

# Public Document Pack

## Argyll and Bute Council Comhairle Earra-Ghàidheal Agus Bhòid

Customer Services  
Executive Director: Douglas Hendry



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4 February 2016

### NOTICE OF MEETING

A meeting of the **POLICY AND RESOURCES COMMITTEE** will be held in the **COUNCIL CHAMBER, KILMORY, LOCHGILPHEAD** on **THURSDAY, 11 FEBRUARY 2016** at **10:30 AM**, which you are requested to attend.

Douglas Hendry  
Executive Director of Customer Services

### BUSINESS

**1. APOLOGIES FOR ABSENCE**

**2. DECLARATIONS OF INTEREST (IF ANY)**

**3. MINUTES** (Pages 1 - 6)

Policy and Resources Committee held on 17 December 2015

**\* 4. BUDGETING PACK**

To consider, and if so minded, make recommendation to Council in respect of -

(a) Revenue Budget 2016 - 2017

- i. Introductory Report and Recommendations for Budget papers on Revenue Budget
- ii. Planning Our Future Consultation – Findings Report
- iii. Service Choices – Assessing Equality Impact
- iv. Revenue Budget Overview
- v. Report on Fees and Charges
- vi. Revenue Budget Monitoring 2015-16 as at 31 December 2015
- vii. Report on Financial Risks Analysis
- viii. Report on Reserves and Balances

(b) Capital Plan 2016 - 2020

- i. Introductory Report and Recommendations for Budget Papers on Capital Plan

- ii. Capital Plan Summary
- iii. Corporate Asset Management Strategy
- iv. Corporate Asset Management Plan
- v. Service Asset Management Plans:
  - o Community Services Asset Management Plan
  - o Customer Services Asset Management Plan
  - o ICT Group Asset Management Plan
  - o Development and Infrastructure Asset Management Plan

**[Please note that the Budgeting Pack of papers relative to the consideration of the foregoing matters is enclosed separately with this agenda pack, please bring these papers with you to the meeting]**

- \* **5. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY** (Pages 7 - 58)  
Report by Head of Strategic Finance
- 6. FINANCIAL REPORTING 2015/16 SUMMARY** (Pages 59 - 64)  
Report by Head of Strategic Finance
- 7. COMPLIANCE WITH TEACHER NUMBERS COMMITMENT** (Pages 65 - 82)  
Recommendation from Community Services Committee held on 10 December 2015 and report by Executive Director – Community Services
- 8. POLICY AND RESOURCES COMMITTEE WORK PLAN** (Pages 83 - 86)

Items marked with an “asterisk” are items, on the basis of information available at the time this Agenda is published, on which the Committee may not have delegated powers to act, and which may therefore require to be referred to the Council or another Committee, and that referral may depend on the decision reached at the meeting.

## **Policy and Resources Committee**

Councillor Dick Walsh (Chair)	Councillor Rory Colville
Councillor Robin Currie	Councillor Maurice Corry
Councillor Mary-Jean Devon	Councillor Donald Kelly
Councillor Roderick McCuish	Councillor Iain MacLean
Councillor Alistair MacDougall	Councillor Aileen Morton
Councillor Ellen Morton (Vice-Chair)	Councillor Gary Mulvaney
Councillor James Robb	Councillor Len Scoullar
Councillor Isobel Strong	Councillor Sandy Taylor

Contact: Hazel MacInnes Tel: 01546 604269

**MINUTES of MEETING of POLICY AND RESOURCES COMMITTEE held in the COUNCIL  
CHAMBER, KILMORY, LOCHGILPHEAD  
on THURSDAY, 17 DECEMBER 2015**

**Present:**

Councillor Dick Walsh (Chair)

Councillor Rory Colville	Councillor Douglas Philand
Councillor Robin Currie	Councillor James Robb
Councillor Roderick McCuish	Councillor Len Scoullar
Councillor Alistair MacDougall	Councillor Isobel Strong
Councillor Aileen Morton	Councillor Sandy Taylor
Councillor Ellen Morton	

**Attending:**

Douglas Hendry, Executive Director of Customer Services  
 Cleland Sneddon, Executive Director of Community Services  
 Pippa Milne, Executive Director of Development and Infrastructure Services  
 Patricia O'Neill, Central Governance Manager  
 Kirsty Flanagan, Head of Strategic Finance  
 Peter Cupples, Finance Manager  
 Judy Orr, Head of Customer and Support Services  
 Helen Ford, Project Manager, Helensburgh CHORD  
 Michael Casey, Schools Development Project Manager  
 Margaret Moncur, Finance Manager

**1. APOLOGIES FOR ABSENCE**

Apologies for absence were received from Councillors Mary Jean Devon, Donald Kelly and Gary Mulvaney.

**2. DECLARATIONS OF INTEREST**

There were none intimated.

**3. MINUTES**

The Minutes of the meeting of the Policy and Resources Committee held on 29 October 2015 were approved as a correct record.

**4. FINANCIAL REPORT MONITORING PACK - OCTOBER 2015**

The Committee considered a report providing a summary of the financial monitoring reports as at the end of October 2015. The report provided summaries of the Revenue Budget Monitoring Report as at 31 October 2015; Monitoring of Financial Risks; Reserves and Balances; Capital Plan Monitoring Report as at 31 October 2015 and Treasury Monitoring Report as at 31 October 2015.

**Decision**

The Committee noted –

1. The Revenue Budget Monitoring Report as at 31 October 2015.
2. The current assessment of the Council's financial risks.

3. The overall level of reserves and balances and the monitoring of the earmarked reserves.
4. The Capital Plan Monitoring Report as at 31 October 2015.
5. The Treasury Monitoring Report as at 31 October 2015.

(Reference: Report by Head of Strategic Finance dated 17 November 2015, submitted)

### **5. PERFORMANCE REPORT - FINANCIAL QUARTER 2 2015/16**

The Committee considered a report inviting them to review the Customer Services Departmental Performance Report with the Scorecards for Strategic Finance and Customer Services for financial quarter two 2015/16.

#### **Decision**

The Committee noted the Customer Services Departmental Performance Report with the Scorecards for Strategic Finance and Customer Services for financial quarter two 2015/16.

(Reference: Report by Executive Director – Customer Services dated December 2015, submitted)

### **6. SCOTTISH WELFARE FUND DELIVERY OPTIONS 2016/2017 ONWARDS**

The Committee were presented with a report inviting them to consider 4 options on how the new permanent Scottish Welfare Fund could be delivered by the Council in future within the resources made available for this purpose by the Scottish Government.

#### **Motion -**

That the Committee –

1. Agree that from 1 April 2016 all Scottish Welfare Fund awards will be made by cash as described in option 2 contained within the detail of the report.
2. Agree that customers be encouraged to apply for Scottish Welfare Grants online wherever possible in order to reduce administration costs.
3. Note the financial and staffing implications of the proposed option as described within the report and that the telephony service will only be available from 1 April 2016 Monday to Friday and from 1.30pm to 5.00pm excluding public holidays.

Moved Councillor Dick Walsh, seconded Councillor Ellen Morton.

#### **Amendment**

That the Committee -

1. Progress Option 3 as detailed in the report.

2. That the tender should allow for delivery of the service on a same service basis or a cash substitute basis as outlined in Option 2.
3. Delegate to the Executive Director – Customer Services to ensure that the tender includes a clause to address concerns as raised in paragraph 4.25 of the report.

Moved Councillor James Robb, seconded Councillor Sandy Taylor.

### **Decision**

On a show of hands vote the Motion was carried by 9 votes to 3 and the Committee resolved accordingly.

(Reference: Report by Executive Director – Customer Services dated 4 December 2015, submitted)

### \* **7. STREET LIGHTING INNOVATIVE ENERGY SAVING UPDATE REPORT**

The Committee considered a recommendation from the Environment, Development and Infrastructure Committee held on 12 November 2015 in respect of the street lighting project for upgrading the lighting assets within Argyll and Bute.

### **Decision**

The Committee agreed the recommendation from the Environment, Development and Infrastructure Committee and agreed to recommend to the Council –

1. To progress with an innovative lighting energy efficient scheme as detailed in the attached business case, the costs of which are summarised at 5.4 of the report by the Executive Director, in order to reduce future cost pressure relating to street lighting electricity.
2. To agree to a tender process being completed and that the energy efficient scheme is progressed utilising the most cost effective model as determined from the tender process.
3. To agree to a tender process being completed and that the energy efficient scheme is progressed utilising the most cost effective model as determined from the tender process.
4. To agree that the remaining reduced electricity budget, as a result of the innovative lighting scheme, is inflated in line with energy costs on an annual basis.
5. To agree that the balance of savings generated is used to fund a column replacement programme with replacements being prioritised on condition.

(Reference: Recommendation from the Environment, Development and Infrastructure Committee held on 12 November 2015 and report by Executive Director – Development and Infrastructure Services dated October 2015, submitted)

**8. POLICY AND RESOURCES COMMITTEE WORK PLAN**

The Committee considered their Work Plan as at December 2015.

**Decision**

The Committee noted the Work Plan

(reference: Policy and Resources Committee Work Plan as at December 2015, submitted)

The Chair advised that in terms of Section 50(A)(4) of the Local Government (Scotland) Act 1973, appendices A & B relating to the following item of business would require him to exclude the press and public should any Member wish to discuss the content of those appendices on the grounds that it was likely to involve the disclosure of exempt information as defined in Paragraphs 8&9 respectively of Part 1 of Schedule 7A to the Local Government (Scotland) Act 1973. In this regard, the press and public were excluded part way through the discussion of the following item of business.

