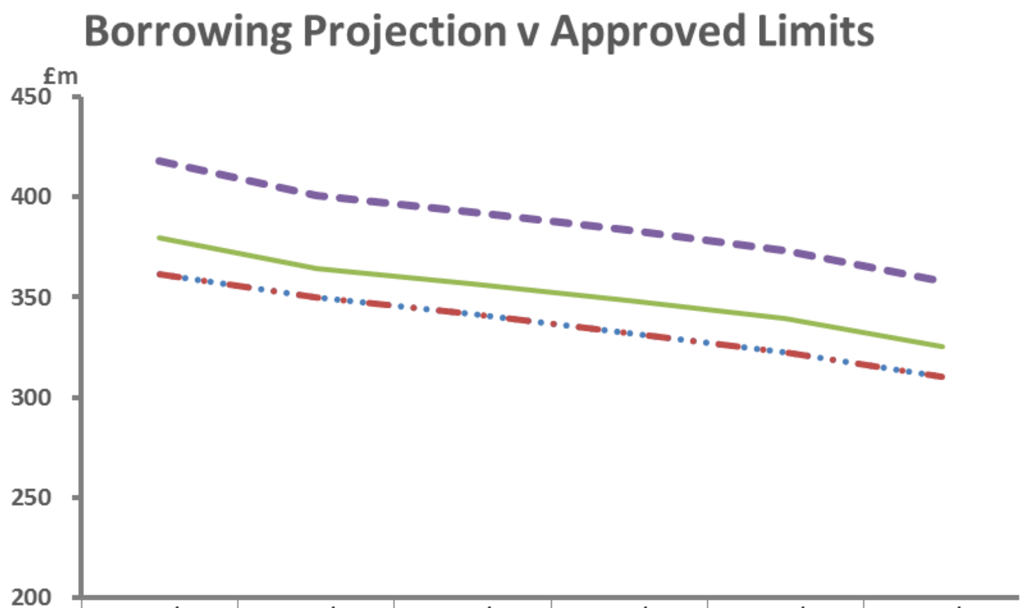
Ratio of financing costs to net revenue stream	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
General Services	4.9%	5.2%	5.1%	5.2%	5.4%	4.7%	4.7%
HRA	20.1%	20.9%	21.1%	21.7%	22.3%	21.8%	17.4%

Current Portfolio Position (excluding PPP/NPD)	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Gross Debt at 31 March	361.672	350.216	341.909	332.294	322.521	310.550	299.422
CFR	361.674	350.218	341.911	332.296	322.523	310.552	299.423
(Under)/Over Borrowed Position	**(0.002)**	**(0.002)**	**(0.002)**	**(0.002)**	**(0.002)**	**(0.002)**	**(0.001)**

Current Portfolio Position	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Investments at 31 March	15.000	15.000	15.000	15.000	15.000	15.000	15.000
Net Debt at 31 March	**346.672**	**335.216**	**326.909**	**317.294**	**307.521**	**295.550**	**284.422**

Operational Boundary	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Anticipated borrowing	379.847	364.194	356.774	348.321	339.373	325.399	311.845
PPP/NPD long-term liability	100.793	98.614	96.019	93.548	90.880	87.857	84.324
Operational Boundary	**480.640**	**462.808**	**452.793**	**441.869**	**430.253**	**413.256**	**396.169**

Authorised Limit	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Operational Boundary + 10%	417.832	400.613	392.452	383.153	373.310	357.939	343.029
PPP/NPD long-term liability	100.793	98.614	96.019	93.548	90.880	87.857	84.324
Authorised Limit	**518.625**	**499.227**	**488.471**	**476.701**	**464.190**	**445.796**	**427.353**



	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Gross Debt at 31 March	361.672	350.216	341.909	332.294	322.521	310.550
CFR (Borrowing need)	361.674	350.218	341.911	332.296	322.523	310.552
Operational Boundary	379.847	364.194	356.774	348.321	339.373	325.399
Authorised Limit	417.832	400.613	392.452	383.153	373.310	357.939

