Leicester
City Council

WARDS AFFECTED: ALL WARDS (CORPORATE ISSUE)

COUNCIL **22nd January 2015**

TREASURY STRATEGY 2015/16

Report of the Acting Director of Finance

1. **Purpose of Report**

1.1 This report establishes the strategy for the Council's borrowing and investments during 2015/16.

2. **Summary**

2.1 Treasury management is the process that ensures that the Council always has enough cash to make the payments that are necessary for its operations, and this involves both borrowing and investment. The Council's borrowing totals some £240 million; and its investments vary from below £180 million to over £230 million depending on circumstances.

2.2 The strategy described in this report differs significantly from the previous one, to reflect changing circumstance. The changes are:-

(a) Current government policy is to fund capital projects by grant, instead of a "borrowing allocation". This means that borrowing is only required when we are funding the costs ourselves (which is rare, given the revenue budget outlook); or when borrowing pays for itself. If government policy continues, we do not believe we will need to borrow money for the foreseeable future, it at all;
(b) Investment balances are high, and (at current interest rates) do not attract enough income. They continue to build up because of the lack of any borrowing requirement and the requirement to set money aside to repay debt as part of the revenue budget;
(c) Ideally we would use balances to repay existing debt, but rule changes mean there is a financial disincentive to do this;
(d) Since the financial crash of 2008, our investments have been restricted to the UK government, other local authorities and the strongest UK banks. Changes to rules on bank liquidity mean that the Government will no longer bear the full cost of "bailing out" a failing bank. Banks which require capital must first look to commercial depositors (including local authorities).This is known as "bail in".

2.3 The consequence of the above for our strategy is:

(a) the focus becomes very much about what we do with our investments;
(b) at the very least we need to widen the parties with whom we invest, in order to spread risk;
(c) where we can do so, we will use investments to repay debt, but the rationale for doing so will be risk reduction rather than savings (as in the past);
(d) we have an opportunity to think laterally about what we do with investments we believe we will not spend at any point in the medium term. The point here is that the marginal costs of using these investments is low at least until interest rates rise.

2.4 We need to be mindful that the position may change:-

(a) our high level of investments is backed to some extent by reserves (although also by grants received in advance of spend and money set aside for debt repayments). These reserves are expected to fall over the next four years;
(b) a new government may introduce supported borrowing again (or provide opportunities to borrow, backed up by new income sources, for example as part of a growth deal).

2.5 The strategy therefore includes a mixture of options for using investment balances which are not used to repay debt:

(a) in part, as a source of finance for medium term local infrastructure projects which are expected to make a return. Such projects may be identified in conjunction with the LLEP;
(b) the option of securing a longer term financial investment which will pay a higher return. Such investments will need to be with high quality public sector institutions. We will consider Government gilts, loans to the new local authority bond agency and bodies such as Transport for London.

2.6 For funds which we may require we will need to restrict exposure to UK banks to enable us to respond rapidly to any “bail in” risks. This will mean shortening the periods of deposit. New counterparties are proposed, including money market funds which pool investment risk over a wider portfolio.

2.7 Additionally, the opportunity now exists to invest limited amounts in the highest rated building societies.

3. <u>Recommendations</u>

3.1 The Council is recommended to approve this treasury strategy, and the authorised borrowing limit in paragraph 6.3. Other than limits which apply specifically to 2015/16, the Council is asked to give this strategy immediate effect.

4.0 **Treasury Strategy**

4.1 This document is the treasury strategy for 2015/16. At the beginning of each year the Council receives this report which identifies how it is proposed to borrow and invest in the light of capital spending requirements, interest rate forecasts and economic conditions.

4.2 The strategy covers the matters listed below:

- i. the Council’s current debt and investments;
- ii. prospects for interest rates;
- iii. capital borrowing required;
- iv. investment strategy;
- v. the balance between holding investments and using them to repay debt (or as a substitute for new borrowing);
- vi. debt rescheduling opportunities;

4.3 The key factors to consider are:

- i. How much new borrowing will cost. Members are asked to note that interest rates for borrowing over a long period of time are different from rates for borrowing over a short period.
- ii. How much interest the Council can get on its investments.
- iii. Ensuring the security of investments.
- iv. When loans are due to be repaid and how much it is likely to cost to refinance them at that time.
- v. Government initiatives which impact on borrowing and investment decisions.