**9. MAJOR CAPITAL REGENERATION PROJECT PROGRESS REPORT**

The Committee considered a report updating them on progress with delivering the 12 major capital regeneration projects led by Development and Infrastructure Services, which excluded the 9 Lorn Arc Projects. The report also advised on key issues which would impact on the successful delivery of the projects from the design development stage through to procurement and implementation.

**Decision**

The Committee noted the current progress and agreed allocation of budget resources to date against each of the projects.

(Reference: Report by Executive Director – Development and Infrastructure Services dated 3 December 2015, submitted)

The Committee resolved in terms of Section 50(A)(4) of the Local Government (Scotland) Act 1973 to exclude the press and public for the following 2 items of business on the grounds that it was likely to involve the disclosure of exempt information as defined in Paragraphs 8&9 respectively of Part 1 of Schedule 7A to the Local Government (Scotland) Act 1973.

**10. ROTHESAY PAVILION UPDATE REPORT**

A report which set out the current position with the Rothesay Pavilion regeneration project was considered by the committee. The report also advised on key issues which would impact on the successful delivery of the project from the design development stage through to procurement and implementation.

**Decision**

The Committee agreed the recommendations as contained within the report by the Executive Director.

(Reference: Report by Executive Director – Development and Infrastructure Services dated 11 November 2015, submitted)

### **11. NEW SCHOOLS REDEVELOPMENT PROJECT**

The Committee considered a report providing an update on the new schools redevelopment project. The report also provided an update in respect of the Dunoon Primary School Refurbishment Project.

The report was supported by a presentation which explained the Council's current financial position for the new schools project and which clarified the revised financial position as a result of the new ESA10 financial arrangements.

#### **Decision**

The Committee agreed the recommendations as contained within the report by the Executive Director.

(Reference: Report by Executive Director – Community Services dated 21 November 2015, submitted)

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**ARGYLL AND BUTE COUNCIL****POLICY AND RESOURCES COMMITTEE****STRATEGIC FINANCE****11 FEBRUARY 2016**

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**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY**

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**1. EXECUTIVE SUMMARY**

- 1.1 This report seeks Members approval of the proposed Treasury Management Strategy Statement and Annual Investment Strategy. These set out the Council's strategy for borrowing and investment for the forthcoming year along with the Council's Prudential Indicators which require to be set for a three year period.
- 1.2 The production of a Treasury Management Strategy Statement and Annual Investment Strategy for the forthcoming financial year is a requirement of the Treasury Management in the Public Services Code of Practice issued by the Chartered Institute of Public Finance and Accountancy.
- 1.3 The Treasury Management Strategy Statement and Annual Investment Strategy meet the requirements of the CIPFA Code of Practice on Treasury Management in Local Authorities.
- 1.4 The draft Treasury Management Strategy Statement and Annual Investment Strategy will be presented to the:
  - Policy and Resources Committee on 11 February 2016
  - Council on 11 February 2016
  - Performance Review and Scrutiny (PRS) Committee on 25 February 2016
  - Council on 21 April 2016, following review and comments from the PRS Committee.
- 1.5 As part of the scrutiny of the Treasury Management Strategy Statement and Annual Investment Strategy, the Performance Review and Scrutiny Committee will be asked to review the attached strategies and comment on it with any amendments required being brought to Council for approval in April.
- 1.6 The main changes to the Treasury Management Strategy Statement from 2015-16 are in the Treasury Indicators to reflect the expected movements in the Council's Capital Financing Requirement.
- 1.7 In terms of the Investment Strategy the main change, is to reduce the minimum Sovereign rating required in respect of counterparties from AA+ to AA. This change is to bring our Investment Strategy closer to Capita's suggested minimum requirement of AA-.
- 1.8 The change would permit the use of countries which are currently rated AA+ on the list if they were subject to future downgrades by the ratings agencies to AA. However, a consequence of the reduction in rating is that Abu Dhabi (UAE) and Qatar would feature on the list of approved countries and it is recommended that

these countries are removed from the list of approved countries for investment.

## **2. RECOMMENDATIONS**

2.1 To refer to Council:

- (i) To approve the proposed Treasury Management Strategy Statement and Annual Investment Strategy subject to review by the Performance Review and Scrutiny Committee in February.
- (ii) To approve the removal of Abu Dhabi (UAE) and Qatar from the list of approved countries for investment.

## **3. IMPLICATIONS**

3.1 Policy – Sets the policy for borrowing and investment Decisions.

3.2 Financial - There are no direct financial implications arising from the recommendations in this report. An effective Treasury Management Strategy does however form a significant part of the Council's financial arrangements and its financial well-being.

3.3 Legal - None.

3.4 HR - None.

3.5 Equalities - None.

3.6 Risk - This report does not require any specific risk issues to be addressed, however members will be aware that the management of risk is an integral part of the Council's treasury management activities.

3.7 Customer Service - None.

**Policy Lead for Strategic Finance: Councillor Dick Walsh**

**Kirsty Flanagan  
Head of Strategic Finance  
3 February 2016**

For further information please contact Peter Cupples. Finance Manager  
Corporate Support 01546-604183.

## **APPENDICES**

Appendix 1 – Treasury Management Strategy Statement and Annual Investment Strategy 2016-17



**Treasury Management Strategy Statement  
and Annual Investment Strategy 2016-2017**

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# 1 INTRODUCTION

## 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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."*

## 1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**In year treasury management reporting** – Members will be updated with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision at each meeting of the Policy and Resources Committee.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

## 1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

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## **Capital issues**

- the capital plans and the prudential indicators..

## **Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and Scottish Government Investment Regulations.

### **1.4 Treasury management consultants**

The Council uses Capita Asset Services as its external treasury management advisors.

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

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

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## 2 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The capital expenditure forecasts are:

Capital expenditure £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Community Services	17,905	13,228	2,199
Customer Services	1,666	1,373	865
Development and Infrastructure Services	15,114	11,325	11,694
Unallocated Capital			
<b>Total</b>	<b>34,685</b>	<b>25,926</b>	<b>14,758</b>

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
<b>Total</b>	<b>34,685</b>	<b>25,926</b>	<b>14,758</b>
<b>Financed by:</b>			
Capital receipts	6,302	8,090	250
Capital grants	9,359	11,852	11,852
Capital reserves	-	-	-
Revenue	1,087	1,818	-
<b>Net financing need for the year</b>	<b>17,937</b>	<b>4,166</b>	<b>2,656</b>

### 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as scheduled debt amortisation (loans pool charges) broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £77.9m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
<b>Capital Financing Requirement</b>			
Opening CFR	259,000	265,766	259,688
Closing CFR	265,766	259,688	251,991
<b>Movement in CFR</b>	<b>6,766</b>	<b>(6,078)</b>	<b>(7,697)</b>

<b>Movement in CFR represented by</b>			
Net financing need for the year (above)	17,937	4,166	2,656
Less scheduled debt amortisation	11,171	10,244	10,353
<b>Movement in CFR</b>	<b>6,766</b>	<b>(6,078)</b>	<b>(7,697)</b>

### 2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end investment balances.

Year End Resources £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
<b>Expected investments</b>	<b>20,000</b>	<b>15,000</b>	<b>10,000</b>

### 2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

### 2.5 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2016/17 Budget	2017/18 Budget	2018/19 Budget
Ratio	7.80%	7.39%	7.39%

The estimates of financing costs include current commitments and the proposals in this budget report.



**2.6 Incremental impact of capital investment decisions on council tax.**

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the capital budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

**Incremental impact of capital investment decisions on the band D council tax**

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
<b>Council tax - band D</b>	38.44	8.92	5.70

### 3 TREASURY MANAGEMENT STRATEGY

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### 3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
<b>External Debt</b>					
Debt at 1 April	161,181	173,379	154,589	169,589	179,589
Change in Debt	12,198	(18,790)	15,000	10,000	2,000
Other long-term liabilities (OLTL)	79,605	77,871	75,994	74,058	72,051
Expected change in OLTL	(1,734)	(1,877)	(1,935)	(2,007)	(2,117)
<b>Actual gross debt at 31 March</b>	<b>251,250</b>	<b>230,583</b>	<b>243,648</b>	<b>251,640</b>	<b>251,523</b>
<b>The Capital Financing Requirement</b>	<b>257,556</b>	<b>259,000</b>	<b>265,766</b>	<b>259,688</b>	<b>251,991</b>
<b>Under / (over) borrowing</b>	<b>6,306</b>	<b>28,417</b>	<b>22,118</b>	<b>8,048</b>	<b>468</b>

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 needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Strategic Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

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

Operational boundary £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Debt	215	210	210
Other long term liabilities	80	80	80
Total	295	290	290

**The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35 (1) of the Local Government in Scotland Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Debt	220	215	215
Other long term liabilities	83	83	83
Total	303	298	298

### 3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

**UK.** UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain

around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing the Bank Rate.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

**USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**EZ.** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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**Greece.** During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

**Portugal and Spain.** The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenomenally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

### 3.4 Borrowing strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Head of Strategic Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
-

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.*

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### 3.5 Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the 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;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

£m	2016/17	2017/18	2018/19
<b>Interest rate exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	190%	190%	190%
<b>Limits on variable interest rates based on net debt</b>	60%	60%	60%
<b>Maturity structure of fixed interest rate borrowing 2016/17</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	30%	
12 months to 2 years	0%	30%	
2 years to 5 years	0%	30%	
5 years to 10 years	0%	40%	
10 years and above	0%	80%	

### **3.5 Policy on borrowing in advance of need**

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **3.6 Debt rescheduling**

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

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council, at the earliest meeting following its action

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## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Introduction: changes to credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

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## 4.2 Investment policy

The Council's investment policy has regard to the Scottish Government's Investments Investment (Scotland) Regulations (and accompanying Finance Circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendices 5.3 and 5.4. Counterparty limits will be as set through the Council's treasury management practices – schedules.