Appendix 2: Treasury Risk Register

Risk Title	Description	Consequence of Risk	Current Controls	RAG Status
Credit and Counterparty Risk	This is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly due to the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.	That investment funds will not be returned in full to the Council as per the contractual obligation of the counterparty.	The Council sets minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to invest securely. The RAG status is Amber because this risk will never be fully eliminated.	Amber
Liquidity Risk	This is the risk that cash will not be available when it is needed. Whilst it could be said that all counterparties are subject to at least a very small level of liquidity risk, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. While some forms of investment e.g. gilts, Certificates of Deposit, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a) cash may not be available until a settlement date up to three days after the sale; and b) there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.	That the Council has insufficient access to cash to enable it to carry out its activities.	The Council has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested. This has a high level of assurance around regular cash inflows and outflows. Some of the Council's cashflow related investments are invested in Money Market Funds which provide very high daily liquidity.	Green

Risk Title	Description	Consequence of Risk	Current Controls	RAG Status
Market Risk	This is the risk that, through adverse market fluctuations in the value of the sums that the Council borrows and invests, there is a detrimental impact on the Council.	That investment funds will not be returned in full to the Council as per the contractual obligation of the counterparty due to market variations.	Only a proportion of the Council's investments will be invested in instruments whose value are subject to market movements. The proportion will not exceed the maximum percentage the Council will invest in investments over 365 days.	Green
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. The Council has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report	That the Council will be faced with unexpected higher interest costs due to market variations.	The Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.	Green
Legal and Regulatory Risk	This is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, including failure to comply with the CIPFA Codes and that the organisation suffers losses accordingly.	That investment funds will not be returned in full to the Council due to the failure of the counterparty to comply with their contractual obligations	The Council will not undertake any form of investing until it has ensured that it has all necessary powers and has complied with all regulations.	Green

Appendix 3: Permitted Investments, Risks and Mitigating Controls

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Banks unsecured	These are accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks, which are established by more than one country e.g. European Investment Bank. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.	Diversifying investments is crucial to managing bail-in risk, in addition to determining proportionate counterparty and maturity limits. Certificates of Deposit, which are tradable on the secondary market and which can be sold prior to maturity, will also assist in managing credit risk.	The combined secured and unsecured investments in any one bank will not exceed £10m.
Banks Secured	These are covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. Reverse purchase agreements involve the purchase of securities with the agreement to sell at a future date at a higher price. Collateralised arrangement are an investment with collateral such as properties or debt.	These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.	The combined secured and unsecured investments in any one bank will not exceed £10m.
Operational Bank Accounts	The Council will incur operational exposures to its banking services provider, Clydesdale Bank, through current accounts. The bank is not currently on the Council's lending list as its credit ratings are below the investment credit rating criteria of A-. These balances are not classed as investments but are still subject to the risk of bail-in and balances will therefore be minimised.	The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion (which applies to Clydesdale Bank) are more likely to be bailed in than made insolvent, increasing the chance of the Council maintaining operational continuity. .	The Council monitors its operational accounts on a daily basis, transferring any surplus funds to investment accounts and therefore minimising the amount held in the operational bank account at any time.
Government	These are loans, bonds and bills issued or guaranteed by national governments, regional and	These investments are not subject to bail-in, and there is an insignificant risk of insolvency.	Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
	local authorities and multilateral development banks. Includes the UK Debt Management Office.		
Registered Social Landlords	These are loans and bonds issued by, guaranteed by or secured on the assets of Registered Social Landlords (Housing Associations). These bodies are regulated by the Scottish Housing Regulator and by the Homes and Communities Agency for Registered Providers of Social Housing in England.	As providers of public services, they retain the likelihood of receiving government support if needed and are therefore considered low risk.	Policy driven, managing all associated risks.
Money Market Funds	These are diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a management fee.	Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.	It is recommended that no more than 10% of the Council's total investments are invested in any one MMF and that the amount invested is no more than 0.5% of the size of a MMF used for liquidity purposes. For pooled investment vehicles that invest in bonds, equities and property, all of which operate on a variable net asset value (VNAV) it is recommended that no more than 10% of the Council's total investments are invested in each fund. These investments will be held for periods greater than 1 year.
Other types of investments			
Investment Properties	These are non-operational properties that are being held pending disposal, or for a longer-term rental income stream. They 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/complement the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.	Policy driven, managing all associated risks.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
		Member approval required and each application must be supported by the service rationale behind the loan and the likelihood of partial or full default.	
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 must be supported by the service rationale behind the loan and the likelihood of partial or full default. Interest payments and loan repayments will be monitored and the likelihood of partial or full default re-assessed regularly.	Policy driven, amount and loan maturity limit will be determined on a case-by-case basis.
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 must be supported by the service rationale behind the loan and the likelihood of partial or full default. Interest payments, loan repayments, and their timeliness will be monitored and the likelihood or partial or full default reassessed regularly.	Policy driven, amount and loan maturity limit determined on a case-by-case basis, managing all associated risks.
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 must be supported by the service rationale behind the investment and the likelihood of loss. Service investments will be subject to scrutiny by Financial Services on a regular basis, and will include scrutiny of	Policy driven, amount determined on a case-by-case basis, managing all associated risks.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
		financial statements issued by the local authority company.	
Non-local authority shareholdings	These are non-service investments, which may exhibit market risk, will only be considered for longer term investments and are likely to be liquid.	Any non-service equity investment will require separate Member approval and each application must be supported by the service rationale behind the investment and the likelihood of loss. Non-service investments will be subject to scrutiny by Financial Services on a regular basis, reported to Members, and will include scrutiny of financial statements issued by the company.	Policy driven, amount and anticipated time frame for shareholding determined on a case-by-case basis, managing all associated risks.

