Item No. 6

Police and Crime Commissioner for Staffordshire (PCC)

29 January 2015

Report of the Chief Finance Officer

Treasury Management Strategy Report 2015/16

1. Purpose of report

1.1 To outline the PCC Treasury Management Strategy for 2015/16.

2. Summary

2.1 The purpose of a treasury management strategy is to provide a framework for borrowing and cash flow management decisions in the light of the anticipated movement in long and short-term interest rates. Like any strategy, there will need to be some flexibility built in to cope with differing economic conditions and outcomes. This strategy has been prepared in conjunction with the Staffordshire County Council (SCC) Treasury and Pension Fund team, and after consultation with the Chief Finance Officer of the Chief Constable of Staffordshire police.

3. Recommendations

3.1 That the meeting approves the proposed borrowing strategy for the 2015/16 financial year comprising:

a) a borrowing strategy to operate within the prudential limits set out in **Appendix 1**;
b) a borrowing strategy, to maximise the use of cash as far as practically possible with the ability to raise long-term loans following consultation with the Chair of the Ethics, Transparency and Audit (ETA) Committee;
c) a forward borrowing strategy that will not be used; and
d) a loan restructuring strategy that is potentially unlimited where this rebalances risk.

3.2 That in accordance with Government Guidance on local authority investments, approval is given for the adoption of the Annual Investment Strategy (AIS) 2015/16 as set out in **section 7** of this report and detailed in **Appendix 3**, comprising:

a) investment instruments;
b) credit rating criteria;
c) investment duration.

3.3 Also as required by this guidance, that approval is given for policies on:

d) reviewing the strategy;
e) the use of external advisors;
f) training.

3.4 Finally, that the ETA committee nominate one of their members to specialise in treasury management, in order to provide future support to the rest of the committee.

4. **Background**

4.1 The economic environment has improved in the UK during the past twelve months with higher than expected growth and lower inflation. However the financial environment remains one where risks are significant and potentially large in scale.

4.2 One of these risks is related to the fact that the Government is changing how banks that fail are treated, such that there is a risk that local authority depositors such as the PCC, could lose a proportion of their investments (known as “bail-in”). Whilst the recent Bank of England stress tests were passed by the majority of banks the Co-op bank failed the test and will need to do more to address their financial position.

4.3 Further there are other risks to the economic situation with falling oil prices, stagnation in Europe and a Chinese economy under pressure. As a result, the treasury investment strategy retains the low risk approach adopted in recent years based on prioritising security, liquidity and then yield.

4.4 The proposed borrowing strategy continues to use any surplus cash held, with a shift in emphasis to maximise this where it is practical. This is because this strategy can only be pursued if liquid (cash) resources are available and the proposed increase in the capital programme may exhaust cash resources leading to a need to raise loans of some form. If possible these will be short-term in nature, but long-term loans may be needed if this proves impractical to manage or offers better value.

4.5 Maximising the use of internal cash in this way is considered appropriate as it reduces investment risk and ongoing short-term interest rates support the strategy financially. That is, for every £1 of borrowing avoided, the lost investment income is minor compared to the borrowing interest payable.

4.6 The decision on when to borrow short term (less than 12 months) will be made by the PCC Chief Finance Officer (CFO); with longer term borrowing decisions made in conjunction with the Chair of the ETA committee. The overall position is summarised at **paragraph 6.3**.

5. **Economic background**

Interest rates

5.1 In considering borrowing and investment strategies, it is important that account is taken of the likely economic environment and potential level of interest rates.

