

## **EAST AYRSHIRE COUNCIL**

**CABINET – 23 MARCH 2011**

### **TREASURY MANAGEMENT & INVESTMENT STRATEGY STATEMENT 2011/12 TO 2013/14**

#### **Report by Executive Director of Finance and Corporate Support**

#### **1. PURPOSE**

- 1.1** The purpose of the report is to seek Cabinet approval of the proposed Treasury Management Strategy Statement covering the period 2011/12 to 2013/14 that incorporates an annual Investment Strategy and sets out for consideration and approval the required Prudential Indicators.

#### **2. BACKGROUND INFORMATION**

- 2.1** Section 1 of The Local Government in Scotland Act 2003 places a duty on the Council to make arrangements that secure best value. Section 35 of the Act governs capital expenditure limits. It is the duty of the Council to determine and keep under review the maximum amount that it can afford to allocate to capital expenditure together with the associated revenue implications.

The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") along with the Prudential Code for Capital Finance require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Investment Strategy as required by the Scottish Government's Investment Guidance.

CIPFA has defined Treasury Management as:

*"the management of the organisation'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."*

The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are integral element of treasury management activity and include Credit and Counterparty Risk, Liquidity Risk, Market or Interest Rate Risk, Refinancing Risk and Legal and Regulatory Risk.

The strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the current and

projected Treasury position, the Prudential Indicators and the outlook for interest rates.

The purpose of this TMSS is to approve:

- Treasury Management Strategy for 2011-12 to 2013/14
- Prudential Indicators
- Use of Permitted Investments – Appendix B and C

As required by the Prudential Code, the Council adopted the revised CIPFA Treasury Management Code at its Cabinet meeting on 31 March 2010. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices. All treasury activity will comply with relevant statute, guidance and accounting standards.

### 3. TREASURY STRATEGY 2011/12 – 2013/14

#### 3.1 BALANCE SHEET AND TREASURY POSITION

3.1.1 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with Balances and Reserves, are the core drivers of treasury management activity. The estimates, based on the current Revenue Budget and Capital Programmes, are:

	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m
<b>Capital Financing Requirement</b>	326.730	375.898	397.687	396.352
<b>Less:</b> Existing Profile of Borrowing and Other Long Term Liabilities	(272.867)	(320.103)	(339.956)	(336.686)
<b>Cumulative Maximum External Borrowing Requirement</b>	<b>53.863</b>	<b>55.795</b>	<b>57.731</b>	<b>59.666</b>
Balances & Reserves	(50.673)	(35.464)	(34.825)	(31.825)
<b>Cumulative Net Borrowing Requirement</b>	<b>3.190</b>	<b>20.331</b>	<b>22.906</b>	<b>27.841</b>

3.1.2 The cumulative maximum external borrowing requirement represents the difference between capital expenditure not yet financed (CFR) and current levels of borrowing and other liabilities. The use of internal resources in lieu of borrowing has been a cost effective method of financing capital expenditure in the short term however as balances reduce this position will require to be reviewed and the underlying borrowing requirement met from external sources.

3.1.3 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. The current and estimated portfolio

position is set out in the table below. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position. The Council will ensure that external borrowing, net of short-term investments, will not exceed the CFR other than for short-term cash flow requirements.

Treasury Portfolio	31 March 2011 Projected £M	31 March 2012 Estimated £M	31 March 2013 Estimated £M	31 March 2014 Estimated £M
External Borrowing	201.774	250.910	272.663	271.293
Long Term Liabilities	71.093	69.193	67.293	65.393
<b>Gross External Debt</b>	<b>272.867</b>	<b>320.103</b>	<b>339.956</b>	<b>336.686</b>
Investments	(39.000)	(25.000)	(25.000)	(25.000)
<b>Net External Debt</b>	<b>233.867</b>	<b>295.103</b>	<b>314.956</b>	<b>311.686</b>

### 3.1.4 Estimates of Capital Expenditure:

3.1.5 It is a requirement of the Prudential Code that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and housing rent levels of proposed investment programmes. The estimated capital expenditure together with anticipated sources of financing and funding are:

Capital Expenditure	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Non-HRA	41.544	32.647	67.229	40.780	20.385
HRA	14.395	14.392	12.864	10.633	10.574
<b>Total</b>	<b>55.939</b>	<b>47.039</b>	<b>80.093</b>	<b>51.413</b>	<b>30.959</b>

