

Draft

# Treasury Management Strategy

The County Council of the City and County of Cardiff

2017/18



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## **1 Treasury Management**

### **1.1 Treasury management involves:-**

- ensuring cash is available when needed
- investing temporary cash balances and
- ensuring appropriate borrowing facilities to pay for the Council's capital expenditure commitments and for the prudent management of its financial affairs.

1.2 The Council carries out its treasury management activities in accordance with a Treasury Management Code of Practice developed for public services in 2011 by the Chartered Institute of Public Finance and Accountancy (CIPFA). This requires the Council to set out the policies and objectives of its treasury management activities and adopt the four Clauses of Treasury Management. These were formally adopted by the Council in February 2010. Appendix 1 includes a glossary of terms used in relation to Treasury Management.

1.3 The Council's Audit Committee undertakes scrutiny of the accounting, audit and commercial issues in relation to the Council's Treasury Management Strategy and practices.

1.4 A number of reports are produced in relation to the Council's treasury management activities including a strategy at the start of the year, performance reports during the year, a mid year report and an outturn report.

## **2 Treasury Management Strategy**

2.1 The Strategy links plans for capital investment, financing and affordability of those plans and how cash will be safely managed to meet the Council's financial commitments and objectives.

2.2 Council accepts that no treasury management activity is without risk. However the overriding objective is to minimise the risk of adverse consequences or loss, whilst at the same time not unduly constraining investment returns or unnecessarily incurring interest costs.

2.3 The successful identification, monitoring and control of risk are integral elements of treasury management activities. Risks include credit and counterparty, liquidity, interest rate, refinancing, fraud and regulatory. The Council has Treasury Management Practices to address and mitigate these risks which were last updated in March 2016 following a review by Internal Audit and Audit Committee.

2.4 Responsibility for treasury decisions ultimately remains with the Council however, the Council recognises the value in the use of treasury advisors to support the management of risk and to access specialist skills and resources. Support provided by Capita Asset Services Treasury Solutions includes advice on timing of decision making, training, credit

updates, economic forecasts, research, articles and advice on capital finance, with the terms of appointment reviewed periodically.

2.5 The proposed strategy is an integrated strategy for the Council including the Housing Revenue Account and is based on information known at the time of writing this report. Significant changes will be reported in future scheduled reports to Council, Cabinet and Audit Committee during the course of the year. The strategy includes: -

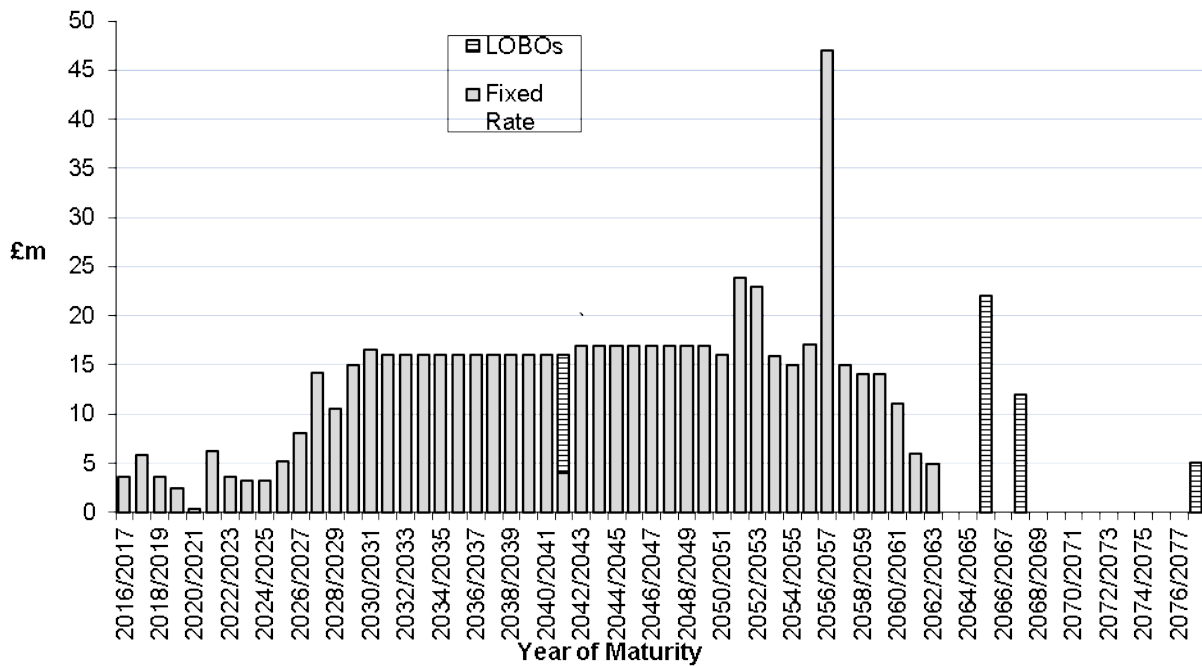
- The current treasury position
- Economic background and prospects for interest rates
- Capital Programme Plan and Capital Financing Requirement (CFR)
- Borrowing, including: -
  - Policy
  - Annual Minimum Revenue Provision (MRP) Policy Statement
  - Council borrowing requirement and choice between internal and external borrowing and
  - Borrowing Strategy
- Treasury management indicators and limits for 2017/18 to 2019/20
- Investment Policy and Strategy, including security and investments approved for use
- Training.

### 3 The Treasury Position

3.1 Borrowing and investments as at 31 December 2016 are shown in the following table. Borrowing is predominantly made up of fixed interest rate loans payable on maturity. Investments fluctuate daily and are represented by fixed term deposits, notice deposit accounts and money market funds. These balances arise due to the timing of cash flows and working capital as well as the existence of reserves, provisions and balances required for future use.

	<b>Principal £m</b>	<b>Average Rate %</b>
<b>External Borrowing</b>		
- Public Works Loan Board	620.8	4.87
- Market Loans	51.0	4.02
- Welsh government	2.6	0.00
- Other	0.9	0.00
<b>Total Debt</b>	<b>675.3</b>	<b>4.78</b>
<b>Treasury Investments</b>	<b>75.1</b>	<b>0.61</b>

3.2 The Council's current debt maturity profile is shown in the following graph on the assumption that all loans run to their final maturity.



3.3 Loan maturities during 2017/18 are circa £6 million. Unless the Council's Lender Option Borrower Option loans (LOBO's) are required to be repaid early, very little debt matures within the next 10 years.

3.4 LOBO products are loans to the Council where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan. The Council has six such loans totalling £51 million.