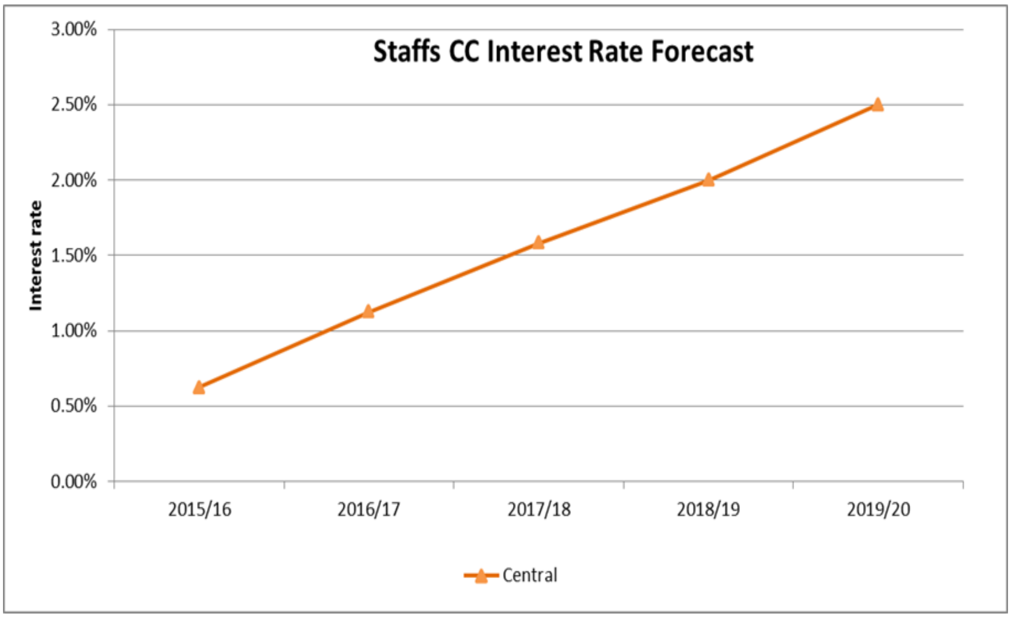
5.2 At the time of writing there is much discussion about when the first rise in bank-rate will occur and two members of the Bank of England’s Monetary Policy Committee (MPC) have voted for a rise recently.

5.3 Forecasting is always difficult in such a complex economic environment; in effect there is a tension between three separate issues:

- Positive momentum in the UK economy that supports a rise, offset by;
- External risks in the Eurozone and other countries around the world; and
- Benign inflationary pressure that reduces pressure for a rise.

5.4 In terms of treasury management, the bank rate (the interest rate set by the Bank of England) is fundamental to the income received and it may also affect expenditure on loan interest where new loans are taken out or variable rate loans are held.

5.5 The following graph shows the forecast for bank rate as used in the Medium Term Financial Strategy of Staffordshire County Council. This shows that short-term interest rates will start to rise in 2015/16.



5.6 But, whilst interest rates are expected to rise in 2015 and thereafter, they are not expected to reach pre-crisis levels for many years into the future. This is important for the strategies that follow, because variable rate investment income is not likely to cancel out fixed loan expenditure (known as the cost of carrying loans).

Credit outlook

5.7 The credit outlook is in one sense positive and in one negative because of legislation to be introduced in 2015/16. This will change the way that failing banks are dealt with; instead of a Government “bail-out” being the default position a “bail-in” by investors will be forced upon a bank.

5.8 This is positive as it provides a way of dealing with a failing bank; in theory this means that there is less chance of wider contagion arising from a failure because a bank can experience difficulties without formally closing. Banks will also be forced to strengthen their balance sheets and in effect become more resilient to a downturn.

5.9 However, what this does mean is that some investors are more likely to lose money; in effect an investment may be "top-sliced" to contribute to losses at a bank. Those investors affected are public sector bodies (such as local authorities) and financial companies; others will be covered by the Financial Services Compensation Scheme (FSCS).

5.10 Stress tests conducted by the Bank of England's Prudential Regulatory Authority (the PRA) also give an indication of the health of the largest and most important UK banks. In mid-December 2014 the most recent results were announced and the majority of the banks "passed" which means that their balance sheets are strong enough to survive an extreme economic downturn. Lloyds Bank and the Royal Bank of Scotland Group did "pass" but are considered to be at risk in such a situation. Both will need to strengthen their balance sheet as a result. Finally, as expected the Co-op Bank "failed" the test and will be expected to reduce its risk profile; it will be monitored closely by the PRA. **Paragraph 7.20** details the progress in "on-boarding" Lloyds bank as banker and ending the contract with the Co-op Bank.

5.11 In terms of the AIS, **section 7** sets out where cash will be invested.

6. Borrowing strategy

6.1 At 31 March 2015, it is anticipated that long-term loan debt will be around 78% funded, i.e. covered by around £39m of fixed interest rate long-term loans. Around £11m is forecast to be needed to complete the borrowing reflecting the strategy of using cash to date.