Capital Financing	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Capital receipts	2.202	2.202	1.730	1.782	2.961
Government Grants	4.219	7.651	8.695	8.695	8.695
Capital Fund	2.500	2.500	3.140	0.639	0.000
Revenue contributions	5.661	6.346	5.661	5.661	5.661
<b>Total Financing</b>	<b>14.582</b>	<b>18.699</b>	<b>19.226</b>	<b>16.777</b>	<b>17.317</b>
Supported borrowing	7.130	7.130	0.000	0.000	0.000
Prudential borrowing	34.227	21.210	60.867	34.636	13.642
<b>Total Funding</b>	<b>41.357</b>	<b>28.340</b>	<b>60.867</b>	<b>34.636</b>	<b>13.642</b>
<b>Total Financing and Funding</b>	<b>55.939</b>	<b>47.039</b>	<b>80.093</b>	<b>51.413</b>	<b>30.959</b>

### 3.1.6 Incremental Impact of Capital Investment Decisions:

**3.1.7** As an indicator of affordability, the table below shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the previously agreed investment programmes. This takes into account any slippage from prior year programmes together with any changes to the anticipated profile of expenditure across financial years.

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2010/11 Approved £</b>	<b>2011/12 Estimate £</b>	<b>2012/13 Estimate £</b>	<b>2013/14 Estimate £</b>
Increase in Band D Council Tax	£0.00	<b>£0.00</b>	(£1.23)	(£3.25)
Increase in Average Housing Rents	£0.10	<b>£0.00</b>	£0.00	£0.00

**3.1.8** The Council agreed a Council Tax in line with the 2010/11 level at its meeting on 10 February 2011. As such, there will be no impact arising from the capital investment decisions for 2010/11. Levels shown for 2012/13 and 213/14 are indicative only and reflect the phasing of the programme between years and will continue to be reviewed in line with future budget decisions.

**3.1.9** The estimate for interest and expenses payments in 2011/12 is £12.818M and for interest receipts is £0.330M. The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on costs net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2010/11 Approved £m</b>	<b>2010/11 Revised £m</b>	<b>2011/12 Estimate £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>
Non-HRA	6.51%	6.16%	<b>6.91%</b>	7.91%	8.85%
HRA	15.47%	14.39%	<b>15.12%</b>	15.51%	15.41%

## **3.2 BORROWING AND RESCHEDULING STRATEGY**

**3.2.1** The Council's balance of Actual External Debt at 31 March 2010 (gross borrowing plus other long-term liabilities) is shown in paragraph 3.1.3. This Prudential Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

**3.2.2** The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is a statutory limit. The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent

but not worst-case scenario but without the additional headroom included within the Authorised Limit.

	<b>2010/11 Approved £m</b>	<b>2010/11 Revised £m*</b>	<b>2011/12 Estimate £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>
<b>Authorised Limit for External Debt</b>	351.159	435.634	<b>467.796</b>	425.055	387.131
<b>Operational Boundary for External Debt</b>	334.437	414.890	<b>445.520</b>	404.814	368.697

\*Revised to reflect requirements of International Financial Reporting Standards (IFRS)

**3.2.3** The Head of Finance has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Cabinet.

**3.2.4** In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the following borrowing options:

- PWLB loans
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Local authority stock issues
- Local authority bills and bonds
- Structured finance

**3.2.5** The issuance of Circular 147 on 20 October by the Public Works Loan Board (PWLB), following the Comprehensive Spending Review increases the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing. The PWLB however still remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term Equal Instalments of Principal (EIP) or Annuity Loans
- Long-term Maturity loans, where affordable

Capital expenditure levels, market conditions and interest rate levels will be actively monitored during the year in order to minimise borrowing costs over the medium to longer term and maintain stability. The differential between debt costs and investment earnings, despite long-term borrowing rates continuing at low levels, remains acute and this is expected to remain a feature during 2011/12. The "cost of carry" associated with medium- and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short-term costs. The use

of internal resources in lieu of borrowing in the short term may again, in 2011/12, be the most cost effective means of financing capital expenditure.

- 3.2.6** PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered in conjunction with the Council's Treasury Advisor and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.
- 3.2.7** The Council currently has £66.6m of market loans which are LOBO loans (Lender's Options Borrower's Option) of which £21.5m of loans are currently in or will be in their call period in 2011/12. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB. The default response will however be early repayment without penalty.
- 3.2.8** The rationale for rescheduling the existing debt portfolio would be one or more of the following:
- Savings in interest costs are achievable with minimal risk.
  - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
  - Amend the age profile of maturing debt to reduce any inherent refinancing risks.

As rescheduling opportunities arise, they will be identified by Arlingclose and discussed with the Head of Finance.