5. **Current Portfolio Position**

5.1 The Council's current debt and investment position is shown in the table below. Members are asked to note that the figures shown represent a snapshot at a single moment in time. The table excludes £30M of debt managed by the County Council on behalf of the City Council and also excludes debt instruments held by contractors for PFI schemes.

Treasury Position As At 28th November 2014	**Amount**
Fixed Rate Funding Public Works Loan Board Stock Market Loans	 £134m £9m £96m
Total Debt	£239m
Investments	£172m
Net Debt	£67m

5.2 The debt is long dated, with repayments mainly due from 38 years to 67 years. Average interest paid is 4.45%, which represents rates which were low when they were taken out.

6. Treasury Limits For 2015/2016

6.1 The treasury strategy includes a number of prudential indicators required by CIPFA's Prudential Code for capital finance, the purpose of which is to ensure that treasury management decisions are affordable and prudent. The recommended indicators and limits are shown below. One of these indicators, the "authorised limit" (para 6.3 below) is a statutory limit under the Local Government Act 2003.

6.2 The first indicator is that over the medium-term net borrowing will only be for capital purposes – i.e. net borrowing should not, except in the short-term, exceed the underlying need to borrow for capital purposes (the "capital financing requirement"). We do not anticipate any difficulties in complying with this requirement.

6.3 The Council is required to set an "authorised limit" on borrowing which cannot be exceeded. The approved limits recommended for 2015/16 are:

	£m
Borrowing	290
Other forms of liability	145
Total	435

6.4 "Other forms of liability" relates to loan instruments in respect of PFI schemes and to pre-unitary status debt managed by the County Council (and charged to the Council). The remainder, "borrowing", refers to conventional loans. In practice, the treasury strategy only manages the borrowing component.

6.5 The Council is also required to set an "operational boundary" on borrowing and other forms of long-term liability, which requires a subsequent report to scrutiny committee if exceeded. In practice, the treasury strategy only manages the borrowing component. The approved limits recommended for 2015/16 are:

	£m
Borrowing	280
Other forms of liability	145
Total	425

6.6 Recommended upper limits on fixed and variable rate debt exposures are shown in the table below. The figures shown are the principal sums outstanding on "borrowing".

	£m
Fixed interest rate	240
Variable interest rate	60

6.7 The Council has also to set upper and lower limits for the remaining length of outstanding loans that are fixed rate as a percentage of the total of all loans. This table also excludes other forms of liability. Recommended limits are:

Upper Limit

	%
Under 12 months	30
12 months and within 24 months	40
24 months and within 5 years	60
5 years and within 10 years	60
10 years and within 25 years	100
25 years and over	100

We would not normally borrow for periods in excess of 50 years.

Lower Limit

	%
Less than 5 years	0
Over 5 years	60

Borrowing and Investment Levels

7.1 It appears likely that the Council's requirement to borrow is now at a peak and is likely to decline in future years. Until 2011, the Government provided support for capital expenditure by a combination of capital grants and "supported borrowing" allocations. Supported borrowing allocations enabled the Council to borrow money, with the costs of financing the debt being met by Revenue Support Grant. Since then Government support has been wholly grant funded.

7.2 The law and codes of practice require that money must be set aside in the budget each year to repay previous years' debt. These rules, very broadly, seek to ensure that the Council's borrowing is repaid over the life of the projects which have been financed. Hence, in the absence of new borrowing, the Council's net borrowing will decline.

7.3 The Council undertakes a number of projects which are not Government supported and can borrow for these – this is known as "unsupported" or "prudential" borrowing. In practice, it has not been necessary to undertake fresh borrowing for several years. We have instead used money set aside to repay debt or other available cash.

7.4 Beyond 2015/16 the money set aside to repay debt will not be used for planned capital spending as Government grant will be used. This does not necessarily mean that we shall immediately repay debt, unless it is beneficial to do so - as noted above for a number of years we have not borrowed but have instead used cash balances as an alternative to borrowing.

7.5 The cumulative impact of these policies is that we have anticipated the need to repay debt and a cumulative total £220m of balances have been used as an alternative to external borrowing. Currently this saves the Council approximately £7m per year in interest.