6.2 There are three main options in the borrowing strategy:

a. To use cash (i.e. do not borrow).
b. To bring borrowing up to the amount needed to fully fund the capital programme at any point in time.
c. To forward borrow up to two years in advance, as allowed in the Prudential Code.

6.3 The following table shows a forecast of the levels of debt (with the increase mainly driven by the planned investment in the IT programme) and loans at 31 March 2015 and for the next three years if the first option, i.e. using cash in lieu of borrowing was followed.

	2014/15 £m	**2015/16 £m**	**2016/17 £m**	**2017/18 £m**
Forecast Gross Debt *	50	62	59	61
Forecast Loans Position	(39)	(38)	(36)	(35)
Gap Funded from Cash *	**11**	**24**	**23**	**26**

** This table assumes significant capital receipts will be received (see **6.5**)*

6.4 This table shows that the level of forecast debt increases in 2015/16 and is then reasonably stable over the subsequent two years. Loans on the other hand are slowly maturing (falling) and this also contributes to the widening gap funded from cash.

6.5 In addition, capital receipts are expected in 2015/16 and 2016/17 totalling £14m; if these are not received then the worst case scenario is that debt will rise further with the amount funded from cash increasing to £40m at the end of 2017/18.

6.6 These predictions are uncertain to some extent, but with debt at these levels cash balances will not be sufficient throughout the year and the only other option is to borrow <u>some</u> new loans, either temporarily (for less then 12 months) or more permanently.

6.7 Within this it is important to understand that all of the gap does not need to be closed with loans, a gap should be retained that uses cash because:

- Using cash reduces security risk as investment balances are lower. The Government emphasises the importance of minimising this risk above all others in the regulations discussed later in this report; taken with the advent of bail-in risk the risk to the PCC is an important one to ameliorate.
- There is less exposure to variable interest rate changes; this exposure arises when a fixed term loan is taken out with corresponding variable rate investments. This is avoided when cash is used.
- The low interest rate environment allows a portion of the capital programme to be funded at low cost through the use of cash and this opportunity should continue to be maximised.

6.8 However, the strategy proposed is one that aims to balance the liquidity needs of day to day cash management with the low risk approach that is offered by using cash. As the year progresses and the effects of the capital programme start to be felt, the question arises as to what loans should be raised to provide the liquidity necessary to allow the PCC to continue to pay it’s bills.

Short-term loans

6.9 The first option is to take up market loans for less than 12 months; typically from 1 to 3 months. These are low cost and of course the treasury team can respond flexibly to liquidity pressures in raising these when needed.

6.10 Their disadvantage is potentially one of availability; at the moment liquidity can be difficult to raise quickly from banks and building societies so local authorities are the most obvious source. Loans raised depend upon others having cash and being prepared to lend it to the PCC.

6.11 A loan facility from the PCC banker, Lloyds will also be investigated in order to provide a contingency plan in this area, but this will only be arranged if it is economically viable.

Long-term loans

6.12 Long-term loans are those for a duration of more than 12 months; the traditional source is the PWLB (Public Works Loan Board) (effectively the UK Government) but in the past banks have participated in this market.

6.13 These loans are relatively more expensive now than in the past as the Government increased the margin over Gilts several years ago (this is now 0.80% under the “certainty rate” regime). However, loans can be raised and cash received within 3 working days so the PWLB provides a strong contingency against liquidity availability.

6.14 That is not to say that this facility will always be available in its current form; there has been a history of unannounced changes in the past and further changes remain a risk.

6.15 The exact type of loan to be raised will be considered at the time; but with the present normal yield curve and the maturity profile of the existing loan portfolio shorter-term loans will be considered that offer good value for money.

6.16 A key part of the CIPFA Code of Practice for Treasury Management is to assess the risk of a treasury management strategy. It sets out a number of risks to be considered and this assessment for the six risks considered most relevant is shown at **Appendix 2** and summarised in the following table:

Risk	**Assessment**
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Medium
Refinancing	Medium
Regulatory and legal	Medium

6.17 Overall the strategy of maximising the use of cash in lieu of borrowing is considered a relatively low risk strategy although it is impossible to eliminate all treasury risk. The consequences of using cash are the possibility of extra costs in the future if interest rates rise; although this must be balanced with the extra cost now if loans were taken (the cost of carry).