- 3.2.9** Borrowing and rescheduling activity will be reported to the Governance & Scrutiny Committee in accordance with agreed timetables.
- 3.2.10** The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely affect on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

The Council's existing approved limits of fixed interest rate exposure is 150% and variable rate exposure is 40%. It is proposed to maintain these during the term of the proposed strategy.

	<b>2010/11 Approved %</b>	<b>2010/11 Revised %</b>	<b>2011/12 Estimate %</b>	<b>2012/13 Estimate %</b>	<b>2013/14 Estimate %</b>
<b>Upper Limit for Fixed Interest Rate Exposure</b>	150%	150%	150%	150%	150%
<b>Upper Limit for Variable Interest Rate Exposure</b>	40%	40%	40%	40%	40%

**3.2.11** The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

<b>Maturity structure of fixed rate borrowing</b>	<b>Existing level at 31/03/10 %</b>	<b>Lower Limit for 2011/12 %</b>	<b>Upper Limit for 2011/12 %</b>
under 12 months	0.02%	0%	10%
12 months and within 24 months	0.02%	0%	20%
24 months and within 5 years	0.07%	0%	50%
5 years and within 10 years	6.28%	0%	50%
10 years and within 20 years	20.36%	0%	50%
20 years and within 30 years	28.41%	0%	60%
30 years and within 40 years	15.37%	0%	70%
40 years and within 50 years	29.47%	0%	80%
50 years and above	-	0%	90%

### **3.3 INVESTMENT STRATEGY**

**3.3.1** The Local Government Investments (Scotland) Regulations 2010 require that an Annual Investment Strategy (AIS) or Annual Investment Report must be produced.

**3.3.2** The Council's accepted order for investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

**3.3.3** Permitted investments for the Council's use are contained in Appendix B and C. The Head of Finance, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Governance & Scrutiny Committee.

**3.3.4** The Council has included within the 2011-12 Strategy, term deposits with a maximum duration of 2 years with selected banks, subject to minimum credit rating criteria (long-term minimum: A+(Fitch), A1(Moody's), A+(S&P).

The management of risks, including the risk of loss of the borrowed capital are identical to all forms of investment as set out in this strategy. The risk associated with interest rate changes are based on the Interest Rate forecast at Appendix A and the current "cost of carry".

**3.3.5** The Council's in-house investments are made with reference to the outlook for the UK Bank Rate and money market rates.

**3.3.6** In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.)

**3.3.7** The Council selects countries and the institutions within them (see Appendix C), for the counterparty list after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ for counterparties; AA+ for sovereign ratings)
- Credit Default Swaps (where quoted)
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms/potential support from a well-resourced parent institution
- Share Prices
- Macro-economic indicators
- Corporate developments, news and articles, market sentiment.

**3.3.8** The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

**3.3.9** The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12, albeit with rises anticipated in the coming months. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.

**3.3.10** To protect against an anticipated period of low interest rates for investments and to provide certainty of income, 2-year deposits and longer-term secure investments, including gilts and bonds with a maximum maturity of 5 years, will be actively considered within the limits the Council has set for Permitted Investments (see Appendix B&C). The longer-term investments will be likely to include:

- Term Deposits with counterparties rated at least A+ (or equivalent)
- Supranational Bonds (bonds issued by multilateral development banks): Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

**3.3.11** The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise because of the Council having to seek early repayment of the sums invested. The limit the overall risk within the portfolio limits of 40%; 10%; and 5% have been set respectively for investments with expected durations of up to 2 years, 2 to 5 years, and over 5 years.

No. 12	Upper Limit for total principal sums invested over 364 days	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	Under 12 months	100%	100%	100%	100%	100%
	12 months to 2 years	40%	40%	40%	40%	40%
	2 years to 5 years	-	-	10%	10%	10%
	5 years to 10 years	-	-	5%	5%	5%
	10 years and above	-	-	5%	5%	5%

### **3.3.12 Collective Investment Schemes (Pooled Funds):**

The Council's Treasury Advisor has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.

**3.3.13** Investments in pooled funds will only be undertaken following a full option appraisal and in conjunction with advice from Arlingclose. The Council's does not currently have any investments in Pooled Funds.

## **3.4 OUTLOOK AND EXPECTED MOVEMENT IN INTEREST RATES**

**3.4.1** The economic interest rate outlook provided by the Council treasury advisor, Arlingclose Ltd, is attached at Appendix A. The Council will reappraise its strategy on a quarterly basis to ensure that it continues to reflect evolving market conditions and expectations for future interest rates.