3.5 Apart from the option to increase rates these loans are comparable to PWLB loans and have no other complications such as variation in interest rates or complex terms. Interest rates on these loans range between 3.81% and 4.35% and are below the Council's average rate of interest payable. Details of the loans are shown in the next table.

<b>Lender Option Borrower Option (LOBO) Loans</b>			
<b>Potential Next Repayment Date</b>	<b>Loan Value £m</b>	<b>Option Frequency Every</b>	<b>Full Term Maturity Date</b>
01/03/2017	6	6 months	23/05/2067
21/05/2017	6	6 months	21/11/2041
21/05/2017	6	6 months	21/11/2041
21/05/2017	6	6 months	23/05/2067
15/01/2018	5	5 years	17/01/2078
21/11/2020	22	5 years	23/11/2065

3.6 It should be noted that £24 million of the LOBO loans are currently subject to the lender potentially requesting a change in the rate of interest payable every six months. A further £5 million and £22 million

have call options in January 2018 and November 2020 respectively and every five years thereafter.

- 3.7 Risk of early repayment is deemed to be low, however in the longer term, options will need to be considered to reduce any potential large repayments in a single year.

#### 4 Economic background and prospects for Interest Rates

- 4.1 The following table gives the Council's treasury management advisor's latest forecast of interest rates taking into account the 20 basis point certainty rate reduction available for PWLB loans to eligible local authorities. It is a central forecast, acknowledging for example that the bank rate may rise sooner if there are sustained and robust UK growth, employment and inflation expectations.

	<b>January 2017 %</b>	<b>March 2017 %</b>	<b>March 2018 %</b>	<b>March 2019 %</b>	<b>March 2020 %</b>
Bank Rate	0.25%	0.25%	0.25%	0.25%	0.75%
5yr PWLB rate	1.35%	1.60%	1.70%	1.80%	2.00%
10yr PWLB rate	2.08%	2.30%	2.30%	2.50%	2.80%
25yr PWLB rate	2.71%	2.90%	3.00%	3.20%	3.40%
50yr PWLB rate	2.46%	2.70%	2.80%	3.00%	3.20%

Forecast at December 2016

Financial markets remain volatile and economic forecasts remain uncertain particularly due to international political factors and the implications of the referendum vote in June 2016 on the economy. Growth and consumer confidence for the UK economy has remained strong however and inflation expectations in the short term have risen due to the fall in value of sterling impacting on the price of imports. Growth and inflation are two key factors used by the Bank of England in determining when to change interest rates.

- 4.2 The bank rate, was reduced in August 2016 to 0.25%, having remained unchanged since March 2009, and further quantitative easing and low cost funding was made available for bank lending to counter what the Bank of England forecast would be a sharp slowdown in the Economy. Given uncertainty re growth prospects, base rate is forecast to remain at current levels until 2019. As a consequence, and coupled with the Bank of England's funding for lending scheme, returns from Council investments are likely to remain minimal. In respect of future borrowing rates, PWLB rates have been experiencing significant volatility due to political events nationally and internationally, however the overall longer term trend is for borrowing rates to rise, albeit gently. This is as a result of higher levels of UK Government borrowing and reversal in quantitative easing. This will result in higher future borrowing costs for the Council.

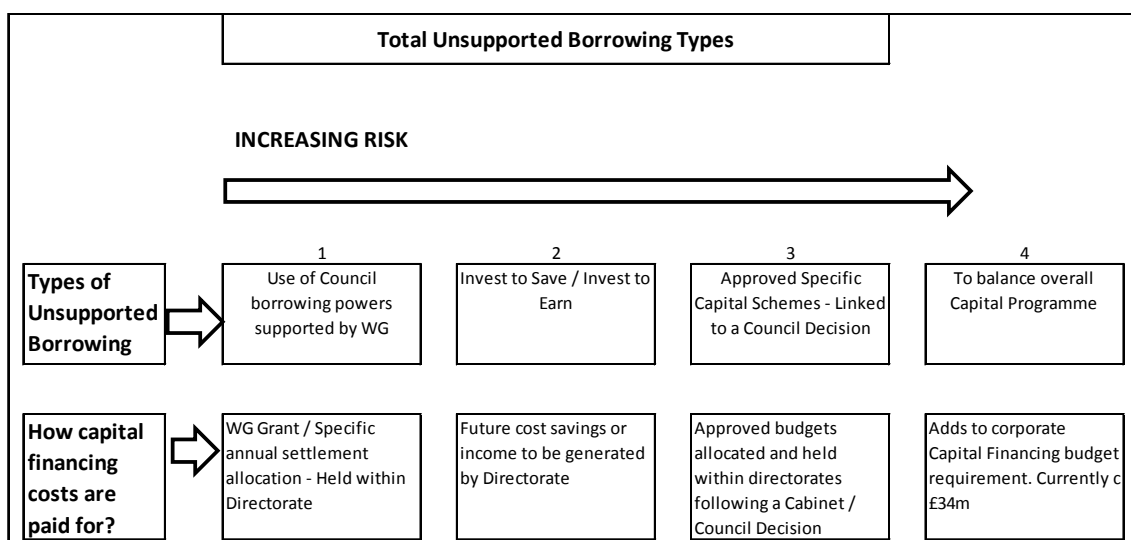
## 5 **Capital Programme Plan and Capital Financing Requirement (CFR)**

5.1 The detailed capital programme will be approved as part of the Budget Proposals in February 2017. Capital Expenditure commitments and pressures include:

- Ensuring a sustainable property asset base which is fit to deliver service improvements.
- Meeting the aspirations of directorates to invest in existing assets or creating new capital assets in order to improve service delivery and meet pressures of increasing demand.
- The need to maintain the highway and associated infrastructure such as roads, traffic signals, bridges, street lighting and address the backlog of repairs to avoid higher costs in future.
- To continue annual commitments and meet mandatory investment in services such as disabled adaptations, while Welsh Government General Capital Funding has been reduced.
- Meeting the economic development, regeneration, employment and capital city aspirations of Cardiff and the region including City Deal.
- Requirement for capital investment to meet savings targets, to generate income, to reshape the way services are delivered.
- Implementing the Council's 21<sup>st</sup> century schools investment programme by completion of band A and securing match funding for band B to commence in 2019/20.
- Meeting expenditure commitments pending the generation of capital receipts.
- Sustaining Public Housing Welsh Quality Standards and investment in creation of new Council Housing as part of the Housing Partnership programme.