6.18 The outturn and half-year reports will update the position later in the year.

Policy on borrowing in advance of need

6.19 The Prudential Code allows borrowing to take place for the current year plus two future years. Although, Government guidance states that there should be a specific policy on borrowing in advance of need.

6.20 As the borrowing strategy proposed for 2015/16 involves maximising the use of cash, the policy is not to borrow in advance this year. This will be revisited annually as part of the overall borrowing strategy.

Loan restructuring

6.21 Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- Replace existing loans with new loans at a lower rate (known as loan rescheduling).
- Repay loans early, without replacing the loans. As this would increase the use of cash this is no longer a viable option with the debt levels outlined earlier.

6.22 Currently loan restructuring would be very expensive and unattractive for the PCC:

- Gilt yields are historically low at the time of writing this report. This would lead to large penalties to compensate the PWLB if loans were repaid early;
- New loans are much more expensive than in the past even though gilt yields are so low. Since 2010 the Government has increased the margin on top of gilts at which it onward lends to local government via the PWLB (now 0.80%).

6.23 Market conditions and regulations do change so the outcome cannot be foreseen. It is proposed to allow unlimited loan restructuring with the decision being delegated to the CFO, and reported retrospectively to the ETA Panel.

7. Annual Investment Strategy 2015/16

7.1 The portfolio of investments can reach as high as £40m in cash each year, but on average balances are under £20m. Since the financial crisis the PCC has taken a low risk approach and this AIS continues in this vein.

Investment options

7.2 The main investment options to consider are related to:

- the credit risk of investment counterparties;
- the length of the investment; and
- the type of financial instrument that are used.

7.3 These issues of credit worthiness, liquidity and type of financial instrument have to be considered in the light of the regulatory framework provided by the Government.

7.4 Key parts of this framework are the Government Guidance on Local Government Investments issued in March 2010 and the CIPFA Code of Practice for Treasury Management in the Public Services. These state that the two prime risk issues are:

- the security of capital; and
- the liquidity of investments.

7.5 In addition, Government guidance also specifies the type of financial instruments that can be used and they divide them into what they term ‘specified’ investments and ‘non-specified’ investments.

Specified investments

7.6 Specified investments are investments made in sterling for a period of less than a year that are not counted as capital expenditure and are invested with:

- the UK Government;
- a local authority;
- a parish or community council (the PCC is unlikely to use these);
- a body, or in an investment instrument, that has a ‘high credit rating’.

7.7 The first three named investments can be used by the PCC by virtue of their inclusion within the guidance (referred to as regulation investments subsequently in this report). The assessment of the fourth aspect is dealt with in the paragraphs that follow.

Money Market Funds

7.8 Money Market Funds (MMF's) are pooled investment vehicles consisting of money market deposits and similar instruments; these are used by the PCC currently and more widely by other public and private sector bodies.

7.9 MMF's proposed for use would be 'AAA' rated, the highest possible credit rating and they would have the following attributes:

- Diversified – MMF's are diversified across many different investments, far more than could be achieved individually;
- Same day liquidity – this means that funds can be accessed on a daily basis;
- Ring-fenced assets – the investments are owned by the investors and not the fund management company;
- Custodian – the investments are managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.

7.10 All treasury activity carries an element of risk and MMF's are no different. In the event of a further financial crisis, the failure of one or more of an MMF's investments could lead to a run on the MMF as investors rush to redeem their investment. This could then spread to other MMF's as investors take flight from this asset class.

7.11 The very low interest rate environment also threatens the ongoing continuity of MMF's. Each MMF charges a fee and this could mean that interest earned became negative after its deduction. If this problem arose then it would be a matter of moving funds to an alternative class of investment.

7.12 All of these issues point towards the fundamental need for diversification across investment categories. This issue is dealt with later in this report (see **paragraph 7.25**).

7.13 MMF's as described in these paragraphs are judged to meet the definition of an instrument that the meets the definition of a "high credit rating".

The Credit Management Strategy for 2015/16

7.14 The assessment of what is a "high credit rating" for banks or building societies is set out in this section of the report.