### **3.5 FREQUENCY OF TREASURY MANAGEMENT REPORTING**

**3.5.1** It is proposed that the frequency and type of reporting to Cabinet on treasury management activity and performance during 2011/12 will be:

- (i) a quarterly and year end review against the strategy approved for the year.
- (ii) The Council will produce an outturn report on its treasury activity no later than 30 September after the financial year-end.
- (iii) Reports will, in line with the existing procedure for finance and service strategy reports also be presented to the Governance and Scrutiny Committee.

### **3.6 ELECTED MEMBER TRAINING**

**3.6.1** CIPFA's Code of Practice requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. The Council has incorporated this requirement into its Treasury Strategy, Practices and Procedures and will continue to review provision as necessary.

## **4. FINANCIAL IMPLICATIONS**

**4.1** The financial implications of the proposed Treasury Management and Investment Strategy Statement have been included within the respective estimates for the General Fund and Housing Revenue Account for 2011/12 onwards.

## **5. RISK IMPLICATIONS**

**5.1** The CIPFA Code of Practice requires the Council to put in place Policies and Practices that assist in the delivery of the service and help reduce the overall risk exposure within the activity.

## **6. LEGAL AND POLICY IMPLICATIONS**

**6.1** The Treasury Management Policies and Practices will be updated as necessary to reflect the content of this report.

## 7. **RECOMMENDATIONS**

**7.1** It is recommended that Cabinet

- (i) Approves the Treasury Management and Investment Strategy Statement 2011/12 to 2013/14
- (ii) Approve the Prudential Indicators as detailed in section 3 of the report.
- (iii) Otherwise notes the content of the report.

Alex McPhee

**Executive Director of Finance and Corporate Support**

**16 March 2011**

### **LIST OF BACKGROUND PAPERS**

- Treasury Management & Investment Strategy Statement 2010/11 to 2012/13 – Cabinet 31 March 2010
- Treasury Management Annual Report 2009/10 and Update on 2010/11 Strategy – Governance & Scrutiny 27 August 2010
- CIPFA Code of practice for Treasury Management in the Public Services 2009

Any person wishing further information on this report should contact Craig McArthur, Head of Finance, Tel: 01563 576300.

**Implementation Officer:** Craig McArthur, Head of Finance

## APPENDIX A

### Arlingclose's Economic and Interest Rate Forecast

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
<b>Official Bank Rate</b>											
<b>Upside risk</b>	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75	2.75
<b>Downside risk</b>	-	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
<b>1-yr LIBID</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50	3.50	3.50
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
<b>5-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	2.00	2.25	2.75	3.25	3.50	3.75	4.00	4.00	4.00	4.00	4.00
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>10-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	3.50	3.75	3.75	4.00	4.25	4.50	4.75	4.75	4.75	4.75	4.75
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>20-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
<b>Central case</b>	4.25	4.50	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>50-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	4.25	4.25	4.50	4.75	4.75	4.75	4.75	4.50	4.50	4.50	4.50
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25

#### Economic Forecast:

- The recovery in growth is likely to be slow, uneven and more “Square root” than “V” shaped.
- The initial reaction to the Comprehensive Spending Review (CSR) is positive but implementation risks remain.
- The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- Gilts will remain volatile as the growth versus headline inflation debate escalates

#### Underlying assumptions:

- The framework and target announced in the Comprehensive Spending Review to reduce the budget deficit and government debt are the same as announced in June and focuses on how the cuts are to be distributed. The next big fiscal milestone will be the Office Of Budget Responsibility's assessment of the CSR's implications for growth, employment and inflation.

- The minutes of the Monetary Policy Committee (MPC) meeting suggest an increased likelihood of further Quantitative Easing. Money supply is weak and growth prospects remain subdued. The analysis and projections in November's Quarterly Inflation Report will give the Bank of England the opportunity to re-evaluate the outlook for economic activity and inflation and the fiscal impact of the CSR.
- Consumer Price Inflation (CPI) is stubbornly above 3% and could remain higher than the MPC has previously forecast.
- The employment outlook remains uncertain, as unemployment remains near a 16-year high at just over 2.4 Million.
- The recently announced Basel III capital/liquidity rules and extended timescales are positive for banks. However, the restructuring of UK bank balance sheets is ongoing and expected to take a long time to complete, and is a pre-condition for eventual normalisation of credit conditions and bank lending.
- A high savings ratio combined with a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore future trend rate of growth despite quarter 2 strong performance.
- Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.
- The US Federal Reserve downgraded its outlook for US growth; the Fed is concerned enough to signal further Quantitative Easing through asset purchases might be required. Industrial production and growth in the Chinese economy are showing signs of slowing. Both have implications for the global economy.