5.2 There are two main types of borrowing to pay for capital expenditure: -

- 'Supported Borrowing' - costs of servicing are included within the annual Revenue Support Grant (RSG) the Council receives from Welsh Government.
- 'Unsupported Borrowing' – costs of servicing to be met by the Council from Council tax, savings, additional income or sale of assets. The types of unsupported borrowing typically undertaken by the Council and how capital financing costs are paid for are shown in the next diagram.



5.3 Where capital expenditure has been incurred without a resource to pay for it immediately e.g. via capital receipts, grants or other contributions, this will increase what is termed the Council's Capital Financing Requirement (CFR). The Council is required to make annually from its revenue budget, a prudent provision for the repayment of historic capital expenditure. This reduces the CFR. Calculation of the CFR is summarised in the table below.

	Opening Capital Financing Requirement (CFR)
+	Capital Expenditure incurred in Year
-	Grants, Contributions, reserves and receipts received to pay for capital expenditure
-	Prudent Minimum Revenue Provision & Voluntary Repayment
=	Closing Capital Financing Requirement (CFR)

5.4 It is the Capital Financing Requirement that results in the need to borrow money. The actual CFR as at 31 March 2016 (Excluding provision for Landfill) and estimates for current and future years are shown below:

Capital Financing Requirement as at 31 March					
	2016 Actual £m	2017 Estimate £m	2018 Estimate £m	2019 Estimate £m	2020 Estimate £m
General Fund	432	451	476	474	479
Housing Revenue Account	277	274	287	298	301
<b>Total</b>	<b>709</b>	<b>725</b>	<b>763</b>	<b>772</b>	<b>780</b>

5.5 The timing of capital expenditure, capital receipts and new schemes that may be considered for approval in future years are risks to the CFR forecast, however summarising the above, it can be seen that the Council's underlying need to borrow is increasing. This will eventually need to be paid for by revenue savings, revenue income or Council Tax and Housing Rents.



5.6 As the Council realigns itself strategically to lower funding levels it needs to consider the level of debt, potential financial resilience and Wellbeing and Future Generations (Wales) Act 2015 issues that may be a consequence of increasing borrowing. General Fund Capital financing costs as a percentage of controllable budget which are committed in the long term are increasing. Even if they remain static, they will account for a greater proportion of the Council's revenue base budget as the level of demand continues to exceed funding. This clearly limits the scope for additional borrowing in future years and will be a factor considered by Members when determining the current and future capital programme along with: -

- The Prudential Indicators highlighting longer term impact of capital decisions on the revenue budget and affordability, prudence and sustainability
- Use of control mechanisms for different types of unsupported borrowing before approval.
- Determining core areas of long term investment e.g. Maximum exposure limits to unsupported borrowing for 'Discretionary' type services
- Whether the inherent risks in a project are better managed via commercial options rather than direct Council investment

## **6 Borrowing**

### **6.1 Borrowing Policy**

6.1.1 Borrowing to pay for capital investment has long-term financial consequences and risks, with decisions taken many years ago impacting currently and in the future in the form of interest and provision for repayment of capital expenditure. These costs are assumed in the Council's revenue budgets.

6.1.2 Loans are not generally undertaken for specific schemes or directorates; they are pooled and taken in the name of the Council and secured on all revenues of the Council. This includes Housing Revenue Account debt and investments for the reasons set out in the Budget report of February 2016.

6.1.3 The Council's Borrowing Strategy for 2017/18 and the capital financing revenue budgets included in the Medium Term Financial Plan (MTFP) will consider all options to meet the long-term aims of:

- Promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact.
- Pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities.
- Reduction over time in the average rate of interest on overall Council borrowing.

- Ensuring any refinancing risk is manageable each financial year, using opportunities to re-profile borrowing where cost effective to do so both in the short and long term.
- Ensuring borrowing plans are aligned to known capital expenditure spending plans, the useful life of assets created, financial reserve levels and consistent with the prudent provision for the repayment of any such expenditure paid for by borrowing.
- Having regard to the effects on current and future Council Tax and Rent Payers.

6.1.4 The Council will only borrow if needed and not do so just to gain financially. However, this option may be considered if it is felt that by borrowing in advance of need up to a maximum of three years, there may be opportunities to lock into favourable long-term rates with associated credit risks that can be managed.

## 6.2 Prudent Repayment of Capital Expenditure – Annual Minimum Revenue Provision (MRP) Policy Statement for 2017/18

6.2.1 The Council has a statutory duty to calculate and set aside each year from its annual revenue budget an amount ‘which it considers to be prudent’. This results in a reduction in the Council’s underlying need to borrow (CFR).

6.2.2 Legislation does not define what constitutes a ‘prudent provision’. Instead WG has provided guidance and examples in order to interpret that term. Whilst authorities must consider that guidance, other approaches can be adopted if they are deemed prudent by the Section 151 Officer and individually designed for each local authority circumstance.

6.2.3 A statement on the Council’s policy for its annual MRP is required to be submitted to full Council for approval before the start of the financial year to which the provision will relate. Decisions in respect of the allocation of MRP have short, medium and very long term impacts. Impacts of changes in policy decisions should be considered over that time horizon including compliance with legal duties under the Well-being of Future Generations (Wales) Act 2015.

6.2.4 Following consideration by Audit Committee in November 2016, it is proposed that the Council’s MRP Policy will be as included in Appendix 2.

## 6.3 Council’s Borrowing Requirement

6.3.1 The following table shows the level of external borrowing currently held by the Council and any scheduled loan repayments. It compares this to the projected CFR based on current, known estimates and timing of the Council’s capital expenditure plans, subject to approval of the Council’s budget in February 2017. The difference between the projected CFR in 2019/20 (£780 million) and the level of external borrowing after any planned repayments (£666 million) is £114 million, i.e. there is a requirement for further external borrowing over the medium term.

<b>Gross Debt compared to Capital Financing Requirement</b>					
	<b>2015/16 Actual £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>	<b>2019/20 Estimate £m</b>
External borrowing at 1 April	470	666	673	671	668
Known New borrowing	202	14	4	tbc	tbc
Scheduled repayments	(6)	(7)	(6)	(3)	(2)
<b>External Borrowing at 31 March</b>	<b>666</b>	<b>673</b>	<b>671</b>	<b>668</b>	<b>666</b>
Capital Financing Requirement	709	725	763	772	780
<b>Under / (Over) borrowing</b>	<b>43</b>	<b>52</b>	<b>92</b>	<b>104</b>	<b>114</b>

6.3.2 To be meaningful for treasury management purposes, the CFR figures in this strategy exclude the accounting provisions for the management and aftercare of landfill sites which may not be incurred for many years to come. Accordingly, when setting the treasury indicators, landfill provision is excluded from the calculations, except for the setting of the Authorised Limit for external debt, which is required to be set under statute.