Appendix 4: Policy on Repayment of Loans Fund Advances

The purpose of the Loans Fund is to record advances from the loan fund for expenditure incurred, or loans made to third parties, which a local authority has determined are to be financed from borrowing as set out in Regulation 2 of The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 ["the Regulations"]. The Council is also statutorily required to repay Loans Fund advances and to therefore prudently determine the periods over which it will repay Loans Fund advances as well as the amount of repayment in any financial year.

Loans Fund advances comprise several items and the estimated opening balances for 2018/19, where applicable for this Authority, are shown below:-

- The Authority's capital expenditure (£295.113m),
- grants to third parties and expenditure on third party assets which would be classified as capital expenditure by a local authority (£0m), and
- loans to third parties (£0m), and
- expenditure for which a borrowing consent has been issued by the Scottish Government (£0m).

Prudent repayment of Loans Fund advances

The Loans Fund Advance is effectively the repayment of the 'principal' linked to the expenditure classified above which is unfinanced and is required to be funded from borrowing. Repayment of Loans Fund advances are required to be made in line with Scottish Government statutory guidance on Loans Fund Accounting. The Authority's annual accounts require to include a disclosure of details of Loans Fund transactions. The HRA Loans Fund advances and associated annual repayments are identified separately from that of the General Fund.

The broad aim of prudent repayment is to ensure that the Authority's unfinanced capital expenditure is financed over the period of years which that expenditure is expected to provide a benefit and that each year's repayment amount is reasonably commensurate with the period and pattern of the benefits.

The statutory guidance requires the Authority to approve a policy on Loans Fund repayments each year, and recommends a number of options for calculating prudent repayments. The Authority's policy is as follows:

For the majority of projects undertaken by the Council the policy is to repay loans fund advances on an annuity basis which is similar to the repayment of a mortgage where principal payments are lower at the start of the mortgage and build up to deliver full repayment over the term of the mortgage. However there are some projects, such as Ayrshire Growth Deal, where income streams are attached to the project which can be reasonably associated with the borrowing which will be undertaken. In these circumstances it is more appropriate for the advances to be repaid on a profile which matches this income. Therefore for these unique projects, loans fund advances are profiled for repayment to match the income and not on the annuity basis. This complies with the options available under the statutory guidance.

The repayment of Loans Fund advances will therefore be equal to the annual amount determined in accordance with Schedule 3 of the Local Government (Scotland) Act 1975.

Estimates of prudent Loans Fund repayment

The Authority's latest estimates of its Loans Fund account information are as follows:

Year	Opening Balance £m	Advances to GF £m	Advances to HRA £m	Repayment by GF £m	Repayment by HRA £m	Closing Balance £m
2016/17 actual	288.566	23.253	0.000	-8.929	-1.973	300.917
2017/18	300.917	0.000	5.323	-8.931	-2.197	295.113
2018/19 - 22/23	295.113	64.558	45.968	-37.279	-18.140	350.219
2023/24 - 27/28	350.219	14.571	0.000	-33.093	-32.274	299.423
2028/29 - 32/33	299.423	0.000	0.000	-29.415	-31.483	238.526
2033/34 - 37/38	238.526	0.000	0.000	-37.414	-28.891	172.221
2038/39 - 42/43	172.221	0.000	0.000	-36.828	-18.590	116.803
2043/44 - 47/48	116.803	0.000	0.000	-31.185	-12.311	73.307
2048/49 - 52/53	73.307	0.000	0.000	-26.564	-11.824	34.919
2053/54 - 57/58	34.919	0.000	0.000	-19.006	-9.657	6.256
2058/59 - 62/63	6.256	0.000	0.000	-2.857	-3.040	0.359
2063/64 & later	0.359	0.000	0.000	-0.359	0.000	0.000

Policy on Apportioning Interest to the HRA

Interest and expenses are allocated to the HRA based on borrowing taken in year.