## 4.3 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow            5 years
  - Dark pink       5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
  - Light pink       5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
  - Purple            2 years
  - Blue              1 year (only applies to nationalised or semi nationalised UK Banks)
-

- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

The Capita Asset Services’ creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency’s ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council’s lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on sovereign support for banks and the credit ratings of that supporting government.

**4.4 Country and sector limits**

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch with the exception of Abu Dhabi (UAE) and Qatar. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy with a minimum credit rating of AA from Fitch.

**4.5 Council Permitted Investments**

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

The permitted investment which may be used in the forthcoming year:

**Cash Type Instruments**

- a. Deposits with the Debt Management Account Facility (UK Government);
- b. Deposits with other local authorities or public bodies;
- c. Money Market Funds;
- d. Enhanced Money Market Funds;
- e. Call account deposit accounts with financial institutions (banks and building societies);
- f. Term deposits with financial institutions (banks and building societies);
- g. UK Government Gilts and Treasury Bills;
- h. Certificates of deposits with financial institutions (banks and building societies);
- i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.);
- j. Corporate Bonds;

**Other Funds**

- k. Investment properties;
- l. Loans to third parties, including soft loans;
- m. Shareholdings in a local authority company;
- n. Non-local authority shareholdings;
- o. Loans to third parties as part of the Council's Empty Homes Strategy;
- p. Loans to third parties as part of the Council's SHF Front Funding Facility;
- q. Loans to third parties as part of the Council's Long Term Loan Funding to RSL's;
- r. Hub Co Sub Debt.

Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in Appendix 5.4.

**Common Good** permitted investments are shown at Appendix 5.3, and where applicable the same counterparty selection criteria will be applied.

For those permitted cash type investments the Head of Strategic Finance will maintain a counterparty list in compliance with the counterparty selection criteria as stated above. These criteria select which counterparties the Council choose from, rather than defining what its investments are.

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#### 4.6 Investment Strategy

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

**Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

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

The Council is asked to approve the treasury indicator and limit: -

<b>Maximum principal sums invested &gt; 364 days</b>			
	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>
Principal sums invested > 364 days	£20m	£20m	£20m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 364 days) in order to benefit from the compounding of interest.

#### 4.7 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

#### 4.8 External fund managers

The Council at present does not use fund manager but may consider the use of a manager in the future.

#### 4.9 Policy on the Use of External Service Providers

The Council uses Capita Asset Services as its external treasury management advisors.

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

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

#### **4.10 Scheme of Delegation**

Please see Appendix 5.6.

#### **4.11 Role of the Section 95 Officer**

Please see Appendix 5.7.

#### **4.12 Treasury Management Policy**

Please see Appendix 5.8.

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## 5 APPENDICES

1. Interest rate forecasts
  2. Economic background
  3. Treasury management practice (TMP1) – permitted investments
  4. Treasury management practice (TMP1) – credit and counterparty risk management
  5. Approved countries for investments
  6. Treasury management scheme of delegation
  7. The treasury management role of the section 95 officer
  8. Treasury Management Policy Statement
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## 5.1 APPENDIX: Interest Rate Forecasts 2016 - 2019

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
<b>Bank Rate View</b>	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.30%	1.50%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.80%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
<b>Bank Rate</b>													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Capital Economics	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	-	-	-	-	-
<b>5yr PWLB Rate</b>													
Capita Asset Services	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
Capital Economics	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
<b>10yr PWLB Rate</b>													
Capita Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
<b>25yr PWLB Rate</b>													
Capita Asset Services	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
<b>50yr PWLB Rate</b>													
Capita Asset Services	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Capital Economics	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

## 5.2 APPENDIX: Economic Background

**UK.** UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time, (as he confirmed in a speech on 19 January):

- *Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.*
- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there



could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments could well lead the Bank of England to lower the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted.

Confidence is another big issue to factor into forecasting. Recent volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could also impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy, (a silver lining!). Another silver lining is that the UK will not be affected as much as some other western countries by a slowdown in demand from emerging countries, as the EU and US are our major trading partners.

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that rates ought to rise sooner and quicker, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would aggressively raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q4 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, rather than in 2017, with Q3 2016 being the current front runner in terms of timing; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

**USA.** GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.0% in Q3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while

November was also reasonably strong (and December was outstanding); this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**EZ.** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

**Greece.** During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

**Portugal and Spain.** The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. A left wing / communist anti-austerity coalition has won a majority of seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

**China and Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 and the start of 2016, in implementing several stimulus measures to try to ensure the economy hits the growth

target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

**Emerging countries.** There are also considerable concerns about the vulnerability of some emerging countries, and their corporates, which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis, (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries), there is now a strong flow back to those western economies with strong growth and a path of rising interest rates and bond yields.

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and a deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

### **CAPITA ASSET SERVICES FORWARD VIEW**

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 19 January 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. . There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 4 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to

compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in January 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2017.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens.
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

### 5.3 APPENDIX: Treasury Management Practice (TMP1): Permitted Investments

This Council approves the following forms of investment instrument for use as permitted investments as set out in table 1 and 2.

#### Treasury risks

All the investment instruments in tables 1 and 2 are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of 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 the highest, relative, level of creditworthiness.
2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, 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. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, 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 b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in tables 1 / 2 headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get cash, or term i.e. money is locked in until an agreed maturity date.
3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.
4. **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. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report. All types of investment instrument have interest rate risk.
5. **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, and that the organisation suffers losses accordingly.

#### Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 4.2 and 4.3.

2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.
3. **Market risk:** this authority does not purchase investment instruments that are subject to market risk in terms of fluctuation in their value.
4. **Interest rate risk:** this authority 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. See paragraph 4.4.
5. **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations. All types of investment instruments

### Unlimited investments

Regulation 24 states that an investment can be shown in tables 1 and 2 as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

The authority has given the following types of investment an unlimited category: -

1. **Debt Management Agency Deposit Facility.** This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government's sovereign rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.
2. **High credit worthiness banks and building societies.** See paragraph 4.2 for an explanation of this authority's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the authority will ensure diversification of its portfolio ensuring that no more than £10m can be placed with any one institution or group at any one time.

### Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted'.

### DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

- a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.
- b) **Term deposits with high credit worthiness banks and building societies.** See paragraph 4.2 for an explanation of this authority's definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The authority will ensure diversification of its portfolio of deposits ensuring that no more than £10m can be placed with any one institution or group. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.
- c) **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.
- d) **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.
- e) **Collateralised deposits.** These are deposits placed with a bank which offers collateral backing based on specific assets. Examples seen in the past have included local authority LOBOs, where such deposits are effectively lending to a local authority as that is the ultimate security.

## 2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either partial or full direct ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

- a. **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1b. but Government full, (or substantial partial), ownership, implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers that this indicates a low and acceptable level of residual risk.
- b. **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently covered under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.

## 3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

- a. **Government liquidity funds.** These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due to the higher quality of underlying investments, they offer a lower rate of return than MMFs. However, their net return is typically on a par with the DMADF, but with instant access.
- b. **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or capabilities to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.
- c. **Enhanced Money Market Funds .** These funds are similar to MMFs, can still be AAA rated but have Variable Net Asset Values (VNAV) as opposed to a traditional MMF which has a Constant Net Asset Value (CNAV). They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time,



which means they are more volatile. These funds can have WAM's and Weighted Average Life (WAL's) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

- d. **Gilt funds.** These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in highly rated government securities. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.
- e. **Bond funds.** These can invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in non-government bonds.

#### 4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

- b. **Treasury bills.** These are short term bills (up to 12 months, although none have ever been issued for this maturity) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.
- c. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.
- d. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** e.g. National Rail. This is similar to a gilt due to the explicit Government guarantee.
- e. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. Use limited to issues of nations with at least the same sovereign rating as for the UK.
- f. **Bonds issued by Multi Lateral Development Banks (MLDBs).** These are similar to c. and e. above but are issued by MLDBs which are typically guaranteed by a group of sovereign states e.g. European Bank for Reconstruction and Development.

## 5. SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

- a. **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly financial institutions). They are negotiable instruments, so can be sold ahead of maturity and also purchased after they have been issued. However, that liquidity can come at a price, where the yield could be marginally less than placing a deposit with the same bank as the issuing bank.
- b. **Commercial paper.** This is similar to CDs but is issued by commercial organisations or other entities. Maturity periods are up to 365 days but commonly 90 days.
- c. **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a financial institution, company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.
- d. **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

## 6. OTHER

**Property fund.** This is a collective investment fund specialising in property. Rather than owning a single property with all the risk exposure that means to one property in one location rising or falling in value, maintenance costs, tenants actually paying their rent / lease etc, a collective fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the potential for the property sector to rise in value. However, timing is critical to entering or leaving this sector at the optimum times of the property cycle of rising and falling values. Typically, the minimum investment time horizon for considering such funds is at least 3-5 years.

**Table 1: permitted investments in house – Common Good**

This table is for use by the in house treasury management team.