6.3.3 Some of the CFR may be financed by internal borrowing in the short term, dependent on the sustainability and risks of any internal borrowing position.

#### 6.4 External versus Internal borrowing

6.4.1 Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (Internal Borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review.

6.4.2 A high level balance sheet review undertaken at a point in time suggests that a maximum level of internal borrowing is circa £80 million. However, this is dependent on cash flows, the timing of use of Earmarked Reserves and provisions and longer term pressures in the Medium Term Financial Plan.

#### 6.5 Borrowing Strategy

6.5.1 In the short term, using internal borrowing to meet the CFR is deemed manageable. However, based on the current forecasts of capital expenditure plans and high level analysis of the sustainability of internal borrowing from the Council's balance sheet position for future years,

external borrowing will be required to be undertaken in the very short term.

6.5.2 The following strategy is proposed to manage the Council's Capital Financing Requirement: -

- Whilst investment rates remain lower than long term borrowing rates internal borrowing will be used to minimise short-term costs where possible.
- In order to mitigate against the risk of borrowing rates rising faster than currently anticipated, external borrowing for an element of the Council's borrowing requirement will be taken as has been done in previous years.

6.5.3 If there was a significant risk of a sharp rise in long and medium-term rates, then fixed rate borrowing may be undertaken whilst rates were still comparatively lower. If there was a significant risk of a sharp fall in rates, then long-medium term borrowing would be deferred, following consideration of internal borrowing capacity.

6.5.4 Current interest rates on the Council's existing debt portfolio compared to new borrowing rates and the high penalty rates charged by the PWLB for early debt repayment, results in limited options for restructuring of debt. Options have been considered but these have resulted in very short term financial gains outweighed by the risk of higher longer term costs.

## **7 Treasury Management Indicators and limits**

### **7.1 Indicators and Limits for 2017/18 – 2019/20**

7.1.1 The Council is required to set its treasury management indicators for the years 2017/18 - 2019/20. Appendix 3 gives further background in respect of the Prudential Indicators.

7.1.2 The Council must set and keep under review how much it can afford to borrow from debt or other long-term liabilities for the forthcoming year and the following two financial years (the Affordable Borrowing Limit). It must have regard to the Prudential Code and locally determined indicators when setting this limit and be content that capital investment plans are within sustainable limits and that the impact upon future Council Tax payers and tenants is acceptable.

7.1.3 It is recommended that the Council approve the following authorised limits (Statutory limit under Section 3(1) of the Local Government Act 2003) and operational boundaries for the next three years (figures for 2016/17 are for comparison only). The undertaking of other long-term liabilities, within the overall limit, is delegated to the Section 151 Officer based on the outcome of financial option appraisals and best value considerations.

## 7.2 Authorised limit for external debt

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Limit for external borrowing and other long-term liabilities	780	802	802	802

7.2.1 This limit is consistent with known commitments, existing plans and proposals contained within the budget for capital expenditure, financing and revised accounting requirements in relation to Landfill obligations. The limit for the Council overall has been set at a constant level of £802 million for 2017/18 to 2019/20.

7.2.2 Whilst there is currently no self imposed or nationally imposed overall cap on the level of General Fund borrowing, the exit from the Housing Subsidy system set a cap for the Housing Revenue Account based on its CFR, with financial penalties from WG if breached. The table below shows the Council is forecast to be within the cap currently set.

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
HRA CFR forecast at 31 March	274	287	298	301
HRA CFR Current Cap	316	316	316	316
<b>Headroom / (Excess)</b>	<b>42</b>	<b>29</b>	<b>18</b>	<b>15</b>

7.2.3 The HRA thirty-year business plan will need to be monitored closely in order to ensure that any risks to the breach of the Cap and any unsupported borrowing is prioritised for investment in assets, remains affordable and sustainable in the long term.

## 7.3 Operational boundary for external debt

7.3.1 The proposed operational boundary or projected level of external debt (excluding landfill) is set at the anticipated level of the CFR at the end of each year. This will be subject to the level and timing of borrowing decisions.

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Boundary for external borrowing and other long-term liabilities	725	763	772	780

7.3.2 The Council's actual external debt represented by borrowing at 31 March 2016 was £666 million, with no significant other long-term liabilities.

## 7.4 Limits for fixed and variable interest rate exposure

Various upper limits must be set in order to manage risk and reduce the financial impact on the Council of any adverse movement in interest rates. The limits below reflect that whilst the majority of Council borrowing is currently at long term fixed rates, there could be exposure to

variable rates. This is in the form of interest on LOBO loans being changed early, the strategy to utilise internal borrowing where possible and short term external borrowing when required to manage cash flow.

	<b>2016/17</b> %	<b>2017/18</b> %	<b>2018/19</b> %	<b>2019/20</b> %
Upper limit for fixed interest rate exposure	100	100	100	100
Upper limit for variable rate exposure	25	25	25	25

## 7.5 Maturity structure of fixed rate borrowing

Limits are set to guard against a large element of the Council's debt maturing and having to be refinanced in a very short space of time, when it may not be economically favourable to do so. The limits have been set to reflect the current debt portfolio, and to allow enough flexibility to enable new borrowing to be undertaken for the optimum period. The table assumes that loans run to their final maturity, however a separate column is also included to show the maturity profile should the Council repay its LOBO loans early.

<b>Maturity structure of borrowing in 2017/18</b>	<b>Upper limit</b> %	<b>Lower limit</b> %	<b>Actual to Maturity</b> %	<b>Actual if LOBOs Repaid Early</b> %
Under 12 months	10	0	0.53	4.83
12 months and within 24 months	10	0	0.87	0.87
24 months and within 5 years	15	0	0.95	4.21
5 years and within 10 years	20	0	3.19	3.19
10 years and within 20 years	30	0	21.35	21.35
20 years and within 30 years	35	0	24.29	22.51
30 years and within 40 years	35	0	26.46	26.46
40 years and within 50 years	35	0	19.84	16.58
50 years and within 60 years	15	0	1.78	0.00
60 years and within 70 years	5	0	0.74	0.00

## 8 Investments

### 8.1 Policy

8.1.1 The Council has regard to the WG Guidance on Investments issued in 2004 and its subsequent amendments, as well as the 2011 revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA Treasury Management Code).