7.6 Even after using balances as an alternative to borrowing large cash balances remain. Much of these are temporary in nature and held against commitments - for example grants received in advance of expenditure, and funds earmarked for committed capital projects. The level of such balances is expected to decline over 2015/16 and later years. However, it is estimated that over the medium term we will have around £50m of investments which we will never spend (unless Government policy changes).

Interest Rates

7.7 Interest rates, both long term and short term are very low by historical standards. Our treasury advisors, Arlingclose, forecast that short term rates will rise from 2015 but that the rate of increase will be slow. By the end of 2017 they see short term rates of 1.75% and beyond that, over the medium term they do not see short term rates rising beyond 3% to 3.5%, and such rates are lower than the historical long term average. If our current position continued we would have a high level of investments earning very little in the short term with only a modest improvement over the medium term.

7.8 At the time of writing this report the interest rate on fixed rate borrowing from the PWLB for 50 year loans is 3.4% and our advisors see this rising to 4.2% by the end of 2017. This is historically extremely cheap, but we have no need to take it.

Investment Risks

7.9 Within the Eurozone economic growth is forecast by many commentators to stagnate whilst government debts continue to rise, and the direct and indirect impacts of these factors increase the credit risk of many investments.

7.10 At the same time changes have been made to reduce the need for taxpayer bailouts when banks run into trouble. Measures to strengthen bank's balance sheets serve to reduce the risk to investors. However other changes increase the risk to large investors - the deposits of small investors now take priority over the deposits of larger investors such as the Council and formal mechanisms now require that large investors are "bailed in" to any bank restructuring (i.e. a proportion of their investments will be converted into bank equity, which may have little or no value) before any taxpayer bailout takes place.

7.11 Within an environment of low interest rates and increasing risks our treasury strategy should emphasise risk reduction, and an increase in investment return whilst striking a cautious balance between risk and reward.

7.12 Our advisors provide tools to help us monitor the credit risk of bank and building society investment. Existing tools look at such factors as credit ratings and share prices. The analysis of building societies is new, and enables us to include some societies on our approved investment list.

7.13 A new tool helps us assess the risk of "bail ins" when we deposit money with a bank or building society, and the various "failure thresholds" which would result in loss.

7.14 Whilst the increasing risk of "bail ins" present a challenge to investors the clarification of how this will be implemented is helpful as it helps investors to understand, and hence manage, these risks.

Investments up to One Year

7.15 Some of our investments are primarily held to manage the Council's cashflow for periods of up to one year.

7.16 Deposits with banks and building societies are now less attractive because of the low interest rates paid. Also because of 'bail in' risk the maximum period that we will invest for has been reduced for many banks. Within the new shorter maximum (one year, less for weaker banks) bank deposits remain useful for managing the Council's cashflow.

7.17 We will continue to place deposits with other local authorities and with the Government through its Debt Management Office. Such investments are highly secure, although interest rates are also very low.

7.18 We are proposing to make use of money market funds. These are pools of highly credit rated investments such as deposits and short dated bonds which reduce risk by diversification. The funds include the strongest international banks and are actively managed preventing us having to monitor the underlying investments. Cash is repayable on demand making these useful tools for managing the Council's short-term cashflow (particularly if we make the medium term investments described below).

7.19 We are also proposing to make use of funds similar to money market funds, often described as money market plus funds. These still pool highly credit rated investments but have a longer average maturity than money market funds. These are useful for managing cash over periods from one month ahead to up three months ahead and offer higher returns than money market funds. There is a risk, however, that funds underperform if market interest rates rise faster than the fund managers expect.

7.20 It is proposed that unrated building societies be added to our lending list. The maximum exposure to any one building society proposed is £1m and the maximum exposure to unrated building societies is £10m.

7.21 Building societies will only be added to our lending list on the recommendation of our treasury advisors. This guidance takes into account both the financial strength of each building society and the potential exposure to "bail in".

7.22 The unrated building societies under consideration are: Leeds, Cumberland, Scottish, Vernon, Darlington, Furness, Harpenden, Hinckley and Rugby, Leek United, Loughborough, Mansfield, Market Harborough, Marsden, Melton Mowbray, National Counties, Newbury and Tipton & Coseley.

7.23 Unrated building societies do not publish financial information as frequently as publically quoted banks and the main publically available information on their financial strength comes from their annual accounts. However the underlying business model of building societies is conservative and the sector as a whole has a track record of being well regulated.