**1.1 Deposits**

	* Minimum Credit Criteria / colour banding	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	term	no	100	2 years
Term deposits – local authorities	--	term	no	100	2 years
Call accounts – banks and building societies	Green	instant	no	100	Call
Term deposits – banks and building societies	Green	term	no	100	2 years
Fixed term deposits with variable rate and variable maturities: - Structured deposits.	Green	term	no	50	2 years
Collateralised deposit	UK sovereign rating	term	no	50	1 year

**1.2 Deposits with counterparties currently in receipt of government support / ownership**

	* Minimum Credit Criteria / colour banding	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
UK part nationalised banks	Blue	term	no		
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	AA	term	no		
Fixed term deposits with variable rate and variable maturities: - Structured deposits	AA	term	yes		

### 1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

	* Minimum Fund Rating	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
1. Government Liquidity Funds	AAA	instant	No see note A	100	1 Year
2. Money Market Funds	AAA	instant	No see note A	100	1 Year
3. Enhanced Money Market Funds with a credit score of 1.25	AAA	T+1 to T+5	yes	100	1 Year
4. Enhanced Money Market Funds with a credit score of 1.5	AAA	T+1 to T+5	yes	100	1 Year
5. Bond Funds	AAA	T+2 or longer	yes	100	1 Year
6. Gilt Funds	AAA	T+2 or longer	yes	100	1 Year

NOTE A. The objective of MMFs is to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero.

### 1.4 Securities issued or guaranteed by governments

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	yes	100	1 Year
UK Government Gilts	UK sovereign rating	Sale T+1	yes	100	1 Year
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	yes	100	1 Year
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	yes	80	1 Year
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	yes	80	1 Year

**1.5 Securities issued by corporate organisations**

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating	Sale T+1	yes	80	2 years
Certificates of deposit issued by banks and building societies	UK sovereign rating	Sale T+1	yes	50	2 years
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating	Sale T+1	yes	50	2 years
Commercial paper other	AA	Sale T+1	yes	20	2 years
Corporate Bonds issuance covered by UK Government (implicit) guarantee	UK sovereign rating	Sale T+3	yes	50	2 years
Corporate Bonds other	AA	Sale T+3	yes	20	2 years
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating	Sale T+3	yes	80	2 years

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**1.6 Other**

	* Minimum Credit Criteria / fund rating	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Property funds	--	T+4	yes	100	5 Years

**Table 2: permitted investments for use by external fund managers – Common Good****2.1 Deposits**

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Term deposits – local authorities	--	term	no	100	2 Years
Call accounts – banks and building societies **	Green	instant	no	100	Call
Term deposits – banks and building societies	Green	term	no	100	2 Years
Collateralised deposit	UK sovereign rating	term	no	50	1 Year

**2.2 Deposits with counterparties currently in receipt of government support / ownership**

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
UK part nationalised banks	Blue	Term or instant	no	100	1 Year
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	AA+	Term or instant	no	100	1 Year

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

### 2.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

	* Minimum Fund Rating	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
1. Government Liquidity Funds	AAA	instant	No see note A	100	1 Year
2. Money Market Funds	AAA	instant	No see note A	100	1 Year
3. Enhanced Money Market Funds with a credit score of 1.25	AAA	T+>1	yes	100	1 Year
4. Enhanced Money Market Funds with a credit score of 1.5	AAA	T+>1	yes	100	1 Year
5. Bond Funds	AAA	T+>1	yes	100	1 Year
6. Gilt Funds	AAA	T+>1	yes	100	1 Year

NOTE A. The objective of these funds is to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero.

### 2.4 Securities issued or guaranteed by governments

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	yes	100	1 Year
UK Government Gilts	UK sovereign rating	Sale T+1	yes	100	1 Year
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	yes	100	1 Year
Sovereign bond issues (other than the UK govt)	AAA	Sale T+1	yes	80	1 Year
Bonds issued by multilateral development banks	AAA	Sale T+1	yes	80	1 Year

**2.5 Securities issued by corporate organisations**

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating	Sale T+1	yes	80	2 year
Certificates of deposit issued by banks and building	AA	Sale T+1	yes	50	2 years
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating	Sale T+1	yes	50	2 years
Commercial paper other	AA	Sale T+1	yes	20	2 years
Corporate Bonds issuance covered by UK Government (implicit) guarantee	UK sovereign rating	Sale T+3	yes	50	2 years
Corporate Bonds other	AA	Sale T+3	yes	20	2 year
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating	Sale T+3	yes	50	2 years
Floating Rate Notes	AA	Sale T+1	yes	80	2 years

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.



#### 5.4 APPENDIX: Treasury Management Practice (TMP1): Credit and Counterparty Risk Management

##### Argyll and Bute Council and Common Good Funds Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
<b>Cash type instruments</b>				
a. Deposits with the Debt Management Account Facility (UK Government) <b>(Very low risk)</b>	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.
b. Deposits with other local authorities or public bodies <b>(Very low risk)</b>	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply.  Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment.  Non- local authority deposits will follow the approved credit rating criteria.	£unlimited, maximum 1 year.	£unlimited maximum 1 year.
c. Money Market Funds (MMFs) <b>(Very low risk)</b>	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	£10m per fund	100%

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
d. Enhanced Money Market Funds (EMMFs) <b>(low risk)</b>	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the EMMFs have a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	£5m per fund	100%
e. Call account deposit accounts with financial institutions (banks and building societies) <b>(Low risk depending on credit rating)</b>	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
f. Term deposits with financial institutions (banks and building societies) <b>(Low to medium risk depending on period &amp; credit rating)</b>	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
g. Government Gilts and Treasury Bills <b>(Very low risk)</b>	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£10m, maximum 1 year.	100%, maximum 1 year.
h. Certificates of deposits with financial institutions <b>(Low risk)</b>	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	£5m, per counterparty 1 year	20% maximum 1 year.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) <b>(Low to medium risk depending on period &amp; credit rating)</b>	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
j. Corporate bonds <b>(Medium to high risk depending on period &amp; credit rating)</b>	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Corporate bonds will be restricted to those meeting the base criteria.  Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	£5m maximum 1 year.	20% maximum 1 year.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
<b>Other types of investments</b>				
k. Investment properties	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio.  Property holding will be re-valued regularly and reported annually with gross and net rental streams.	£10m.	20%.
l. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£10m maximum 5 years.	10% maximum 5 years.
m. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	50%.	20%.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
n. Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	5%.	100%.
o. Loans to third parties as part of the Council's Empty Homes Strategy	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 Head of Strategic Finance approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default. Each funding request will be accompanied by financial projections and be subject to an assessment of the project and borrower.	£1.5m and a maximum of 10 years.	N/A
p. Loans to third parties as part of the Council's SHF Front Funding Facility	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 Head of Strategic Finance approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default. Each funding request will be accompanied by financial projections and be subject to an assessment of the project and borrower.	£5m and a maximum of 3 years.	N/A
q. Loans to third parties as part of the Council's Long Term Loan Funding to RSL's	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 Head of Strategic Finance approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default. Each funding request will be accompanied by financial projections and be subject to an assessment of the project and borrower.	£5m and a maximum of 30 years.	N/A

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
r. Hub Co sub debt	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be highly illiquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	£10m	N/A

**The Monitoring of Investment Counterparties** - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Capita Asset Services, 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 by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

**Use of External Fund Managers** – It is the Council’s plan to consider the use external fund managers for part of its investment portfolio. The fund managers are contractually committed to keep to the Council’s investment strategy. The performance of each manager is reviewed at least annually by the Head of Strategic Finance and the managers are contractually required to comply with the annual investment strategy.

**5.5 APPENDIX: Approved countries for investments (as at 20.1.16)**

AAA

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

AA+

- Finland
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar



## **5.6 APPENDIX: Treasury management scheme of delegation**

### **(i) The Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;

### **(ii) The Performance Review and Scrutiny Committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

### **(iii) The Audit Committee**

- Review the overall internal and management control framework related to the treasury function.
- Review internal and external audit reports related to treasury management.
- Review provision in the internal and external audit plans to ensure there is adequate audit coverage of treasury management.
- Monitor progress with implementing recommendations in internal and external audit reports.

### **5.7 APPENDIX: The Treasury Management Role of the Section 95 Officer**

The Head of Strategic Finance:-

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- reviewing and considering risk management in terms of treasury activities.

The nominated Elected Member (Council Leader/Policy Lead Strategic Finance):-

- acting as spokesperson for treasury management.
- taking a lead for elected members in overseeing the operation of the treasury function.
- review the treasury management policy, strategy and reports.
- support and challenge the development of treasury management.

**5.8 APPENDIX: Treasury Management Policy Statement**

1. This organisation defines its treasury management activities as: “The management of the 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. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

The policy in respect of borrowing and investments is to minimise the cost of borrowing and maximise investment returns commensurate with the mitigation of risk.

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**ARGYLL AND BUTE COUNCIL****POLICY AND RESOURCES COMMITTEE****STRATEGIC FINANCE****4 FEBRUARY 2016**

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**EXECUTIVE SUMMARY****FINANCIAL REPORT MONITORING PACK – DECEMBER 2015**

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**1. INTRODUCTION**

1.1 This report provides a summary of the financial monitoring reports as at the end of December 2015. There are five detailed reports summarised in this Executive Summary:

- Revenue Budget Monitoring Report as at 31 December 2015
- Monitoring of Financial Risks
- Reserves and Balances
- Capital Plan Monitoring Report as at 31 December 2015
- Treasury Monitoring Report as at 31 December 2015

The web link to the detailed reports is as follows:

<http://www.argyll-bute.gov.uk/financial-monitoring>

**2. DETAIL****2.1 Revenue Budget Monitoring Report**

2.1.1 This report provides a summary of the current revenue budget monitoring position to ensure net expenditure is contained within budget. It provides corporate and departmental information with comparisons on a forecast outturn and a year to date basis.

2.1.2 The current forecast outturn position is a projected underspend of £0.869m, of this £0.130m will require to be earmarked at the year-end to fund the Waste Model resulting in a reduced forecast underspend of £0.739m. This compares to an underspend reported at 31 October 2015 of £0.864m, a decrease in the forecast underspend of £0.125m.

