Bath & North East Somerset Council		
MEETING	**Cabinet**	
MEETING DATE:	**13th February 2020**	EXECUTIVE FORWARD PLAN REFERENCE: E 3160
TITLE:	**Treasury Management Performance Report to 31st December 2019**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 31st December 2019
Appendix 3 – Average monthly rate of return for 1st 9 months of 2019/20
Appendix 4 – The Council's External Borrowing Position at 31st December 2019
Appendix 5 – Arlingclose's Economic & Market Review Q3 of 2019/20
Appendix 6 – Interest & Capital Financing Budget Monitoring 2019/20
Appendix 7 – Summary Guide to Credit Ratings
Appendix 8 – Extract from Treasury Management Risk Register

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan for 2019/20 for the first nine months of 2019/20.

2 RECOMMENDATION

The Cabinet agrees that;

2.1 The Treasury Management Report to 31st December 2019, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 The Treasury Management Indicators to 31st December 2019 are noted.

3 THE REPORT

Summary

3.1 The average rate of investment return for the first nine months of 2019/20 is 1.03%, which is 0.41% above the benchmark rate.

3.2 The Council's Prudential Indicators for 2019/20 were agreed by Council in February 2019 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

3.3 The Council's investment position as at 31st December 2019 is given in **Appendix 2**. The balance of deposits as at 31st December 2019, compared to those as at 30th September 2019, are also set out in the pie charts in this appendix.

3.4 Gross interest earned on investments totalled £456k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 1.03%, which was 0.43% above the benchmark rate of average 7 day LIBID +0.05% (0.62%). This excess is mainly due to the £5m investment held in the CCLA Local Authority Property Fund, which is a long term strategic investment earning a higher rate of interest.

Summary of Borrowings

3.5 The Council's external borrowing as at 31st December 2019 totalled £233.3 million and is detailed in **Appendix 4**.

3.6 The Council's Capital Financing Requirement (CFR) as at 31st March 2019 was £300.7 million. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

3.7 The CFR represents the underlying need to borrow, and the difference between that and the current borrowing of £233.3 million represents re-investment of the internal balances including reserves, reducing the in-year borrowing costs in excess of the potential investment returns.

3.8 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2019 apportioned to Bath & North East Somerset Council is £11.9m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 3.5.

3.9 The borrowing portfolio as at 31st December 2019 is shown in **Appendix 4**.

Strategic & Tactical Decisions

3.10 The Council's 2019/20 savings and income generation proposals included an item for generating additional investment income through taking a longer term investment approach to £10 million of core investment balances. So far during 2019/20, a total of £5 million has been invested in the CCLA Local Authority's Property Fund as part of this investment approach. This also provides further diversification of the Council's commercial property investment portfolio, as set out in the approved Treasury Management Strategy for 2019/20.

3.11 As shown in the charts at **Appendix 2**, the investment portfolio of £60.7 million as at 31st December 2019 is diversified across Money Market Funds, Local Authorities, the CCLA Property Fund, highly rated UK and Foreign Banks and a UK Building Society. The Council uses AAA rated Money Market funds to maintain very short term liquidity.

3.12 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

3.13 The Council has reviewed its current investment holdings with its Treasury Management advisors to assess whether any of the investments placed are directly related to companies involved in fossil fuel companies. It was confirmed that the Council does not currently invest directly in equities or certificates of deposits that were not issued by banks or building societies and does not have any investments in fossil fuel companies. The main area where there is a potential for this type of investment is in the strategic diversified income funds which the Council is considering as part of its longer term investment approach, as these funds invest part of their portfolio in equities. A review into the two funds the council is considering using has shown that direct investment in fossil fuel companies forms a low proportion of the overall fund's investments (between 4% and 8%).

3.14 The Council's average investment return is currently slightly below the budgeted level of 1.20%, although the impact of this is offset by the Council investment balances being higher than forecast.

Future Strategic & Tactical Issues

3.15 Our treasury management advisors economic and market review for the third quarter 2019/20 is included in **Appendix 5**.