## Permitted Investments

### Permitted Investments identified for use by the Council

The Local Government Investments (Scotland) Regulations 2010 requires Local Authorities to draft their strategy in a way that identifies the different types of treasury risk that their permitted investments are exposed to – credit or security risk (of default), liquidity risk (risks associated with committing funds to longer term investments) and market risk (effect of market prices on investment value). The Strategy should describe the controls in place for limiting those risks.

Permitted Investments identified for the Council's use are:

- Deposits in the Debt Management Office Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- \*Certificates of deposit with banks and building societies
- \*Gilts: (bonds issued by the UK government)
- \*Bonds issued by multilateral development banks
- Treasury-Bills (T-Bills)
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
- Money Market Funds and other Collective Investment Schemes with a Variable Net Asset Value (VNAV)

1. \* *Investments in these instruments will be on advice from the Council's treasury advisor.*

For credit rated counterparties, the minimum criteria will be the lowest equivalent short-term and long-term ratings assigned by Fitch, Moody's and Standard & Poor's (where assigned).

*Long-term minimum: A+ (Fitch); A1 (Moody's); A+ (S&P)*

*Short-term minimum: F1 (Fitch); P-1 (Moody's); A-1 (S&P)*

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

## EAST AYRSHIRE COUNCIL

## COUNTERPARTY INVESTMENT LIST 2011/12

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limits %/£m	Maximum Maturity Limit	Treasury Risk Exposure	Controls to Mitigate Treasury Risks
Term Deposits	UK	DMADF, DMO	No limit	2 Years	Liquidity risk, market risk	Maturity Limit 2 Years
Term Deposits/Call Accounts	UK	Other UK Local Authorities	20%/£10m	2 Years	Credit risk, security risk	Maturity Limit 2 Years
Term Deposits/Call Accounts	UK/Non-UK	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent)	See detailed breakdown	2 Years	Credit risk, security risk	Ongoing monitoring in conjunction with Arlingclose
Gilts	UK	DMO	No limit	5 Years	market risk	Maturity Limit 5 Years
T-Bills	UK	DMO	No limit	2 Years	Liquidity risk, market risk	Maturity Limit 2 Years
LA Bills	UK	Other UK Local Authorities	No limit	2 Years	Credit risk, security risk	Maturity Limit 2 Years
Bonds issued by multilateral development banks		(For example, European Investment Bank/Council of Europe, Inter American Development Bank)	No limit	5 Years	market risk	Maturity Limit 5 Years
Money Market Funds	UK/Ireland/ Luxembourg domiciled	CNAV MMFs (AAA-rated) VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value)	20%/£10m	These funds do not have a maturity date	Market risk	Ongoing monitoring in conjunction with Arlingclose
Other MMFs and Collective Investment Schemes	UK/Ireland/ Luxembourg domiciled	Pooled funds	20%/£10m	These funds do not have a maturity date	Market risk	Ongoing monitoring in conjunction with Arlingclose

**APPENDIX C**

**EAST AYRSHIRE COUNCIL**

**COUNTERPARTY INVESTMENT LIST 2011/12**

<b>Instrument</b>	<b>Country/ Domicile</b>	<b>Counterparty</b>	<b>Maximum Counterparty Limit %/£m</b>	<b>Maximum Group Limit (if applicable) %/£m</b>
Term Deposits/Call Accounts	UK	Santander UK Plc (Banco Santander Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Lloyds TSB (Lloyds Banking Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Barclays Bank Plc	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Clydesdale Bank (National Australia Bank Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	HSBC Bank Plc	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Nationwide Building Society	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	NatWest (RBS Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Royal Bank of Scotland (RBS Group)	20%/£10m	20%/£10m
Term Deposits/Call Accounts	UK	Standard Chartered Bank	20%/£10m	20%/£10m
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Canada	Bank of Montreal	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Finland	Nordea Bank Finland	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	France	BNP Paribas	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	France	Credit Agricole CIB (Credit Agricole Group)	£5m (country limit 25%)	£5m (country limit 25%)

Term Deposits/Call Accounts	France	Credit Agricole SA (Credit Agricole Group)	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	France	Société Générale	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Netherlands	ING Bank NV	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Netherlands	Rabobank	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Sweden	Svenska Handelsbanken	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	Switzerland	Credit Suisse	£5m (country limit 25%)	£5m (country limit 25%)
Term Deposits/Call Accounts	US	JP Morgan	£5m (country limit 25%)	£5m (country limit 25%)

**Non-UK Banks** – restricted to a maximum exposure of 25% per country. This means that effectively all investments can be made with non-UK institutions, but it limits the risk of over-exposure to any one country.