2.1.3 The current underspend includes balances that are non-recurring underspends totalling £1.464m. These specifically include

- £0.514m for the excess pay award – when the 2015-16 budget was prepared the pay award was estimated at 2%, however, was subsequently settled at 1.5% resulting in an underspend equivalent to 0.5%
- £0.500m council tax empty homes income
- £.0450m for loans charges.

2.1.4 The changes from the position reported at October 2015, contributing to the revised underspend as at 31 December 2015, are noted as:

- Community Services: A £400k underspend is now forecast within

Education Service as a result of a review of budgets across the service.

- Integration: Increase in the forecasted overspend of £396k. This relates mainly to the continued increase in demand for homecare and supported living services within Adult Care offset by a reduction in the underspend within Children and Families.
- Development and Infrastructure: An overall decrease to the forecasted underspend of £449k resulting in an overall forecast overspend. This includes increased vacancy savings, an underspend in street sweeping and increased crematorium income. These underspends are offset by reduction in berthing dues at Rothesay Harbour due to planned maintenance at Wemyss Bay, additional expenditure in respect of Dangerous Buildings and a projected overspend in relation to Winter Maintenance.
- Other Corporate Budgets: A £450k underspend is forecasted due to reduced loan charges.

## 2.2 Monitoring of Financial Risks

2.2.1 This report outlines the process and approach developed in carrying out a financial risks analysis and provides an update on the current assessment of financial risks.

2.2.2 There are a number of Council wide risks identified. All have been assessed as remote or unlikely with the exception of the auto enrolment into the pension scheme which impacts on employers superannuation. The majority of staff will not be auto enrolled until 2017 and the estimated worst case financial impact has been built into the medium term budget outlook.

2.2.3 There are currently 62 departmental risks totalling £8.397. Only 9 of the risks are categorised as likely, with a potential impact of £2.373m, and no risks have been categorised as almost certain. These will continue to be monitored and action taken to mitigate or manage these risks.

2.2.6 The top 3 risks in terms of their likely financial impact are noted in the table below.

SERVICE	TITLE OF RISK	DESCRIPTION OF RISK	LIKELIHOOD	FINANCIAL IMPACT £000
Adult Care	Increased complexity of care packages - Older People, Physical Disability, Learning Disability and Mental Health	Level of service demand remains at current commitment or increases due to needs becoming more complex.	3	950
Adult Care	Growth in Older People population	Growth in elderly population exceeds expectation reflected in Demand Pressure thereby putting increased demand on services.	3	700
Roads and Amenity Services	Winter Maintenance	Adverse weather conditions which require greater than budgeted number of gritting runs.	4	700

## **2.3 Reserves and Balances**

2.3.1 This report summarises the overall level of reserves and balances and monitors the spending of the earmarked reserves, providing detailed information on the unspent budget earmarked balances.

2.3.2 The Council has usable reserves of £50.478m. Most of these are earmarked for specific purposes. The General Fund contingency level remains at 1.5% of net expenditure. There is currently an estimated surplus over contingency and this is being directed towards the delivery of the Single Outcome Agreement.

2.3.3 The total surplus over contingency is now £12.458m which represents a decrease of £0.681m compared to the surplus reported at the end of October of £13.139m. The reason for this decrease is the change to the forecast outturn for 2015-16 offset by the funding agreed by Council in respect of the Innovation Fund and the Employability Team.

## **2.4 Capital Plan Monitoring Report**

2.4.1 Capital Plan Monitoring Report – this report provides a summary of the current capital plan monitoring position. Information is provided in terms of monitoring year to date budget, current full year budget, future years total budget and funding and non-financial in terms of project performance.

2.4.2 Actual net expenditure to date is £17.543m compared to a budget for the year to date of £17.100m giving rise to an overspend for the year to date of £0.443m. The forecast outturn for the year is forecast underspend of £6.036m.

2.4.3 The £0.443m year to date overspend is made up of an overspend with fleet , projects funded by external grant income which has yet to be received and a number of small non-material variances within a number of projects.

2.4.4 The forecast underspend for the year of £6.036m. The main variances are summarised below:

- £4.955m of net underspends in respect of the replacement of Campbeltown and Oban High Schools due to ESA10 arrangement delays.
- Net underspends of £0.319m within Education projects.
- £1.282m of underspend in respect of the CHORD projects for Helensburgh and Campbeltown with a proposal to slip funds into 2016-17.
- Forecasted underspend of £0.403m in the Kintyre Renewables Hub project, due to decreased expenditure and additional grant funding received.
- £0.428m, relates to underspends in the Oban Airport Business Park, Pier Upgrades, Bridge Strengthening, Kilmory Biomass and Health and Safety projects.
- Overspends of £0.223m in fleet management, work where expenditure is as per approved business cases, and £0.107m on the Mid Argyll Office Rationalisation and Rothesay Library projects.

- The remaining balance of £0.383m overspend is made up of non-material variances less than £0.050m each.

2.4.5 The total Capital Plan forecast overspend of £0.709m is again largely made up of the £0.547m of overspends in previous years carried forward. £0.184m relates to the Rothesay CHORD funding gap, £0.223m relates to expenditure on fleet management, £0.054m for the Mid Argyll Office Rationalisation and again, the projected underspends of £0.646m within Education, Kintyre Renewables Hub and Health and Safety projects are also taken into account. The remaining balance of £0.347m overspend is made up of non-material variances less than £0.050m each.

## **2.5 Treasury Monitoring Report**

2.5.1 This report provides information on the current levels and recent transactions in relation to the capital financing limit, total borrowing, temporary borrowing and long term borrowing and investments.

2.5.2 In December £9.5m of new borrowing was taken at 2.96% from the PWLB using the Project Rate which the Council had applied for access to in May 2015. External Loans have been repaid in the period to 1 November 2015 to 31 December 2015 amounting to £11.293m.

2.5.3 Borrowing is estimated to be £13.296m below the capital financing requirement for the period to 31 March 2016. This reflects the approach taken to minimise surplus cash on deposit in order to avoid overdue exposure to investment/credit worthiness risks. However, if it becomes clear that longer term interest rates are likely to increase significantly the position will be reviewed to ensure the Council locks in funding at low interest rates.

2.5.4 Investments at 31 December 2015 were £53.2m with a return for the last quarter of 0.717% compared to the average 7 day rate of 0.359%.

## **3. RECOMMENDATIONS**

3.1 Members to note the revenue budget monitoring report as at 31 December 2015.

3.2 Members to note the current assessment of the Council's financial risks.

3.3 Members to note the overall level of reserves and balances and note the monitoring of the earmarked reserves.

3.4 Members to note the capital plan monitoring report as at 31 December 2015.

3.5 Members to note the treasury monitoring report as at 31 December 2015.

## **4. IMPLICATIONS**

4.1 Policy – None.



- |     |                    |   |
|-----|--------------------|---|
| 4.2 | Financial -        | Outlines the revenue and capital monitoring for 2015-16 as at 31 December 2015. |
| 4.3 | Legal -            | None.   |
| 4.4 | HR -               | None.   |
| 4.5 | Equalities -       | None.   |
| 4.6 | Risk -             | Details of financial risks are included within the report.                      |
| 4.7 | Customer Service - | None.   |

**Policy Lead for Finance: Councillor Dick Walsh**

**Kirsty Flanagan  
Head of Strategic Finance  
26 January 2016**



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ARGYLL AND BUTE COUNCIL  
COMMUNITY SERVICES

POLICY AND RESOURCES COMMITTEE  
4 FEBRUARY 2015

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**COMPLIANCE WITH TEACHER NUMBERS COMMITMENT**

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**1.0 EXECUTIVE SUMMARY**

- 1.1 The purpose of this report is to advise Policy and Resources Committee of the findings of the Community Services Committee on the compliance with teacher numbers commitment report. The purpose of the report is to provide an update of the Council's position in relation to the teacher numbers commitment made as part of the financial settlement for 2015/16 with the Scottish Government.
- 1.2 It was recommended that the report should be referred to the Policy and Resources Committee for further consideration by the Community Services Committee. The report also highlights the position outlined in the letter from Angela Constance, Cabinet Secretary for Education and Lifelong Learning in relation to the financial consequences arising from the 2015-16 teacher numbers census.
- 1.3 It is recommended that the Policy and Resources Committee:
- a) Note the report referred to the Policy and Resources Committee by the Community Services Committee.
  - b) Note the position outlined in the letter from Angela Constance, Cabinet Secretary for Education and Lifelong Learning in relation to the financial consequences arising from the 2015-16 teacher numbers census.

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ARGYLL AND BUTE COUNCIL  
COMMUNITY SERVICES

POLICY AND RESOURCES COMMITTEE  
4 FEBRUARY 2015

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## COMPLIANCE WITH TEACHER NUMBERS COMMITMENT

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### 2.0 INTRODUCTION

2.1 At its meeting of 10 December 2015, the Community Services Committee considered a report updating members on the Council's position in respect of meeting the teacher numbers commitment in relation to the financial settlement for 2015-16. As part of its decision the Committee agreed to refer the report to the Policy and Resources Committee to give consideration to the financial implications arising from the position represented in the report.

### 3.0 RECOMMENDATIONS

3.1 It is recommended that the Policy and Resources Committee:

- a) Note the report referred to the Policy and Resources Committee by the Community Services Committee.
- b) Note the position outlined in the letter from Angela Constance, Cabinet Secretary for Education and Lifelong Learning in relation to the financial consequences arising from the 2015-16 teacher numbers census.