8.1.2 The Council recognises that given the nature of investments, a trade-off between security, liquidity and yield cannot be avoided i.e. there is risk of default. The Council will aim to achieve the optimum return on its

investments commensurate with proper levels of security and liquidity, however the level of risk will be contained by ensuring: -

- All investments and repayments are in sterling
- Investment instruments identified for use in the financial year are listed under 'Specified' investments and 'Non-Specified' investment categories, dependant on their complexity and risk
- A list of highly credit worthy counterparties with whom to invest is created and monitored
- Diversification of approach, investment product and counterparties are sought where possible to avoid concentration of risk
- Any set limits are implemented with immediate effect following approval of this Treasury Management Strategy by Council
- Continual monitoring of treasury activities with the categories of investments that may be used, the credit criteria and associated limits in determining with whom to invest and timing of decisions being delegated to the Section 151 Officer.

The Markets in Financial Instruments Directive (MiFID II) is to be implemented in the UK in January 2018. The aim is to ensure financial institutions undertake more extensive checks on their client's suitability for investment products. Organisations undertaking investments will be either classified as 'retail' or 'professional'.

Whilst there is likely to be additional administrative costs to the Council, the Council will aim to secure professional status with each organisation it invests with. Not doing so may limit the products and interest rates offered by financial institutions for what may be similar risk.

In order to secure professional status, the Council will need to demonstrate to each financial institution, that it meets certain Qualitative and Quantitative criteria. These are likely to include an assessment of expertise, size of portfolio, number of similar transactions undertaken in a year.

## **8.2 Specified Investments**

8.2.1 A specified investment is defined as one:

- being for a period up to one year.
- which is in straightforward easily understood low risk products.
- not involving corporate share or loan capital.
- where the principal sum to be repaid at maturity is the same as the initial principal sum invested.

8.2.2 Specified investments may comprise up to 100% of the Council's total investments.

<b>Instruments approved for use</b>	<b>Minimum Credit Criteria</b>
Debt Management Agency Deposit Facility	Assumed Government Guarantee
Term deposits – UK government and other Local Authorities	Assumed Government Guarantee
Deposits with the Council's banking services provider	Long-term A /Short-term F1
Term deposits – banks and building societies	Long-term A /Short-term F1
Term deposits with variable rate and variable maturities up to one year e.g. structured investment products	Long-term A /Short-term F1
Deposits with banks wholly or partly nationalised or where guaranteed by high credit rated (sovereign rating) countries	Long-term A /Short-term F1 Assumed Government Guarantee

### 8.3 Non-Specified Investments

8.3.1 These are all other investments not meeting the definition of a specified investment which could be used in order to achieve diversification and manage liquidity needs. A maximum upper level of £60 million is to be set for non-specified investments including investments for greater than one year.

<b>Instruments approved for use</b>	<b>Min Credit Criteria</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Term deposits with Local Authorities (with maturities in excess of 1 year)	Assumed Government Guarantee	15	2 Years
Term deposits – banks and building societies (with maturities in excess of 1 year)	Long-term AA- /Short-term F1+	15	2 Years
Deposits over one year with banks wholly or partly nationalised institutions where guaranteed by high credit rated (sovereign rating) countries	Long-term A /Short-term F1 Government Guarantee	20	2 Years
Term deposits with variable rate and variable maturities in excess of 1 year e.g. structured investment products	Long-term AA- /Short-term F1+	10	2 Years
Certificates of Deposit (In-house)	Long-term AA- /Short-term F1+	10	Maximum 2 year duration
UK Government Gilts and Gilt funds (In-house)	Assumed Government Guarantee	40	Maximum 3 year duration



Treasury Bills (In-house)	Assumed Government Guarantee	40	6 Months
Collective Investment Scheme structures - Money Market Funds	AAA Constant Net Asset Value	60	Weighted Average Maturity 60 days
Other Collective Investment Schemes structures - e.g. enhanced cash funds, Government and Corporate Bond, Gilt or Liquidity Funds and floating rate notes	AAA Variable Net Asset Value	20	Weighted Average Maturity 3 years

8.3.2 The Council uses money market funds and other collective investment funds which pool together investments in a diversified portfolio of products and sectors mainly high quality, short-term money market instruments such as bank deposits, certificates of deposit, government guaranteed bonds, corporate bonds and commercial paper. It should be noted that any such funds are triple A rated and allow instant access.

#### 8.4 Security

8.4.1 Credit and fraud risk are managed through procedural requirements and controls. The Council uses Fitch Credit ratings as a basis for assessment of credit worthiness of institutions it will invest with (See Appendix 4). Changes in the criteria and decisions with whom to invest are delegated to the Section 151 Officer. Commercial organisations (counterparties) on its approved list will have at least the short-term credit rating of F1 and be authorised institutions within the meaning of the Financial Services and Markets Act 2000. The rating F1 infers “Highest Credit Quality” and indicates the strongest capacity for timely payment of financial commitments.

8.4.2 For internally managed investments provided by the private sector, the lending list for any new direct investment in an organisation is based on the following credit criteria:

<b>Fitch Ratings (minimum)</b>	<b>Long-term</b>	<b>Short-term</b>	<b>Limit £m</b>
Overnight to one year	A	F1	10
Overnight to two years	AA-	F1+	12
UK Part Nationalised Banks overnight to two years	A	F1	15

8.4.3 For internally managed funds the maximum limit for direct investment in any one group of related companies is £15 million.

8.4.4 Credit ratings are monitored regularly through use of the treasury management advisor’s credit service. If a downgrade results in the

counterparty or investment scheme no longer meeting the Council's criteria, its further use for new investment will be withdrawn immediately.

8.4.5 Where investments are held with a counterparty which falls below the Council's approved criteria for new investment, the investments will be reviewed and options to call back funds before the maturity date would be investigated. It should be noted that any early repayment is only at the discretion of the borrower and often at a penalty.

8.4.6 Whilst Fitch ratings form the basis of the Council's threshold criteria, the Council will also have regard to the following when determining with whom to invest:

- Rating updates provided by treasury advisors in respect of all three credit rating agencies, as well as other market data.
- Media reports as well as sovereign credit ratings with the minimum requirement being a Fitch sovereign rating of AA- for non UK based institutions.
- The informed judgement of treasury staff and treasury management advisors after consideration of wider economic factors.
- Financial sector and country exposure.
- The extent to which organisations who do not meet the above criteria, are nationalised.

## 8.5 **Liquidity**

8.5.1 The Council aims to have sufficient funds to ensure it does not become a forced borrower for a significant period of time at rates in excess of what may be earned on such investments. In determining the maximum periods for which funds may be available and can be invested, short term cash flow forecasts are undertaken and a longer term balance sheet review is undertaken as part of the calculation of Prudential Code indicators.