7.15 Government guidance also requires an explanation of how credit quality is monitored, what happens when it changes and what additional sources of information are used to assess credit quality.

7.16 In the past a broad list of banks and building societies were utilised; however, over time the number of approved banks and building societies has fallen away because of poor returns relative to the risk of investing.

7.17 The position for 2015/16 is that only one bank will be used, Lloyds, and this will be in the context of their banking relationship with the PCC.

7.18 As with any bank, the credit environment will be monitored to make a subjective judgement on the creditworthiness of Lloyds, this includes:

- Credit Default Swaps (CDS) (i.e. the cost of insuring against counterparty default);
- Share price;
- Macro-economic factors;
- Information in the press.

7.19 The PCC is responsible for all its investment decisions. Meetings with colleagues from the Treasury and Pension Fund Team at the County Council take place on a quarterly basis and a review of the lending list will take place at these meetings.

Banking

7.20 At the time of writing this report the implementation of the new banker, Lloyds Bank is expected by the beginning of February.

7.21 Following a short period of parallel running it is expected that this process will be fully complete by the 28 February 2015 when the Co-op Bank accounts will be closed and the contract ended.

7.22 Under the new arrangements funds will be retained with Lloyds bank each night earning interest at a market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 7.25**. It is important to note that funds will be available on the day, they are not committed for any period of time.

Investment duration

7.23 In terms of duration the arrangements set-out in this report are relatively simple; funds invested with banks (either through a MMF) or with Lloyds are liquid and available at one days notice. Other regulation investments may be invested for up to 12 months but more typically a month or two.

7.24 The current lending list is shown at **Appendix 3**. The maximum recommended investment duration for 2015/16 works within the definition of a specified investment, which is to not invest for more than a year.

Investment diversification

7.25 Having determined the list of highly rated counterparties and the duration of investments, the last piece of the process is to overlay the methodology for ensuring diversification.

7.26 Ensuring diversification has never been more important than now; it protects the security of the investments by limiting loss in the event of a counterparty default. **However, diversification does not provide protection from a systemic failure of the banking sector**.

7.27 Financial limits force investments to be spread. For regulation investments (the least risk of all) there is no limit. All investments could be placed here.

7.28 For MMF’s a limit is in place in order to meet liquidity requirements; £1.5m per MMF. And for Lloyds bank a limit is set that minimises processing costs and also provides a small amount of additional liquidity; £0.5m.

7.29 Where cash balances are very low then this may mean that all investments are placed with the MMF’s and Lloyds bank. However, balances will be within the limits stated above.

7.30 It is proposed that both the application and amendment of this policy are delegated to the CFO with the outcome reported in the regular treasury management reports to the ETA Panel.

Non-specified investments

7.31 The Government guidance defines non-specified investments as all other types of investment that do not meet the definition of specified investments. In contrast to specified investments, Government guidance indicates that the AIS should:

- set out procedures for determining which categories should be prudently used;
- identify such investments;
- state an upper limit for each category of non-specified investment;
- state upper limits for the total amount to be held in such investments.

7.32 Currently, non-specified investments are not in use.

Risk

7.33 Although guidance sets out two important risks that are faced when deposits are made with counterparties (see **paragraph 7.4**), these are not the only risk issues faced.

7.34 **Appendix 4** sets out a high-level risk assessment of six of the key risks. These are listed below together with the risk assessment. The proposed strategy has been evaluated against these risks and the judgement is that the most important risks have been reduced as far as possible, this is not to say that all risk has been eliminated which is not possible in treasury terms.

Risk	**Assessment**
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and legal	Low

Review of strategy

7.35 Guidance requires that the circumstances under which a revised strategy is to be prepared should be stated.

7.36 The main circumstances where a revised strategy would be prepared include a change in:

- the economic environment;
- the financial risk environment;
- the budgetary position; or
- the regulatory environment.

7.37 The responsibility for assessing these circumstances will rest with the CFO.

Policy on the use of external service providers

7.38 The policy on the use of external providers must also be disclosed. Currently the PCC has no contracted external treasury adviser and this is considered appropriate with the arrangements set out.