### 4.0 DETAIL

4.1 A report providing an update of the Council's position in relation to the teacher numbers commitment made as part of the financial settlement for 2015/16 with the Scottish Government was considered at the Community Services Committee meeting of 10 December 2016. The report outlined the exceptional efforts made by the Council to try to meet the commitment, a range of other issues which have impacted on the ability of the council to recruit and retain teaching staff and the extraordinary measures used to improve teacher recruitment.

4.2 The full decision of the Committee:

- a) noted the commitment to maintain overall teacher numbers and pupil : teacher ratio at 2014/15 levels as part of the 2015/16 budget settlement;
- b) noted the level of supernumerary teaching posts above the staffing entitlement model that the Council require to retain to meet this commitment;

- c) noted the efforts made by the Council to recruit sufficient teachers to meet the commitment on the date of the census in September 2015 whilst addressing additional national policy ambitions (eg Raising attainment for all);
- d) noted the other factors which impacted on the Council's ability to meet the teacher number commitment;
- e) noted that the Council was unable to recruit sufficient teaching staff despite considerable efforts to meet the commitment which potentially will result in the loss of some or all of the share of the Scottish Government's additional £51m resources to maintain teacher numbers;
- f) noted that this potential loss of additional grant may be mitigated by deleting supplementary teacher posts with a resultant full year saving of c. £1.57m;
- g) noted that no class in any Argyll and Bute school could not be staffed despite the national shortage of teachers due to the application of an efficient and equal staffing model at the commencement of session 2015/2016; and
- h) agreed that the issue of teacher numbers commitment be referred to the Policy and Resources Committee for consideration of the financial implications arising from the position represented in this report.

4.3 Subsequent to the Community Services Committee meeting and following representations to the Scottish Government from the Convention of Scottish Local Authorities (COSLA), the Society of Local Authority Chief Executives (SOLACE) and the Association of Directors of Education in Scotland (ADES), a letter was received by the Council from Angela Constance, Cabinet Secretary for Education and Lifelong Learning (see appendix 2 attached). In the letter, The cabinet Secretary advised that both the number of teachers in Scotland's schools and the overall pupil teacher ratio (PTR) were maintained at a national level since last year. As such the Scottish Government confirmed that it therefore will maintain the existing distribution of the original £41 million allocation of funding across all 32 local authorities to help meet the costs of maintaining teacher numbers. It would therefore not seek to claw back funding from individual local authorities that did not manage to meet the commitment in full.

4.4 The Scottish Government did however confirm that only those authorities who have maintained or increased their teacher numbers will receive a share of the additional £10 million referred to in the Scottish Government letter of 5 February 2015. This means that Argyll and Bute Council will retain its share of £41 million (£0.722 million) however will not receive a share of the additional £10 million (£0.173m). Please note the letter from the Cabinet Secretary refers to a sum of £0.692m however we understand this to refer to the share of the £41m for financial year 2016-17.

## 5.0 IMPLICATIONS

- 5.1 Policy The outcome of the teacher number census has an impact on the ability of the Council to meet its commitments in relation to the financial settlement.
- 5.2 Financial The position notes that the council will not have its share of the original £41m national funding allocation to help meet the cost of maintaining teacher numbers. However the Scottish Government has confirmed that the Council, as one of the authorities that was unable to fully meet the teacher numbers commitment, would not receive its share of the additional allocation of £10m to help meet the costs of maintaining teacher numbers (£0.173m).
- 5.3 Legal The Council meets its duties in terms of the Education Standards in Scotland's Schools Act 2000.
- 5.4 HR All permanently contracted staff have been allocated to schools. All supernumerary posts have been filled on temporary contracts with the exception of secondary subject supernumeraries.
- 5.5 Equalities None
- 5.6 Risk There are risks to the Council in terms of reputation, financial, operational and HR risks as a result of the national teacher shortages.
- 5.7 Customer Service None

**Cleland Sneddon**  
**Executive Director of Community Services**

**Policy Lead, Councillor R Colville**  
11 January 2016

**For further information contact:** Ann Marie Knowles – Tel: 01369 708474

## APPENDICES

Appendix 1 – Community Services Committee Report “Compliance with Teacher Numbers Commitment” dated 10 December 2015

Appendix 2 – Letter from the Cabinet Secretary for Education and Lifelong Learning dated 16 December 2015

**COMPLIANCE WITH TEACHER NUMBERS COMMITMENT**

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**1.0 EXECUTIVE SUMMARY**

- 1.1 The purpose of this report is to provide an update of the Council's position in relation to the teacher numbers commitment made as part of the financial settlement for 2015/16 with the Scottish Government. It outlines the efforts made by the Council to meet the commitment, a range of other issues which have impacted on the ability of the council to recruit and retain teaching staff and the extra ordinary mechanisms used to deliver the required numbers.
- 1.2 It is recommended that the Community Services Committee:
- a Note the commitment to maintain overall teacher numbers and pupil: teacher ratio at 2014/15 levels as part of the 2015/16 budget settlement.
  - b Note the level of supernumerary teaching posts above the staffing entitlement model that the council require to retain to meet this commitment.
  - c Note the efforts made by the Council to recruit sufficient teachers to meet the commitment on the date of the census in September 2015 whilst addressing additional national policy ambitions (e.g. Raising attainment for all).
  - d Note the other factors which impacted on the Council's ability to meet the teacher number commitment.
  - e Note that the Council was unable to recruit sufficient teaching staff despite considerable efforts to meet the commitment which potentially will result in the loss of some or all of the share of the Scottish Government's additional £51m resources to maintain teacher numbers.
  - f Note that this potential loss of additional grant may be mitigated by deleting supernumerary teacher posts with a resultant full year saving of c. £1.57m.
  - g Note that no class in any Argyll and Bute school could not be staffed despite the national shortage of teachers due to the application of an efficient and equal staffing model at the commencement of session 2015/2016.
  - h Agree that the issue of the teacher numbers commitment is referred to the next meeting of the Policy and Resources Committee for consideration of the financial implications arising from the position represented in this report.

**COMPLIANCE WITH TEACHER NUMBERS COMMITMENT**

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**2.0 INTRODUCTION**

- 2.1 The purpose of this report is to provide an update of the Council's position in relation to the teacher numbers commitment made as part of the financial settlement for 2015/16 with the Scottish Government. It outlines the efforts made by the Council to meet the commitment, a range of other issues which have impacted on the ability of the council to recruit and retain teaching staff and the extra ordinary mechanisms used to deliver the required numbers.

**3.0 RECOMMENDATIONS**

It is recommended that the Community Services Committee:

- a Note the commitment to maintain overall teacher numbers and pupil: teacher ratio at 2014/15 levels as part of the 2015/16 budget settlement.
- b Note the level of supernumerary teaching posts above the staffing entitlement model that the council require to retain to meet this commitment.
- c Note the efforts made by the Council to recruit sufficient teachers to meet the commitment on the date of the census in September 2015 whilst addressing additional national policy ambitions (e.g. Raising attainment for all).
- d Note the other factors which impacted on the Council's ability to meet the teacher number commitment.
- e Note that the Council was unable to recruit sufficient teaching staff despite considerable efforts to meet the commitment which potentially will result in the loss of some or all of the share of the Scottish Government's additional £51m resources to maintain teacher numbers.
- f Note that this potential loss of additional grant may be mitigated by deleting supernumerary teacher posts with a resultant full year saving of c. £1.57m.
- g Note that no class in any Argyll and Bute school could not be staffed despite the national shortage of teachers due to the application of an efficient and equal staffing model at the commencement of session 2015/2016.
- h Agree that the issue of the teacher numbers commitment is referred to the next meeting of the Policy and Resources Committee for



consideration of the financial implications arising from the position represented in this report.

#### 4.0 DETAIL

- 4.1 In January 2015, John Swinney, Cabinet Secretary for Finance, Constitution and Economy wrote to each Council Leader requiring them to meet a number of conditions as part of the financial settlement for local government for 2015/16. Two of the conditions related to Education Services – to offer places for all probationer teachers and to maintain teacher numbers and pupil: teacher ratios at 2014/15 levels. To assist with meeting this commitment, Mr Swinney advised he would add £10m to the previous grant level of £41m to be distributed to local authorities.
- 4.2 COSLA sought an opportunity to move the position away from this commitment noting it was for local authorities to determine the best use of resources to meet educational outcomes and that individual local authorities were at different levels. The Scottish Government advised these were non-negotiable commitments that the requirement was for absolute numbers regardless of roll changes (previous years' commitments were to maintain teacher numbers in line with roll changes) and for Councils to confirm acceptance by 20 February 2015.
- 4.3 At its meeting of 12 February 2015, the Council agreed to accept the commitment but highlighted to the Cabinet Secretary a number of key points. These included noting Argyll and Bute had a declining pupil roll which would lead to supernumerary posts; noting this was an input measure unrelated to educational outcomes; noting that Argyll and Bute had a very low pupil: teacher ratio and might be penalised if it increased marginally when authorities with much higher starting ratios would not if they maintained their ratio. A full copy of the letter sent to the Cabinet Secretary is attached at appendix one.
- 4.4 During 2015, a number of local authorities have reported a crisis in teacher recruitment with examples of schools, predominantly in rural areas, having to send pupils home as they could not staff all classes or having to deploy central team staff in classrooms to avoid doing so. In addition to an overall teacher shortage, recruitment difficulties are particularly acute in certain subject areas such as the sciences, mathematics, Gaelic, etc. There are also substantial recruitment difficulties for Councils in filling Head Teacher posts.
- 4.5 In recognising the emerging recruitment issues, the 2015/16 staffing exercise ensured class compositions in primary were as efficient as possible whilst meeting the national class size maximas for each age group and were equitable across all primary settings in their allocations. There were a few examples of disagreement from parent councils to this equity model where some schools had benefitted from an allocation above their entitlement over previous years. This approach has however ensured that every class in Argyll and Bute has been able to be staffed in session 2015/16.