Longer Term Investments

7.24 Historically, our investments represent money received in advance of need and monies set aside to repay debt or reserves. Consequentially, they are a short term resource. However, the changes described in this report suggest around £50m is now best seen as a longer term resource.

7.25 As has been identified above we estimate that we hold £50m of cash on investments that we will never spend and our expectation, therefore, is that cash balances will decline from the current high levels over the next few years down to £50m.

7.26 Conventional bank deposits with a maturity in excess of one year are not considered appropriate, even for the strongest banks. Whilst the risk of being "bailed in" is considered to be low it is real and the interest rates are not considered to be adequate to reflect this risk. We shall continue to deposit money with other local authorities for periods up to two years.

7.27 Investments via “covered bonds” are another option. Here money is loaned to a bank for period of between one to five years and is secured on bank assets, such as the bank’s mortgage portfolio. This security is recognised within the new “bail in” arrangements, although only to the extent that the realisation value of the security covers the value of the investment.

7.28 In theory, we would like to use investments to repay debt. This has always required a premium to be paid (i.e. why would a lender accept repayment of a loan paying 4% which it cannot reinvest at the same rate?). This does not necessarily make the deal uneconomic – it simply ensures debt is repaid at fair value. However rules recently imposed have increased the premium payable. Whilst we can, and should, use investments to repay some debt we will need to be selective about the loans to repay, and recognise we are primarily doing it to reduce investment risk rather than to make savings for the revenue budget. This strategy permits us to do so.

7.29 We may be able to repay debt managed by the County on our behalf (dating from reorganisation), as long as the County still has some borrowing need (we will tell them we would like to do this). The recharging arrangements for this debt are quite complex and we would have to be able to agree mutually agreeable changes to these with the County.

7.30 Some investments can be set aside for an investment fund. We can support capital projects, at a marginal cost to us of 0.5% in the short-term (i.e. what we lose on the investments), and not much more in the medium term. We would be able to fund schemes with a short life (say up to 10 years) at rates matching what we get on our investments. The fund would be less suitable for funding longer term projects, as rates beyond 10 years’ time are not knowable; however, schemes with secure longer term income streams may be viable. Use of this fund could be considered as a means of investing in commercial property to generate future revenue income and capital growth. Some schemes may be identified in conjunction with the LLEP.

7.31 A report will be prepared for the Executive setting out the parameters of such a fund, the maximum, and the minimum and the assessment criteria. Such schemes will result in additions to the capital programme, to which normal approval rules will apply.

7.32 Other options for our long-term investments include:-

(a) Using some of them to buy a government gilt, or a number of gilts, over a period of time. This can lock us into longer term interest rates of around 3%, at negligible risk and would give us revenue savings;

(b) We can lend to the new Local Authority Bond Agency, which is being set up to lend to other local authorities following an initiative of the LGA. Rates payable are likely to be good. However, we remain unconvinced that many authorities are actually going to borrow from the agency and there may therefore not be any need for our cash (many authorities are in the same position we are);

(d) We can look to lend long-term to a high quality institution (such as the European Investment Bank, Transport for London or another local authority).

7.33 No further approval shall be required from the Executive in respect of the investments described in the Annual Investment Strategy appended to this report which lays down detailed controls over the credit worthiness requirements and other controls over money market funds, deposits and similar investments. Further executive approval is required in respect of the investment fund.

8. Debt Rescheduling & Premature Repayment of Debt

8.1 This report proposes the premature repayment of debt using cash that is currently invested.

8.2 Rescheduling is also an option that may be considered. The only difference is that instead of using existing cash balances to fund the repayment we would fund it by borrowing a new loan on more attractive terms than the old loan.

8.3 The raising of the new replacement loan need not take place at the same time as the old loan is repaid - it may be beneficial to borrow it at a later stage. This is relevant in the current situation where the Council has a high level of cash balances which it expects to decline over the next few years, especially given the current low rate of interest paid on investments.

8.4 If, for example, we repay an existing loan on which we pay interest at a rate of 4% and replace it with a new loan also paying 4% then there will no revenue savings. If, however, we defer taking the new loan then for each year that we delay raising a new loan the interest saving will be 3.5% (4% interest saved less, say, 0.5% interest foregone on investments).