## 8.6 **Investment Strategy**

8.6.1 Given uncertainty of financial markets, the Specified and Non Specified investments above allow for a range of products to be available to manage short term investment balances and diversification.

8.6.2 Given the likelihood of internal borrowing and the interest rate forecasts identified above, longer term investments above one year will be unlikely. The Debt Management Agency Deposit Facility will be used only as a last resort.

8.6.3 The Investment Strategy for 2017/18 will continue to adapt to changing circumstances and market sentiment, with a pragmatic approach taken. Credit criteria changes are delegated to the Section 151 Officer. This allows a prompt response to uncertainties, with the Council being kept informed of significant changes through the various reports it receives on treasury activities during the course of the year. Should the Council be

the Lead authority for the Cardiff Capital Region City Deal Joint Cabinet, then this flexibility initially is essential to ensure no adverse impacts on the Council in respect of Treasury management activities.

## **9 Treasury Management Training**

- 9.1 Treasury staff directly and regularly involved in borrowing and lending activities are provided access to a wide range of training. This includes seminars and workshops organised by treasury advisors bringing together practitioners from different authorities; seminars organised by CIPFA and other national bodies; regular contact with a client relationship manager as well as their briefing notes and articles. Staff responsible for treasury activity on a day to day basis have a recognised accountancy qualification and are encouraged to undertake relevant treasury management training.
  
- 9.2 The Council's Audit Committee Members who are responsible for scrutiny of treasury management activities have also been provided with training and offered one to one training opportunities in order to support their role.

## **APPENDIX 1 - Glossary of Terms**

### **Bank Rate**

The rate of interest set by the Bank of England as a benchmark rate for British banks.

### **Bonds**

A long-term debt security issued by a company, a financial institution, a local authority, national government or its affiliated agencies. It represents an undertaking to repay the holder the fixed amount of the principal on the maturity date plus a specified rate of interest payable either on a regular basis during the bond's life (coupon) or at maturity.

### **Borrowing**

Loans taken out taken out by the authority to pay for capital expenditure or for the prudent management of the Council's financial affairs, which are repayable with interest.

### **Capital Expenditure**

Capital expenditure pays for improvements to existing and new assets used in the delivery of Council services as well as other items determined by Regulation. Capital resources are scarce, costly and also have long term revenue implications over many years and even generations where capital expenditure is funded by borrowing. Hence the requirement of the Prudential Code to ensure what is charged as Capital Expenditure is Prudent, Sustainable and Affordable.

The statutory definition of capital expenditure is given in the Local Government Act 2003, the Local Authorities (Capital Finance) Regulations 2003 and 2004 as amended. Statute relies on the accounting measurement of cost in International Accounting Standard (IAS) 16 to determine whether expenditure is eligible to be capitalised or whether it should be treated as revenue expenditure. Key to what is eligible as capital spend are the following words in IAS 16 - 'Costs directly attributable to bringing the specific asset into working condition for its intended use'.

### **Capital Financing Requirement (CFR) (Real and Notional)**

An authority's underlying need to borrow for a capital purpose. It measures capital expenditure incurred but not yet financed by the receipt of grants, contributions and charges to the revenue account. This is termed the Real CFR. Revised accounting guidance from Wales Audit Office on accounting for Landfill Obligations requires a provision to be created and charged to capital. As this is for future spend, this is not incurred expenditure, hence caution needs to be adopted when comparing the latter figure compared to external borrowing to ensure borrowing in advance of need does not take place.

### **Capital Market**

A market for securities (debt or equity), where companies and governments can raise long-term funds (periods greater than one year). The raising of short-term funds takes place on other markets (e.g. the money market).

### **Capital Programme**

The Capital Programme sets out the Council's capital expenditure plans for the forthcoming financial year as well as for the medium term. It is approved annually at Council and identifies the estimated cost of those schemes, their projected phasing over financial years as well as the method of funding such expenditure.

### **Certificates of Deposits (CDs)**

A certificate issued for deposits made at a deposit-taking institution (generally a bank). The bank agrees to pay a fixed interest rate for the specified period of time, and repays the principal at maturity. CDs can be purchased directly from the banking institution or through a securities broker. An active interbank secondary market exists to buy and sell CDs.

### **Chartered Institute of Public Finance & Accountancy (CIPFA)**

CIPFA is the professional body for people in public finance. As a specialised public services body, they provide information, guidance, and determine accounting standards and reporting standards to be followed by Local Government.

### **Collective Investment Scheme Structures**

Schemes whereby monies from a number of investors are pooled and invested as one portfolio in accordance with pre-determined objectives.

### **Corporate Bonds**

Bonds that are issued by a company or other non-government issuers. They represent a form of corporate debt finance and are an alternative means of raising new capital other than equity finance or bank lending.

### **Counterparty**

One of the parties involved in a financial transaction with whom the Council may place investments.

### **Counterparty / Credit Risk**

Risk that a counterparty fails to meet its contractual obligations to the Council to repay sums invested.

### **Credit Criteria**

The parameters used as a starting point in considering with whom the Council may place investments, aimed at ensuring the security of the sums invested.

### **Credit Default Swaps**

A financial transaction which the buyer transfers the credit risk related to a debt security to the seller, who receives a series of fees for assuming this risk. The levels of fees reflect the perceived level of risk.

### **Credit Rating**

A credit rating assesses the credit worthiness of an individual, corporation, or even a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. Ratings usually consist

of a long-term, short-term, viability and support indicators. The Fitch credit rating of F1 used by the Council is designated as “Highest Credit quality” and indicates the strongest capacity for timely payment of financial commitments.

### **Debt Management Account Deposit Facility (DMADF)**

The Debt Management Office provides this service as part of its cash management operations and of a wider series of measures designed to improve local and central government’s investment framework and cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.

### **Debt Restructuring**

Debt restructuring is a process that allows an organisation to reduce, renegotiate and undertake replacement debt.

### **Diversification of Investments**

The process of creating a portfolio of different types of financial instruments with regard to type, price, risk issuer, location, maturity, etc. in order to reduce the overall risk of the portfolio as a whole.

### **Duration (Maturity)**

The length of time between the issue of a security and the date on which it becomes payable.

### **External Borrowing**

Money borrowed from outside of the Council.

### **Financial Instrument**

Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another. Typical financial liabilities are borrowing and financial guarantees. Typical financial assets include bank deposits, amounts owed by customers, loans receivable and investments.

### **Fitch Credit Ratings**

A commercial organisation providing an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The opinion is usually provided in the form of a credit rating.