Appendix 5: Counterparty Limits

The status of counterparties is monitored regularly. The Council receives credit rating and market information from Arlingclose Limited, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately and, if required, new counterparties which meet the criteria will be added to the list. The list of local authorities in the table are those, which are credit rated; however, the Council may lend to rated and unrated UK local authorities.

The Council may invest its funds with any of the counterparties detailed below, subject to the cash limits (per counterparty) and time limits shown. This list reflects the current (January 2018) counterparty list and will be updated throughout the year based on information received by our Treasury Adviser.

					COUNCIL SPECIFIC LIMITS		
Counterparty	**Fitch Long-term**	**Moody's Long-term**	**S & P Long-term**	**Banking Group**	**Individual Cash Limit (£/%)**	**Group Cash Limit (£/%)**	**Max Investment period**
UNITED KINGDOM: BANKS							
BANK OF SCOTLAND PLC	A+	Aa3	A	Lloyds Banking Group			6 months
LLOYDS BANK PLC	A+	Aa3	A			£10,000,000	6 months
BARCLAYS BANK PLC	A *+	A1	A		£10,000,000		100 days
CLOSE BROTHERS LTD	A	Aa3					6 months
GOLDMAN SACHS INT'L BANK	A	A1	A+		£10,000,000		100 days
HSBC BANK PLC	AA-	Aa3	AA-		£10,000,000		6 months
NATIONAL WESTMINSTER BANK	BBB+ *+	A3	BBB+	RBS Group			35 days
ROYAL BANK OF SCOTLAND PLC/T	BBB+	A3	BBB+			£10,000,000	35 days
ABBEY NATIONAL TREASURY SERV	A *+			Santander Group			6 months
SANTANDER UK PLC	A *+	Aa3	A		£10,000,000	£10,000,000	6 months

Counterparty	Fitch Long-term	Moody's Long-term	S & P Long-term	Banking Group	COUNCIL SPECIFIC LIMITS Individual Cash Limit (£/%)	Group Cash Limit (£/%)	Max Investment period
UK: BUILDING SOCIETIES							
COVENTRY BUILDING SOCIETY	A	A2					6 months
DARLINGTON BUILDING SOCIETY					£1,000,000		100 days
FURNESS BUILDING SOCIETY					£1,000,000		100 days
HINCKLEY & RUGBY BUILDING SOCIETY					£1,000,000		100 days
LEEDS BUILDING SOCIETY	A-	A3					100 days
LEEK UNITED BUILDING SOCIETY					£1,000,000		100 days
MANSFIELD BUILDING SOCIETY					£1,000,000		100 days
MARSDEN BUILDING SOCIETY					£1,000,000		100 days
MELTON MOWBRAY BUILDING SOCIETY					£1,000,000		100 days
NATIONAL COUNTIES BUILDING SOCIETY					£1,000,000		100 days
NATIONWIDE BUILDING SOCIETY	A+	Aa3	A		£10,000,000		6 months
NEWBURY BUILDING SOCIETY					£1,000,000		100 days
SCOTTISH BUILDING SOCIETY					£1,000,000		100 days
TIPTON & COSELEY BUILDING SOCIETY					£1,000,000		100 days
UK: LOCAL AUTHORITIES							
CORNWALL COUNCIL		Aa2		-			4 years +
GREATER LONDON AUTHORITY			AA	-			4 years +
GUILDFORD BOROUGH COUNCIL		Aa2		-			4 years +
LANCASHIRE COUNTY COUNCIL		Aa3		-			4 years +
TRANSPORT FOR LONDON	AA-	Aa3	AA	-			10 years
WANDSWORTH BOROUGH COUNCIL	AA			-			4 years +
WARRINGTON BOROUGH COUNCIL		A1		-			4 years +