8.5 In practice the premature repayment of debt will incur a premium, in which case the financial calculations become more complex, however, the principle remains the same.

8.6 In practice, debt rescheduling will be unlikely unless we successfully run down investment balances first.

9. Managing Credit Risk and Other Risk

9.1 This report outlines the investment strategy. Further details are given in the appendix, which sets the criteria that we apply to ensure that we only invest with borrowers of high credit worthiness. It also deals with measures to manage other key issues, for example ensuring access to liquid funds.

9.2 Investments will always comply with the minimum credit ratings specified in this strategy but other factors will be taken into account as contra-indicators and these will include share price, the cost to investors of buying insurance against default and political and economic developments (especially those to do with the Eurozone).

9.3 At the time of writing this report the Council is in the process of moving its bank accounts from the Co-op bank to Barclays following the completion of a tendering exercise in 2014. This will address the concerns over the credit worthiness of the Co-op Bank. Members may recall also that the Co-operative Bank is withdrawing from the provision of banking service to local authorities and other large public sector organisations.

9.4 Any concerns around the credit worthiness of investments will continue to be reported via six-monthly reports to the Overview Select Committee and, if such concerns exist, via monthly briefing reports to the City Mayor.

9.5 This investment strategy is based on the advice of Arlingclose, our Treasury Advisors and they have consistently taken a cautious approach (for example they advised against investing in Icelandic banks).

10. Sensitivity of This Strategy and Risk Management

10.1 This strategy is based on the view that the economic outlook for 2015/2016 and later years carries a number of significant risks.

10.2 Short-term interest rates are expected to rise slowly over the medium term and the main risk is that they rise faster and/or sooner than expected. If this happens some individual investments may perform worse than expected, but overall the impact on the Council is likely to be that its investment income increases because most of its investments pay interest at short or variable rates.

10.3 There is a related risk that long-term rates rise faster than expected. If this happens some of the investments proposed in this report would decline in value. At the same time debt repayment and debt rescheduling options may become more financially beneficial.

10.4 If long term interest rates decrease, or rise slower than expected then some of the medium term investments proposed in this report would increase in value. However, future debt repayment/debt rescheduling opportunities will become less favourable. Overall the short-term impact on the Council would be limited.

10.5 The main concern around lower than expected interest rates would be the underlying reason. Most likely it would indicate a deteriorating economic situation which could feed into increased credit risk.

10.6 The future level of cash balances is a material consideration. If these are higher than forecast (or decline more slowly than expected) then the Council's investments will increase, and so will investment income. The converse will be true if they are less than forecast or decline more slowly. These impacts will be limited by the low level of interest rates.

10.7 The Council has £96 million of market loans at favourable interest rates on which the lender has the right to periodically propose an interest rate increase. We have the option to refuse and to repay the loans, but would then have to borrow new loans at the prevailing interest rates. In the current interest rate environment the financial risk is believed to be low - it's unlikely that lenders will exercise their option and if they did (which we would probably welcome) the cost of replacement loans (if needed) could be kept low by borrowing short to medium term loans. We would give serious consideration to rescheduling or repaying these loans so as to reduce this risk, even if this did not generate a financial saving or came at a small cost.

10.8 Where, exceptionally, immediate action that does not comply with this strategy will benefit the Council such action will be taken, and will be reported to the City Mayor and the Overview Select Committee.

11. Housing Revenue Account

11.1 The Housing Revenue Account (HRA) operates under a self-financing regime in which it has earmarked debts separate from those of the General Fund. Where appropriate, a separate loans strategy should be operated for each pool. However, the requirements of the HRA for 2015/16 are straightforward in that no new borrowing is required and the strategy described in this report is appropriate for the HRA.

12. Treasury Management Advisors

12.1 Since January 2008 the Council has employed Arlingclose as treasury advisors. The service provides advice on our borrowing and investment policies and strategies. The annual fee for this service is £21,000 and is currently being retendered.

12.2 There have been many challenges in 2014/15 and Arlingclose's performance has been good.

13. Leasing

13.1 The Council is likely to acquire equipment, principally vehicles, to the value of approximately £1 million that would be suitable for leasing.