### **Fixed Rate**

An interest rate that does not change over the life of a loan or other form of credit.

### **Floating Rate Notes**

A money market security paying a floating or variable interest rate, which may incorporate a minimum or floor.

### **Four Clauses of Treasury Management**

In compliance with the First Clause, this Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

In compliance with the Second Clause, this Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, a mid year review and an annual report after its close, in the form prescribed in its TMP's.

In compliance with the Third Clause, this Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Corporate Director Resources in accordance with existing delegations, who will act in accordance with the organisation's policy statement, TMP's and CIPFA's Standard of Professional Practice on Treasury Management.

In compliance with the Fourth Clause, this Council requires the scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and Practices to be undertaken by the Council's Audit Committee due to the technical nature of the documents.

#### **Fraud / Error Risk**

Risk of losses being incurred as a result of fraud, error or corruption in treasury management and failure to institute adequate systems, procedures and other arrangements to prevent irregularities.

#### **Housing Revenue Account (HRA)**

The HRA is an account of expenditure and income that every local authority housing department must keep in accordance with the Local Government & Housing Act 1989. The account is kept separate or ring fenced from other Council activities. Income is primarily generated by the rents and service charges paid by tenants, while expenditure is on the management and maintenance of the housing stock, and capital financing charges on the HRA's outstanding loan debt.

#### **Interest Rate Risk**

Risk that fluctuations in interest rates could impose extra costs against which the Council has failed to protect itself adequately.

#### **Internal Borrowing**

Money borrowed from within the Council, sourced from temporary internal cash balances.

#### **Investments**

The purchase of financial assets in order to receive income and/or make capital gain at a future time, however with the prime concern being security of the initial sum invested.

### **Lender Option Borrower Option Loans (LOBOs)**

Loans to the Council where the lender can request a change in the rate of interest payable by the Council at pre-defined dates and intervals. The council at this point has the option to repay the loan.

### **Liquidity**

The ability of the Council to meet its financial obligations as they fall due.

### **Market Loans**

Borrowing that is sourced from the market i.e. organisations other than the Public Works Loan Board or a Public Body.

### **Medium Term Financial Plan**

Plan outlining the financial strategies and actions that are envisaged by the Council in the medium term regarding the budget.

### **Minimum Revenue Provision (MRP)**

This is the amount which must be charged to the authority's revenue account each year and set aside as provision for repaying external loans and meeting other credit liabilities. The prudent amount is determined having regard to guidance issued by WG. This has the effect of reducing the Capital Financing Requirement (CFR).

### **Money Market**

The market for short-term securities or investments, such as certificates of deposit, commercial paper or treasury bills, with maturities of up to one year.

### **Money Market Funds**

An investment fund which pools the investments of numerous depositors, spreading those investments over a number of different financial instruments and counterparties. Funds with a constant Net Asset Value (NAV) are those where any sum invested is likely to be the same on maturity. Funds with a variable Net Asset Value (NAV) are those where the sum on maturity could be higher or lower due to movements in the value of the underlying investments.

### **Net Asset Value (NAV)**

The market value of an investment fund's portfolio of securities as measured by the price at which an investor will sell a fund's shares or units.

### **Pooling**

The process whereby investments or loans are held corporately rather than for specific projects or parts of the Council, with recharges to those areas for their share of the of relevant income and expenditure using an agreed methodology, where such a recharge is required to be made.

### **Prudential Code for Capital Finance**

The system introduced on 1 April 2004 by Part 1 of the Local Government Act 2003 which allows local authorities to borrow without Government consent, provided that they can afford to service the debt from their own resources and that any such borrowing is prudent and sustainable. This requires the preparation and approval of various indicators.



### **Public Works Loans Board (PWLB)**

The Public Works Loans Board is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

### **Refinancing Risk**

Risk that maturing borrowing or other financing of capital projects cannot be renewed on terms that reflect existing assumptions and that the Council will suffer extra costs as a result.

### **Regulatory Risk**

Risk that actions by the Council or by any person outside of it are in breach of legal powers or regulatory requirements resulting in losses to the Council, or the imposition of extra costs.

### **Security**

Protecting investments from the risk of significant loss, either from a fall in value or from default of a counterparty.

### **Sovereign Credit Ratings**

The credit rating of a country. It indicates the risk level of the investing environment of a country, taking into account political risk and other factors.

### **Sterling**

The monetary unit of the United Kingdom (the British pound).

### **Term Deposits**

A term deposit is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time.

### **Treasury Management**

Treasury management activities are the management of an organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

### **Treasury Bills**

Debt securities issued by a government with a short-term maturity of up to 6 months.

### **UK Government Gilts**

Fixed-interest debt securities issued or secured by the British Government. Gilts are always denominated in sterling though the Government occasionally also issues instruments in other currencies in the Eurobond market or elsewhere.

### **Variable Rate**

An interest rate that changes in line with market rates.

### **Yield**

The annual rate of return paid out on an investment, expressed as a percentage of the current market price of the relevant investment.

## **APPENDIX 2 – Annual Minimum Revenue Provision (MRP) Policy Statement for 2017/18**

It is proposed that the Council's MRP Policy is as follows, with any change in the level, timing and method of provision in year delegated to the Section 151 Officer.

The broad aim of the 'prudent provision' is to ensure that debt arising from Capital expenditure is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits to service delivery (useful life) or in the case of borrowing supported by the WG via the RSG, reasonably in line with the period implicit in the determination of that grant.

- Council Fund historic expenditure prior to 1 April 2004 as well as subsequent supported borrowing approved by the WG is to be provided for at 4.0% on a reducing balance basis in 2017/18, a reduction from the 4.5% figure for 2016/17 and previous years. This is consistent with the support provided by WG as part of the Revenue Support Grant for Supported borrowing. This approach will continue unless WG change the approach to providing support as part of the RSG formula or any revision to MRP Guidance either in Wales or in England. albeit regular reviews of the position will continue.
- HRA supported borrowing, which was part of the previous housing subsidy system is to be provided for at 2% on a straight line basis. MRP on the £187million settlement buyout payment is to be at 2% straight line basis.
- Additional borrowing for a general increase in investment either in the Council Fund or HRA to balance the Capital Programme in a year is to be provided for on a straight line basis over the estimated average life of the assets created.
- Any additional expenditure linked to specific schemes e.g. Invest to Save, 21st Century Schools etc. is to be provided for on a straight line basis, or over the estimated useful life of assets being created or a shorter period as determined by the Section 151 Officer or suggested periods determined by WG as is the case with LGBI.
- Revenue Provision in excess of the above requirements can be made subject to affordability and following advice of the Section 151 officer.
- Subject to agreement of the S151 Officer, MRP may be waived on expenditure recoverable within a prudent period of time through capital receipts (e.g. land purchases) or deferred to when the benefits from investment are scheduled to begin or when confirmed external grant payments towards that expenditure are expected.
- The MRP charged against liabilities under finance leases, or contracts that have the characteristics of finance leases, shall be equal to the principal element of the lease repayment, calculated on an annual basis.