Where appropriate, all permanent primary staff were able to be successfully redeployed into permanent posts with the exception of approximately 1.3 FTE

posts on Islay. The intention for the supernumerary posts were to focus on improvement activities in support of the Attainment Challenge (see Section 3.11) and local supply cover in clusters, where practicable.

4.6 Staffing Targets

The 2014/15 census figures are summarised in the table below and reflect all GTCS registered teachers in schools/early years establishments.

Sep-14		
	No. of Teachers	FTE
Primary	613	419.36
Secondary	492	433.69
Special	16	12.5
<b>Total</b>	<b>1,121</b>	<b>865.55</b>

The target for the census date in September 2015 was therefore 866 FTE teaching staff.

- 4.7 The Council coordinates teacher recruitment centrally for all posts with an FTE above (0.5) FTE with local recruitment undertaken by Head Teachers for posts under (0.5) FTE. Generally this is from the approved supply teacher register. These latter appointments are thereafter reported to HR Services by the respective Head Teachers for contract and payroll purposes. The preparation for the annual census is a resource intensive and highly complex exercise however, due to the recruitment shortages in 2015, this exercise accounted for well over 40 full days of work for the team. This included the repeated review and update of individual staff and school data as well as cross checking revisions of contracts and appointments.
- 4.8 The Executive Director of Community Services, Head of Education and School Support Manager held a video conference prior to the census with Scottish Government officials. In that meeting the exceptional efforts undertaken were highlighted along with the continuing difficulties in recruitment. In addition, proposals for the use of quality improvement staff and temporary staff in support of school improvement work and the Scottish Government Raising Attainment for all initiatives were discussed and noted by Scottish Government representatives as consistent with the approach of a number of other authorities.
- 4.9 The Council has made considerable efforts to try to meet the teacher number commitment. These include:
- Repeated national advertisements running continuously pre summer through to the census date
  - Exhausting all available teaching staff on the supply register
  - Offering placements to all probationary teachers. Despite this offer, 5 probationer teachers were withdrawn at very short notice resulting in a reconfiguration of staffing for these schools who were due to have a probationer placed within their staffing entitlement.
  - Designing a new post graduate diploma in education (PGDE) course in

conjunction with Argyll College UHI to “grow our own” teachers. First intake was in 2015/16. Two places were specifically ringfenced for Gaelic

- Implementation of the shared headship policy where appropriate to assist in minimizing recruitment difficulties
- Reviewing our advertising strategy in collaboration with HR colleagues
- Supporting the local advertisement of hard to appoint posts at considerable cost
- Offering opportunities for extended contracts to teachers on part time or job share contracts
- Appointment of retired teaching practitioners to temporary posts
- Identification of additional staff within Argyll and Bute with active GTCS registration not currently employed and working in teaching posts
- Providing support to individual teachers wishing to secure registration in an alternative sector e.g. Secondary qualified teacher wishing to teach in primary
- Working with appropriate teacher recruitment agencies to identify potential appointees
- Liaison with other local authorities to discuss and identify further options/approaches which might be beneficial. This included Head of Service attendance at the North East Local Authority teacher recruitment summit
- Highlighting social rented housing opportunities where available stock exists via our RSL colleagues and offering relocation packages.

#### 4.10 Other Impacts

In addition to the failures in national workforce planning that has created a shortage of available teaching staff and direct competition between authorities to recruit those that are available; there have been other impacts that have exacerbated the situation for Argyll and Bute.

#### 4.11 Scottish Attainment Challenge/Raising Attainment for All

The First Minister announced the launch of the Scottish Attainment Challenge during the summer which focuses on two key priorities: to raise attainment in Scotland’s schools and to address educational inequalities. Both priorities feature as new statutory duties in the draft Education (Scotland) Bill and are reflected in the draft National Improvement Framework.

4.12 In conjunction with the announcement, the Scottish Government also announced the creation of an Attainment Fund of £100m. The first tranche of funding has been targeted to seven urban authorities on the basis of deprivation indicators and the second tranche to 57 schools across Scotland in authorities outwith the first seven and using the same urban deprivation indicators. Argyll and Bute has only one school (Rosneath Primary School) in the programme.

4.13 The vast majority of the £100m has now been allocated with an expected but yet to be confirmed allocation of only around £20,000 for Rosneath Primary School. There would appear to have been no resources as yet identified to address educational inequalities in a rural context despite repeated communications/requests from specifically affected local authorities.

4.14 As a result of the allocation of resources to urban areas, those recipient authorities have created additional posts which has resulted in a further loss of teaching staff in areas such as Argyll and Bute. This has had a further impact on the Council's ability to meet the teacher numbers commitment.

4.15 Probationer Teachers

Each year the Scottish Government indicates to each authority the potential number of probationer teacher places it requires them to accommodate. This is a positive request and, given the high quality of probationers coming through our universities, gives us an opportunity to encourage suitable probationers to stay with the authority at the end of their probationary period. For 2015/16 however, Argyll and Bute received 5 FTE fewer than expected at relatively late stage which added to the recruitment target.

4.16 Quality Improvement Staff

Following the census date, in November 2015, the Council was requested by Scottish Government officials to recode the quality improvement team so as to exclude them from the census calculation. The Council has complied with this request but have written to the Scottish Government officials to note this is a change in position from the pre-census video conference.

Cover for a range of short and long term absences from existing staffing and the teacher supply register have been implemented, as appropriate – for example there are currently 11 acting Primary Head Teachers and a range of maternity leave covers. In addition consideration has also been given to the cessation of secondments out with the Authority.

4.17 2015/16 Census Figures

The 2015/16 census figures confirmed by the Scottish Government are therefore as follows:

	<b>FTE published in 2014 Census</b>	<b>FTE reported in September 2015 Census return</b>
<b>Primary School Teachers</b>	419	408
<b>Secondary Schools Teachers</b>	434	425
<b>Special Teachers</b>	13	11
<b>Centrally Employed Staff</b>	-	13*
	866	857

\* The deployment of GTCS registered staff from the central team was included following discussion with Scottish Government officials pre census.

	<b>All pupils Primary, Secondary, Special in 2014- 15</b>	<b>All pupils Primary, Secondary, Special in 2015-16</b>
<b>Total number of pupils</b>	10,565	10,445
	<b>Figure Agreed with Scottish Government</b>	<b>Actual Figure reported in September 2015 Census return</b>
<b>Total number of teachers (FTE all sectors)</b>	866	857
<b>Pupil/ Teacher Ratio (all sectors excluding ELC)</b>	12.2	12.4

- 4.18 Both COSLA and ADES have written to the Scottish Government highlighting the exceptional efforts made by local authorities to comply with the teacher number commitment and the impact of the other Government policies and making a case that no penalties be applied. A full sanction removing the Council's share of the £51m would be approximately £0.895m. This compares with the full year costs of 36 FTE supernumerary posts (20 FTE primary and 16 FTE secondary which is broken down as follows: additional 12 FTE within Oban High and Hermitage Academy and 4 FTE within other secondary establishments across the Authority) of c.£1.5m.
- 4.19 Should the sanction be applied it would be open to the Council to remove the supernumerary posts. All appointments to such posts have been made on a temporary basis to ensure no ongoing liability is incurred.

## 5.0 CONCLUSION

- 5.1 The Council entered into agreement with the Scottish Government to maintain teacher number at the 2014/15 levels as part of the 2015/16 financial settlement. Despite all efforts, the national teacher shortages exacerbated by the number of additional posts in urban authorities has meant that insufficient teachers could be recruited to meet that commitment. Efficient application of an equitable staffing model ensured that all classes in Argyll and Bute schools could be staffed. However, it was not possible to maintain the level of supernumerary posts required.

The annual staffing exercise ensured the delivery of the relevant teaching posts in all Argyll and Bute primary schools.

## 6.0 IMPLICATIONS

- 6.1 Policy The outcome of the teacher number census has an impact on the ability of the Council to meet its commitments in relation to the financial settlement.
- 6.2 Financial There is a risk of financial sanctions being applied to

		the Council for all or part of the £0.895m additional grant. The full year cost of the supernumerary posts is however c. £1.57m.
6.3	Legal	The Council meets its duties in terms of the Education Standards in Scotland's Schools Act 2000.
6.4	HR	All permanently contracted staff have been the allocated to schools. All supernumerary posts have been filled are on temporary contracts with the exception of secondary subject supernumeraries.
6.5	Equalities	None
6.6	Risk	There are risks to the Council in terms of reputation, financial, operational and HR risks as a result of the national teacher shortages.
6.7	Customer Service	None

**Cleland Sneddon**  
**Executive Director of Community Services**

**Policy Lead, Councillor R Colville**  
12 November 2015

**For further information contact: Ann Marie Knowles – Tel: 01369 708474**



**Councillor Dick Walsh  
Leader**

**Kilmory  
Lochgillphead  
PA31 8RT**

**Tel: 01369 708539 Fax 01546**

**604349**

**Email: dick.walsh@argyll-bute.gov.uk**

**Mr John Swinney  
Deputy First Minister and Cabinet Secretary for  
Finance, Constitution and Economy  
The Scottish Government  
St Andrew's House  
Regent Road  
Edinburgh  
EH1 3DG**

**Our Ref: DW/WB**

**Your Ref:**

**Date : 19 February 2015**

**Dear John**

**TEACHER NUMBERS 2015-16**

Thank you for your letter of 5<sup>th</sup> February 2015 in connection with the above.