13.2 Before leasing is pursued consideration will be given to the options of finance leasing, operational leasing, and prudential borrowing. At present prudential borrowing is more cost effective. This judgement takes into account the costs of the two forms of finance over the expected economic life of the asset. In addition, because of lease termination charges it is more expensive to dispose of a leased vehicle than an owned vehicle, and this is important because the Council is reviewing the utilisation of the existing fleet.

13.3 In practice, prudential borrowing will mean use of our cash balances.

14. **Financial and Legal Implications**

14.1 The proposals are in accordance with the Council's statutory duties under Local Government Act 2003 and statutory guidance, and comply with the CIPFA Code of Practice on Treasury Management. In accordance with the Council's Constitution the strategy requires full Council approval.

15. **Other Issues**

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

16. **Background Papers**

16.1 Background information is available on the files of the Director of Finance.

17. **Consultation**

17.1 Arlingclose Ltd.

18. **Author**

18.1 The author of this report is David Janes of the Financial Services Division on extension 7490

Alison Greenhill
Director of Finance.

Appendix to Treasury Strategy 2015/16

ANNUAL INVESTMENT STRATEGY 2015/2016

1. Introduction

1.1 This investment strategy complies with the DCLG's Guidance on Local Government Investments and CIPFA's Code of Practice.

1.2 The Investment Strategy states which investments the Council may use for the prudent management of its treasury balances. It also identifies other measures to ensure the prudent management of investments.

1.3 It does not cover the use of investments for infrastructure projects for which a separate policy will be created.

2. Investment Objectives & Authorised Investments

2.1 All investments will be in sterling.

2.2 The overriding policy objective for the Council is the prudent investment of its balances. The Council's investment priorities are
(a) the **security** of capital and
(b) **liquidity** of its investments.

2.3 The council will aim to achieve the **optimum return** on its investments commensurate with the proper levels of security and liquidity.

2.4 The Council will not borrow monies purely to invest or on-lend.

2.5 The list of authorised investments is as follows: -

Short Term Investments

i. Deposits for periods up to one year with credit rated deposit takers (UK banks and building societies);
ii. Deposits for periods up to one year with unrated UK building societies;
iii. Deposits for periods up to one year with other local authorities;
iv. Money Market Funds, Money Market Plus funds and similar pooled funds where funds can be returned on notice of less than one year;
v. Any deposit, bond, note, bill or other loan instrument with a residual maturity of up to one year which has the same economic characteristics as (i), (ii) or (iii).

Longer Term Investments

vi. Deposits for periods up to two years with UK local authorities;
vii. Deposits of any duration which are issued by or explicitly guaranteed by the UK Government;

viii. Deposits of up to five years with UK banks and building societies whose security is provided through a covered bond;

ix. Bonds issued by the Government, other UK local authorities and quasi-Government bodies such as Transport for London (TFL); and the European Investment Bank (EIB) and other similar bonds issued by international development banks with the backing of the Governments of one or more "G7" countries. Such bonds will not be purchased without the approval of the Director of Finance in consultation with the City Mayor;

2.6 The Council will impose upper limits on the total amount of money to be invested in individual organisations and in each sector according to the following criteria: -

i. UK banks and building societies:
   a. £80m in the sector as a whole, of which no more than £10m may be invested in unrated building societies;
   b. £1m per individual unrated building society;
   c. £10m per individual bank (or rated building society) if unsecured;
   d. £20m per individual bank or building society if secured (e.g. covered bonds).

ii. Investments issued or guaranteed by HM Government – unlimited.

iii. Investments in the UK public sector other than the UK Government:
   a. £80m in the sector as a whole;
   b. £20m per individual local authority;
   c. £10m per body for other public sector bodies.

iv. Money Market Funds and Money Market Plus Funds:
   a. £60m in the sector as a whole;
   b. £20m in individual funds.

v. International Development Banks:
   a. £40m in all such institutions;
   b. £10m per individual institution.

vi. An 2% margin of error is permitted on these limits when these limits are breached simply because interest has been paid and has been added to the account balance.