7.39 The treasury service to the PCC is provided by the Treasury and Pension Fund team at SCC, who appointed Arlingclose as its external treasury management adviser from 1 April 2013. This contractor could be used to procure specific consultancy advice, for example on loan rescheduling should this be considered necessary.

Investment management training

7.40 Finally, disclosure of the processes for ensuring officers are well trained in investment management is also needed.

7.41 Treasury management is a specialised area requiring high quality and well trained staff that have an up to date knowledge of current issues, legislation and treasury risk management techniques.

7.42 Training needs for PCC and Police staff who attend quarterly meetings with the SCC Treasury and Pension Fund Team are assessed on an ongoing basis by their organisations.

7.43 At SCC, staff who provide the treasury service attend regular CIPFA and treasury consultant training seminars throughout the year and undertake a personal performance review each year through which training needs are identified.

7.44 In this vein, it is suggested that the ETA Panel nominate a member to develop more detailed knowledge in order that they can more readily evaluate and support the Treasury Management Strategy.

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Background Documents:

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2011)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2011)
3. Local Authorities (Capital Finance and Accounting) Regulations 2003
4. Local Government Investments - Guidance under Section 15(1) (a) of the Local Government Act 2003 issued by the Secretary of State (2010)

Appendix 1

29 January 2015

Prudential indicators for treasury management

Indicator	Estimate 2015/16	Estimate 2016/17	Estimate 2017/18
1. CIPFA Code of Practice for Treasury Management in the Public Services	The PCC has adopted the CIPFA Code of Practice on Treasury Management (2011 version)		
This indicator identifies whether CIPFA's Code of Practice for Treasury Management in the Public Services has been adopted.			
2. External debt			
a. Authorised limit	£72.2m	£69.9m	£66.6m
b. Operational boundary	£70.6m	£68.4m	£54.1m
c. External loans	£38.3m	£36.3m	£34.6m
The authorised limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the capital programme. *The operational boundary represents the Chief Finance Officer's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst case scenario.*			
3. Interest rate exposures			
a. Upper limit (fixed)	£48m	£46m	£46m
b. Upper limit (variable)	(£40m)	(£40m)	(£40m)
Upper limits of fixed and variable borrowing and investments are required to be set. This limits exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
4. Maturity structure of borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	
12 months and within 24 months	10%	0%	
24 months and within 5 years	30%	0%	
5 years and within 10 years	50%	0%	
10 years and above	100%	25%	
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *As a result no more than 10% of fixed rate loans are planned to mature in any one financial year.*			
5. Upper limit for total principal sums invested for over 364 days	£	£	£
Any investments made for over 364 days will be in accordance with the limits on non-specified investments.	nil	nil	nil
6. Borrowing in advance of need (maximum debt)	100%	100%	100%
This is a new indicator; it sets the maximum loans as a proportion of the borrowing need. In 2015/16 the strategy is not to borrow in advance, hence the indicator is set at 100%.			

Appendix 2

29 January 2015

Risk assessment – Borrowing strategy

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Security	A third party fails to meet its contractual obligations (i.e. counter party risk).	Unlikely that there is a failure between the agreement to borrow and sums being received a few days later. However, if have borrowed in advance and invested until needed for capital. This increases exposure to investment risk.	Usually borrow from the Government (PWLB) and maximum 3 day gap between agreement to borrow and receipt of money.	**LOW**	Use of cash to fund borrowing reduces this risk.
Liquidity	Cash is not readily available when it is needed.	Only borrow for capital – usually borrow from Government (PWLB). Can also borrow in the short-term e.g. from other local authorities.	Prudential rules on borrowing and consideration of whether Government is secure.	**LOW to MEDIUM**	Use of cash to fund borrowing increases this risk as liquidity is reduced when borrowing is avoided. The increase in borrowing exacerbates this risk.
Interest rate	Unexpected reduction in short term interest rates.	Depends on the mix between fixed rate borrowing and variable rate borrowing Higher exposure to variable rate borrowing helps the budget.	The control is set out below.	**LOW to MEDIUM**	Pursuing a strategy of using cash reduces the overall net exposure to sudden interest rate falls.
Interest rate	Unexpected increase in short term interest rates.	Mix of variable and fixed rates – Lower exposure to variable rate borrowing helps the budget.	Limit variable rate borrowing to a relatively small proportion (e.g. 20%).	**LOW to MEDIUM**	20% limit provides a suitable risk control.