As you will now be aware, the Scottish Government proposal set out within your letter was considered in detail at a Special CoSLA Leaders meeting held on Friday 6<sup>th</sup> February. The meeting agreed the following motion:

"It is difficult to see how the Scottish Government's letter to all Council Leaders can be described as fair or equitable with regard to financing targets and sanctions on the issue of teacher numbers. Only collective discussions at a national level can resolve the inherent unfairness of the deal. Therefore, CoSLA call upon the Scottish Government to re-engage in national discussion. Further it is imperative that no council is sanctioned as a result of workforce planning issues".

I would strongly urge you to consider the request made by CoSLA and to return to the negotiation table to seek a mutual agreed resolution to this issue through the recognised collective bargaining arrangements. I believe that both sides have a common interest in ensuring the quality of education services in Scotland are of the very highest however this must be done within a balanced budget and I welcome your recognition regarding the very real financial pressures being faced by local authorities. I also hope that the process of negotiation ensures that there are no unintended consequences arising from this proposal that unfairly impact on some local authorities.

You may be familiar with some of these potential consequences through recent negotiations however I present them within this letter for information:



- a) Agreement to a national ratio of 13.5 pupils per teacher should be achievable for Argyll and Bute given our current position however, if this is applied to overall teacher numbers, this will have an impact on the ability of the Council to balance its budget in future. Clarification that the commitment to overall teacher numbers would be calculated excluding natural changes as a result of pupil roll changes would be helpful. The council's proportion of the additional £10m on the normal distribution formula would be around £170,000 equating to only approximately 4 FTE teaching posts.
- b) All authorities are at different starting points in relation to these targets. For example an authority that has made significant reductions to its FTE teacher numbers in previous years and have a high ratio may not be penalised if they maintained teacher numbers in line with 2014-15 levels whereas an authority that has kept its ratio low but planned to implement reductions in 2015-16 would be penalised even if they still had a lower ratio than the first authority. Argyll and Bute would fall into the latter category. I would urge consideration is given to meeting the target ratio rather than on overall teacher numbers
- c) Linked to the above point, clarification is required that the proposed maintenance of overall teacher numbers is applied after the changes in staffing associated with the natural change related to increases or decreases in school rolls as in previous years. This would have a further impact on authorities like Argyll and Bute which have projected reductions in school rolls in 2015-16.
- d) The teacher census figures need to take some cognisance of partnership arrangements between schools and FE colleges or other training/ education institutes. Following Government policy direction, many Argyll and Bute schools have a curriculum that features input from colleges and use their resources to buy such support and this improves the educational experience and outcomes for our young people. This has the effect of reducing the number of FTE teaching staff directly employed by the Council. To fail to recognise this approach, will penalise authorities that have been pro active in designing an education system that is designed around the needs of its learners.
- e) Many authorities including Argyll and Bute have experienced difficulties in recruiting teachers which links to national workforce planning. I would request that the count relates to posts and not teachers in post as many authorities would be unfairly disadvantaged due to their inability to recruit.
- f) The ability of local authorities to reduce its staffing may also be variable – in Argyll and Bute despite significant reductions in pupil numbers, this is not always able to be matched by a reduction in teacher numbers. For example a school that had a single class with 14 pupils two years ago and 6 pupils this year still has the same staffing requirement. The council could be doubly affected as the reducing pupil roll results in a lower per capita grant aided expenditure (GAE) allocation for pupils.
- g) There is almost universal agreement that input measures are not a good single measure for education quality and work on a wider educational



outcomes framework needs to be progressed as a matter of priority. There is no similar protection in place for any other local government employees which introduces an inequity between groups of employees and I would hope that a commitment is secured that this would be the last year that these targets are solely linked to the financial settlement.

If there is no agreement to continue collective negotiations through CoSLA despite the widespread support for this approach, I write to confirm that Argyll and Bute Council will accept the terms of your revised offer. In doing so it would be helpful to have your consideration of the factors outlined above and the clarifications requested by CoSLA in their submission on 2<sup>nd</sup> February 2015.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Dick Walsh', with a stylized flourish at the end.

Dick Walsh  
Council Leader

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Appendix 2 - Letter from Angela Constance, Cabinet Secretary for Education and Lifelong Learning in relation to the teacher numbers commitment for 2015-16

Cabinet Secretary for Education and Lifelong Learning  
Angela Constance MSP

F/T: 0300 244 4000  
E: scottish.ministers@gov.scot



Councillor Dick Walsh  
Leader of Argyll and Bute Council  
Kilmory  
Lochgilphead  
PA31 8RT



16 December 2015

Dear Councillor Walsh

**TEACHER NUMBERS 2016-17**

The Deputy First Minister has set out today in his statement to Parliament the terms of the local government finance proposal for 2016-17. The purpose of this letter is to confirm the position of your authority in relation to the 2015-16 teacher numbers agreement and to set out the terms of a revised commitment which forms part of that proposal.

The commitments made by all 32 local authorities to maintain teacher numbers and pupil teacher ratios in 2015-16 were measured in the results of the annual census of pupils and teachers published on 9 December. Those results show that both the number of teachers in Scotland's schools and the overall pupil teacher ratio (PTR) were maintained at a national level since last year. Mr Swinney has confirmed that, as an act of good faith, he will therefore maintain the existing distribution of the £41 million across all 32 local authorities and will not seek to claw back funding which he was entitled to under the terms of the Scottish Government's agreement with individual local authorities.

However, while overall teacher numbers and PTRs were maintained at a national level they were not maintained by every local authority. In the interests of fairness, only those authorities who have maintained or increased their teacher numbers will receive a share of the additional £10 million which was referred to in Mr Swinney's letter of 5 February 2015. This recognises both the additional staff costs these authorities have incurred and their

contribution to maintaining the national figures. It means that Argyll and Bute Council will retain its share of £41 million (£0.692 million) and will not receive a share of the additional £10 million.

I remain firmly committed to maintaining teacher numbers as a central part of our priority to raise attainment and the local government finance settlement proposal makes provision for a return to a national agreement for 2016-17. In return for maintaining overall teacher numbers at 2015-16 levels, and securing places for all probationers who require one under the teacher induction scheme, the Government will provide a continued funding package of £88 million, made up of £51m (comprising the existing £41 million and an additional £10 million added in 2015) to maintain teacher numbers and £37.6 million to support the teacher induction scheme.

A handwritten signature in black ink, appearing to read 'Angela Constance', written over a horizontal line.

**ANGELA  
CONSTANCE**

## Policy and Resources Committee Work Plan 2016-17

<b>February 2016 - This is an outline plan to facilitate forward planning of reports to the P&amp;R Committee.</b>					
<b>4 February 2016</b>					
	Budgeting Pack 2016/17	Strategic Finance	Annual	5 January 2015	
	Treasury Management Strategy Statement & Annual Investment Strategy	Strategic Finance	Annual	5 January 2015	
	Financial Reporting 2015-16 Summary	Strategic Finance	Every Meeting	5 January 2015	
	Compliance with Teacher Numbers Commitment	Community Services		5 January 2015	Recommendation from Community Services Committee held on 10 December 2015
	Policy And Resources Committee Work Plan	Customer Services	Every meeting	5 January 2015	
<b>17 March 2016</b>					
	Financial Reporting 2015-16 Summary	Strategic Finance	Every meeting	16 February 2016	
	Performance Report FQ3 2015/16	Customer Services	Quarterly	16 February 2016	
	Service Planning 2016-17	IHR/Strategic Finance	Annual	16 February 2016	
	Lorn Arc – Update report	Development and Infrastructure Services	Quarterly	16 February 2016	
	Enhanced Employability Pipeline Strategic Intervention – European Social Fund	Ishabel Bremner		16 February 2016	Email from Ishabel Bremner

## Policy and Resources Committee Work Plan 2016-17

	Major Capital Regeneration Project Progress Report	Development and Infrastructure Services	Quarterly	16 February 2016	
	Scottish Government Funding for Welfare Reform and Discretionary Housing Payment	Customer Services			March 2015 - Requested further report in to a future meeting on progress with proposals.
	Long and Winding Way	Development and Infrastructure Services		16 February 2016	
	Policy And Resources Committee Work Plan	Customer Services	Every meeting	16 February 2016	
<b>12 May 2016</b>					
	Financial Reporting 2016-17 – Summary	Strategic Finance	Every meeting	12 April 2016	
	Carbon Management: Wind Turbine At Glengorm Landfill Site	Strategic Finance	Every meeting	12 April 2016	Council 21 January 2016 Noted that an update paper would be presented to Policy and Resources Committee in May 2016 to confirm the progress made with installation.
	Policy And Resources Committee Work Plan	Customer Services	Every meeting		
<b>Future Items – date to be determined</b>					
	SOA Delivery Plan Review	Customer Services			To come to future meeting – most likely June 2016.

## Policy and Resources Committee Work Plan 2016-17

	<p>IHR Policies:</p> <ul style="list-style-type: none"> <li>• Recruitment and Selection Policy</li> <li>• Maximising Attendance Policy</li> <li>• Improving Employee Performance Policy</li> </ul>	Improvement and HR	Occasional		
	Lorn ARC Tax Incremental Funding (TIF) Asset Project 5 – Oban North Pier Extension – Start Up Report	Development and Infrastructure			Agreed 14 May 2015 that FBC would be presented to a future Committee
	Lorn Arc TIF Asset Project 9 – Existing Access Improvements and Business Park Enablement, Oban Airport Start up Project	Development and Infrastructure	Quarterly		Agreed 14 May 2015 that quarterly updates would be provided to OLI and then P&R
	Records Management and Electronic Document and Records Management Summary	Customer Services			
	Improving Wages in the Care at Home/Housing Support Sector	Community Services			

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