Counterparty	Fitch Long-term	Moody's Long-term	S & P Long-term	Banking Group	COUNCIL SPECIFIC LIMITS Individual Cash Limit (£/%)	Group Cash Limit (£/%)	Max Investment period
UK: OTHER INSTITUTIONS							
LCR FINANCE PLC	AA	Aa2	AA				15 years
NETWORK RAIL INFRASTRUCTURE	AA	Aa2					15 years
UK GOVERNMENT	AA	Aa2	AAu				50 years
WELLCOME TRUST FINANCE PLC		Aaa	AAA				20 years
COMMONWEALTH OF AUSTRALIA	AAA	Aaa	AAAu				
AUST AND NZ BANKING GROUP	AA-	Aa3	AA-		£10,000,000		6 months
COMMONWEALTH BANK OF AUSTRAL	AA-	Aa3	AA-		£10,000,000		6 months
NATIONAL AUSTRALIA BANK LTD	AA-	Aa3	AA-		£10,000,000		6 months
NEW SOUTH WALES TREASURY COR		Aaa	AAA				25 years
WESTPAC BANKING CORP	AA-	Aa3	AA-		£10,000,000		6 months
GOVERNMENT OF CANADA	AAA	Aaa	AAA				
BANK OF MONTREAL	AA-	A1	A+		£10,000,000		6 months
BANK OF NOVA SCOTIA	AA-	A1	A+		£10,000,000		6 months
CAN IMPERIAL BK OF COMMERCE	AA-	A1	A+		£10,000,000		6 months
EXPORT DEVELOPMENT CANADA		Aaa	AAA				25 years
ROYAL BANK OF CANADA	AA	A1	AA-		£10,000,000		6 months
TORONTO-DOMINION BANK	AA-	Aa2	AA-		£10,000,000		6 months
KINGDOM OF DENMARK	AAA	Aaa	AAA				
DANSKE BANK A/S	A	A1	A				100 days
KOMMUNEKREDIT		Aaa	AAA				25 years
REPUBLIC OF FINLAND	AA+	Aa1	AA+				**15 years**
MUNICIPALITY FINANCE PLC		Aa1	AA+				15 years
OP CORPORATE BANK PLC	WD	Aa3	AA-				6 months

Counterparty	Fitch Long-term	Moody's Long-term	S & P Long-term	Banking Group	COUNCIL SPECIFIC LIMITS Individual Cash Limit (£/%)	Group Cash Limit (£/%)	Max Investment period
FEDERAL REPUBLIC OF GERMANY	AAA	Aaa	AAAu				
FMS WERTMANAGEMENT	WD	Aaa	AAA				25 years
KREDITANSTALT FUER WIEFERAUF	AAA		AAA				25 years
LANDESBANK HESSEN-THURINGEN	A+	A1	A		£10,000,000		6 months
LANDESKRED BADEN-WUERTT FOER	AAA	Aaa	AAA				25 years
LANDWIRTSCHAFTLICHE RENTENBA	AAA	Aaa	AAA				25 years
LAND SACHSEN-ANHALT	AAA	Aa1	AA+				15 years
KINGDOM OF THE NETHERLANDS	AAA	Aaa	AAAu				
BANK NEDERLANDSE GEMEENTEN	AA+	Aaa	AAA				5 years
COOPERATIEVE RABOBANK UA	AA-	Aa2	A+		£10,000,000		13 months
ING BANK NV	A+	Aa3	A+		£10,000,000		100 days
NEDERLANDSE WATERSCHAPSBANK			AAA				5 years
KINGDOM OF NORWAY	AAA	Aaa	AAA				
KOMMUNALBANKEN AS		Aaa	AAA				5 years
REPUBLIC OF SINGAPORE	AAA	Aaa	AAAu				
DBS BANK LTD	AA-	Aa1	AA-		£10,000,000		13 months
OVERSEA-CHINESE BANKING CORP	AA-	Aa1	AA-		£10,000,000		13 months
TEMASEK FINANCIAL I LTD		Aaa	AAA				10 years
UNITED OVERSEAS BANK LTD	AA-	Aa1	AA-		£10,000,000		13 months
KINGDOM OF SWEDEN	AAA	Aaa	AAAu				
NORDEA BANK AB	AA-	Aa3	AA-		£10,000,000		13 months
SVENSK EXPORTKREDIT AB		Aa1	AA+				5 years
SVENSKA HANDELSBANKEN-A SHS	AA	Aa2	AA-		£10,000,000		13 months
SWISS CONFEDERATION	AAA	Aaa	AAAu				
CREDIT SUISSE AG	A	A1	A		£10,000,000		100 days

Appendix 6: Economic Background – Arlingclose's View January 2018

The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.