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Market	The market value of loans changes substantially (i.e. how much is the borrowing strategy exposed to long term interest rate change).	How much risk is built into the maturity profile of the loans structure.	This is inversely linked to refinancing risk below.	**MEDIUM**	Use of cash will shorten the duration of the loan portfolio and reduces this risk. Without the use of cash this risk assessment would probably be high.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Need to avoid a high level of borrowing over a short period where you are exposed to high interest rates.	The PCC has a policy of limiting maturing loans to 10% of the loans portfolio.	**MEDIUM**	Using cash to fund borrowing potentially increases the refinancing risk. Without the use of cash this risk assessment would probably be low.
Regulatory and legal risk	Rules governing local government borrowing are changed or amended without notice, which has happened in the recent past.	Local government heavily reliant upon PWLB. Cost and ability to reschedule / manage loans are determined by the Government. The Government could close the PWLB and force local authorities to use market loans for all new borrowing.	Market loans will be evaluated and taken if these are good overall value and dilute reliance on the PWLB. This risk cannot be managed in any other way.	**MEDIUM**	Use of cash means that PWLB loans are not being taken. If the PWLB was closed to new business then market loans would be the only option.

Appendix 3

29 January 2015

Lending List – January 2015	
	Time Limit
Regulation Investments	
UK Government DMADF account	6 months
UK Local Authority	12 months
Bank	
Lloyds (as banker) (£0.500m max)	call only
MMF's	
Federated (£1.5m max)	call only
Morgan Stanley (£1.5m max)	call only

Appendix 4

29 January 2015

Risk assessment - Investments

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Security	A third party fails to meet its contractual obligations (i.e. counter party risk).	Crucial that money invested is returned (principal and interest).	Relies on credit management policy including; credit risk, duration of investment and amount as well as an ongoing review of the credit environment. Prudential limit on investment over 1 year.	**LOW**	Use of the investments identified within the AIS reduces this risk to a low level. The borrowing strategy identified will reduce cash balances and the resulting security risk. With the exception of regulation investments, counterparties also have a financial limit to ensure funds are spread amongst them. Overall this remains a low risk strategy.
Liquidity	Cash is not readily available when it is needed.	Need to plan investment to match cash requirements.	Managed through detailed cash flow forecast and investment in highly liquid funds.	**LOW to MEDIUM**	Same day access accounts are held with two MMF's. Balances are held with Lloyds Banking Group overnight on account. Cash flow plans are completed annually and regularly updated.

Appendix 4 (continued)

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected <u>reduction</u> in Interest rate.	Reduces the return on investment and reduces the level of reserves.	Can reduce risk by; A) netting off investment against borrowing to reduce net exposure B) investing for longer periods.	**LOW**	Investments will be mainly short term – this does not protect against an interest rate reduction. The current interest rate environment has interest rates at historically low levels.
Interest rate	Unexpected <u>increase</u> in interest rates.	In order to take advantage of the unexpected return would need to keep investment short term and increase the amount of cash invested (e.g. by not using cash in lieu of borrowing).	Controlled through the overall strategy.	**MEDIUM**	Current policy allows upturns to be taken advantage of as investments are not fixed for long periods. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Market	Unexpected need to liquidate market instrument quickly and accept 'price on the day'.	Only relevant if invest in market instruments (e.g. CD's, gilts).	Limit investment in market instruments or alternatively have capacity to borrow to avoid need to liquidate. Controlled by limits on non specified investments.	**LOW**	Market instruments are not in use.

Appendix 4 (continued)

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Reflected in the term (duration) of investments. If everything invested shorter term there is a high refinancing risk.	Proportion of investments maturing in the short term.	**LOW to MEDIUM**	The current policy is to invest in the short term. There is an increased risk with this strategy due to frequent 'refinancing' but this is expected to be advantageous in a rising interest rate environment. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Regulatory and legal risk	Rules governing local government investment powers are changed or amended without notice.	Investment powers are granted through statute and guidance.	None.	**LOW**	The current policy of using cash in lieu of borrowing reduces the authority's dependency on interest receipts. The AIS is low risk and uses liquid and conservative investment instruments.