2.7 The following factors apply to both short-term and longer-term deposits.

i. Deposits may be for fixed terms or may be repayable at the option of the borrower and/or the lender and may or may not be negotiable

ii. Deposits may be agreed in advance that run from an agreed future date.

iii. For the purposes of applying the credit rating criteria laid down in this AIS, deposits agreed in advance shall be treated as running from the date they are agreed. However, where a deposit is agreed 10 or fewer working days in advance it shall be treated as running from the date the cash is deposited.

iv. Interest rates may be fixed at the outset or may be varied by agreement. They may also be varied by reference to market rates or benchmarks (eg LIBOR), provided that such rates or benchmarks are capable of independent verification.
v. A deposit to an organisation with an unconditional financial guarantee from a parent organisation shall be treated as if it were as a deposit with that parent organisation.
vi. Where an institution is part of a group then limits shall be set both at group level and at the level of the individual institution.

3. <u>Security of Capital</u>

3.1 The Director of Finance will only invest with the most secure counterparties. This section of the AIS describes how these are identified.

Banks and Rated Building Societies

3.2 The Director of Finance will maintain a list of approved counterparties.

3.3 The Council utilises credit ratings published by Fitch Ratings. Investments are also permitted on the basis of equivalent ratings issued by Moody's Investors Services or Standard and Poor's. In the absence of good reasons to the contrary, decisions will be based on the lowest rating. When applying credit rating criteria it shall be assumed that investments shall be held to maturity. Where, however, the Council has an unqualified option to require the investment to be fully repaid at an earlier date, then for the purposes of applying these criteria it shall be assumed that the investment shall run until the earliest repayment date.

3.4 Minimum credit ratings for UK banks and rated building societies are:

i. 6 months or less: a long-term rating of A- and a short term rating of F2;
ii. 6 months to 1 year: a long-term rating of A and a short term rating of F1;
iii. Over 1 year: only permitted when secured by means of covered bonds and a long-term rating of AA.

3.5 Credit ratings will be monitored:

i. All credit ratings for investments being actively used will be monitored monthly and credit rating alerts will be acted on as soon as practicable (the next working day or sooner);
ii. If a body is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that body will cease;
iii. A deterioration in credit ratings will not automatically lead to a decision to terminate the investment prematurely (and in many cases there will be no contractual provision to permit this).
iv. If a counterparty is upgraded so that it fulfils the Council's criteria, its inclusion will be considered and put to the Director of Finance for approval;

v. If other market intelligence suggests that credit ratings give an over-optimistic view of credit-worthiness, this will be taken into account.

Unrated Building Societies

3.6 For unrated building societies the Director of Finance will maintain a list of approved counterparties. The credit worthiness of unrated building societies will be assessed using advice from the Council's treasury advisors. This advice shall consider the risk of financial stress by reference to the most recently published accounts and by reference to any other publically available market information. In particular regard shall be had to the capital held to absorb financial shocks, liquidity and profitability. The advice shall also consider the extent of the financial loss in the event of a "bail in".

Other Investments

3.7 Investments issued by or subject to an explicit guarantee from the UK government and in other UK local authorities may be made without further evidence of credit worthiness

3.8 The Director of Finance will maintain an approved list of money market funds and money market plus funds. This will be based on an assessment which judges the suitability of the fund manager's management of credit risk (taking into account the credit rating criteria for banks laid down in this AIS), and the advice of Arlingclose.

3.9 Other investments in the UK public sector will be made subject to a business case to be signed off by the Director of Finance in consultation with the City Mayor.

3.10 Investments in International Development banks will be made subject to a business case to be signed off by the Director of Finance in consultation with the City Mayor.

3.11 For all investments regard shall be had to the prospect of support from a parent institution or a strong government, though the role of the latter is now limited by "bail in" rules. In addition for all categories of investments regard will be had to other sources of information including (where applicable) the price of Credit Default Swaps, share prices, developments, news, economic data and market sentiment. Regard shall be had to the likely impact of any "bail in".

4. Investment balances / Liquidity of investments

4.1 The minimum percentage of its overall investments that the Council will hold in short-term investments is 40% and the Council will maintain liquidity by having a minimum of £30m of deposits maturing within 2 months (subject to the availability of funds to invest). There is a regular monthly cycle to the Council's cashflow and these limits apply to the peak cash balance just ahead of the payday. These liquidity targets are guidelines and occasional and temporary deviations from these limits will be permitted on a planned basis where there are good reasons.

4.2 No more than £100m will be held in investments in excess of 366 days.

5. Investment Reports

5.1 Reports will be prepared twice yearly as part of the reports on treasury management activity, and a monthly note is prepared for the Director of Finance and the City Mayor.