## **APPENDIX 3 - Prudential Indicators**

### **The Prudential Code**

**The current system of capital finance is CIPFA's Prudential Code.**

It is a professional Code of practice to support the decisions local authorities have to make to plan for capital investment at a local level. Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part I of the Local Government Act 2003 i.e. compliance with the Code is a statutory requirement.

### **Objectives of the Code**

The key objectives of the Code are:-

- To ensure that capital expenditure plans are affordable, prudent and sustainable
- That Treasury Management decisions are taken in accordance with good professional practice
- That local strategic planning, asset management planning and proper option appraisal are supported
- To provide a clear and transparent framework to ensure accountability

### **Prudential Indicators**

The indicators required are shown below, with further explanation as to their meaning:

#### **1(a). External Debt - Operational Boundary**

The most likely, prudent view of the level of gross external indebtedness. External debt includes both borrowing and long term liabilities (e.g. finance leases). It encompasses all borrowing, whether for capital or revenue purposes.

#### **1(b). External Debt - The Authorised Limit**

The upper limit on the level of gross external indebtedness, which must not be breached without Council approval. It is the worst-case scenario. It reflects the level of borrowing which, while not desired, could be afforded but may not be sustainable. Any breach must be reported to the executive decision making body, indicating the reason for the breach and the corrective action undertaken or required to be taken.

#### **1(c). External Debt - Actual External Debt**

The indicator for actual external debt will not be directly comparable to the operational boundary and authorised limit, since the actual external debt will reflect the actual position at one point in time.

## **2. Financing cost to Net Revenue Stream**

The percentage of revenue budget set aside each year to service debt financing costs

## **3. Capital Financing Requirement (CFR)**

The Capital Financing requirement (CFR) replaced the 'Credit Ceiling' measure of the 1989, Local Government and Housing Act. It measures an authority's underlying need to borrow or use other long-term liabilities, to pay for capital expenditure.

## **4. Capital Expenditure**

The level of capital expenditure incurred and likely to be incurred in future years. This is to be based on an accruals basis and on the definition of capital expenditure.

## **5. Incremental impact of Capital Investment decisions on Council Tax / Average weekly Housing Rents**

This shows the impact of new capital investment decisions included in the budget on the Council Tax and average weekly rent for HRA.

## **6. Gross External Borrowing and the Capital Financing Requirement**

The level of external borrowing is required to be compared to the Capital Financing Requirement which represents the underlying need to borrow. Requires that borrowing in the medium term can only be for capital purposes.

## **7. Adoption of CIPFA's Treasury Management Code of Practice**

CIPFA's Code of Practice for Treasury Management in the Public Services (the CIPFA Code) primary aim is to ensure that public services manage and control the risks attached to its treasury functions in an efficient, effective and economic manner.

Accordingly, the adoption of the Code has been encapsulated in Local Authorities (Capital Finance and Accounting) Regulations that call for explicit compliance with the CIPFA Code.

## **8. Interest Rate Exposures**

Recognition of the impact on revenue budgets of changes in interest rates as well as the need to ensure that local authorities maintain flexibility in their treasury strategy has resulted in the adoption of an interest rate exposure indicator

This indicator sets out for the following three years an upper limit for both fixed rate and variable rate exposure.

## **9. Maturity Structure of Borrowing**

Local Authority debt portfolios consist of a number of loans with differing maturities. Setting limits assists in ensuring any new borrowing in particular when combined with existing borrowing does not result in large concentrations of borrowing maturing in a short period of time.

## **10. Principal sums invested for greater than one year**

This indicator measures the exposure of a local authority to investing for periods of greater than one year.

**APPENDIX 4 – Approved list of Counterparties (Authorised to accept sterling deposits in the UK) (@ 31/12/16)**

	£	Duration
<b>Australia AAA</b>		
Australia and New Zealand Banking Group	12m	2 years
Commonwealth Bank of Australia	12m	2 years
National Australia Bank	12m	2 years
<b>Canada AAA</b>		
Canadian Imperial Bank of Commerce	12m	2 years
Toronto Dominion Bank	12m	2 years
<b>France AA</b>		
Credit Industriel et Commercial	10m	1 year
Societe Generale	10m	1 year
<b>Germany AAA</b>		
DZ Bank (Deutsche Zentral-Genossenschaftsbank)	12m	2 years
<b>Netherlands AAA</b>		
Cooperatieve Centrale Raiffeisen Boerenleenbank (Rabobank Nederland)	12m	2 years
<b>Singapore AAA</b>		
DBS Bank	12m	2 years
Oversea Chinese Banking Corporation	12m	2 years
United Overseas Bank	12m	2 years
<b>Sweden AAA</b>		
Skandinaviska Enskilda Banken	10m	1 year
Svenska Handelsbanken	12m	2 years
<b>Switzerland AAA</b>		
UBS AG	10m	1 Year
<b>United Kingdom AA</b>		
Barclays Bank	10m	1 Year
Close Brothers	10m	1 Year
Goldman Sachs International Bank	10m	1 Year
HSBC Bank plc	12m	2 years
Santander UK plc	10m	1 Year
Standard Chartered Bank	10m	1 Year
Bank of Scotland	10m	1 Year
Lloyds Bank	10m	1 Year
Royal Bank of Scotland	15m	2 Years
Coventry Building Society	10m	1 Year
Nationwide Building Society	10m	1 Year
Local Authorities	15m	2 Years
Debt Management Agency Deposit Facility	n/a	6 Months
<b>Money Market Funds</b>		
BlackRock Institutional Cash Series Sterling Fund	12m	Instant Access
Fidelity GBP Institutional Cash Fund	12m	Instant Access
Goldman Sachs Sterling Reserves Fund	12m	Instant Access

Insight Sterling Liquidity Fund	12m	Instant Access
Legal & General Investment Management Sterling Liquidity Fund	12m	Instant Access
Northern Trust Sterling Government Liquidity Fund	12m	Instant Access
Royal Bank of Scotland Global Treasury Fund	12m	Instant Access
Standard Life Investments Sterling Liquidity	12m	Instant Access