3.16 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus remains on the rate of increase and the medium-term peak.

3.17 Any additional borrowing to take place in 2019/20 will therefore be balanced between a need to maintain an appropriate working cash balance and taking advantage of favourable movements in long term borrowing rates.

PWLB Borrowing Rate Increase

3.18 On 9th October 2019, the PWLB increased the margin applied to loan rates by 100 basis points (1%) without warning; the new margin above gilts is now 180 basis points for certainty rate loans. This shift in policy was implemented by HM Treasury, who cite a substantial increase in the use of PWLB loans at some authorities in recent months, as the cost of borrowing has fallen to record lows, and state that HM Treasury is therefore restoring interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms.

3.19 In line with the Council's Treasury Management advisor's advice, the Council will continue to consider borrowing rates offered by alternative lenders, including other Local Authorities, alongside PWLB rates in order to minimise, where possible, its costs of borrowing.

Budget Implications

3.20 A breakdown of the revenue budget showing interest and capital financing and the forecast year end position based on the period April to December is included in **Appendix 6**. An overall underspend of £2.395m is currently forecast, mainly related to the re-phasing of capital spend leading to lower than forecast borrowing costs and minimum revenue provision (MRP) requirement. This is partly offset by lower internal income related to service charges for funding debt costs in relation to the re-phased capital projects.

4 STATUTORY CONSIDERATIONS

4.1 This report is for information only.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

5.1 The financial implications are contained within the body of the report.

6 RISK MANAGEMENT

6.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

6.2 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and borrowing advice is provided by our Treasury Management consultants, Arlingclose.

6.3 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

6.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year. An extract from the risk register, detailing how the top 5 market risks are managed, is included as **Appendix 8**.

7 CLIMATE CHANGE

7.1 The Council will continue to review its investments to minimise direct investment in fossil fuel related companies.

8 OTHER OPTIONS CONSIDERED

8.1 None

9 CONSULTATION

9.1 Consultation has been carried out with the Cabinet Member for Resources, Section 151 Finance Officer and Monitoring Officer.

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Background papers	*2019/20 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt

These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	£'000	£'000
Borrowing	440,000	233,316
Other long term liabilities	2,000	0
Cumulative Total	**442,000**	**233,316**

2. Operational limit for external debt

The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	£'000	£'000
Borrowing	409,000	233,316
Other long term liabilities	2,000	0
Cumulative Total	**411,000**	**233,316**

3. Upper limit for fixed interest rate exposure

This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	£'000	£'000
Fixed interest rate exposure	**409,000**	**213,316***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the Lender exercise this option to increase the rate).

4. Upper limit for variable interest rate exposure

While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	£'000	£'000
Variable interest rate exposure	**222,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	£'000	£'000
Investments over 364 days	**50,000**	**5,000**

6. Maturity Structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	Lower Limit	Actual as at 31st December 2019
	%	%	%
Under 12 months	50	Nil	8.6*
12 months and within 24 months	75	Nil	2.1
24 months and within 5 years	75	Nil	2.1
5 years and within 10 years	100	Nil	4.3
10 years and above	100	Nil	82.9

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating*

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2019/20 Prudential Indicator	Actual as at 31st December 2019
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AA**

* *The calculation excludes the strategic investment in the CCLA Local Authority's Property Fund which is unrated.*

APPENDIX 2

The Council's Investment position at 30th December 2019

The term of investments is as follows:

Term Remaining	**Balance at 31st December 2019**
	£'000's
Notice (instant access funds)	20,700
Up to 1 month	10,000
1 month to 3 months	5,000
3 months to 6 months	20,000
CCLA Property Fund (Strategic)	5,000
Total	**60,700**

The investment figure is made up as follows:

	Balance at 331st December 2019
	£'000's
B&NES Council	57,186
Schools	3,514
Total	**60,700**

The Council had a total average net positive balance of £56.5m during the period April 2019 to December 2019.

Chart 1: Council Investments as at 31st December 2019 - £60.7m

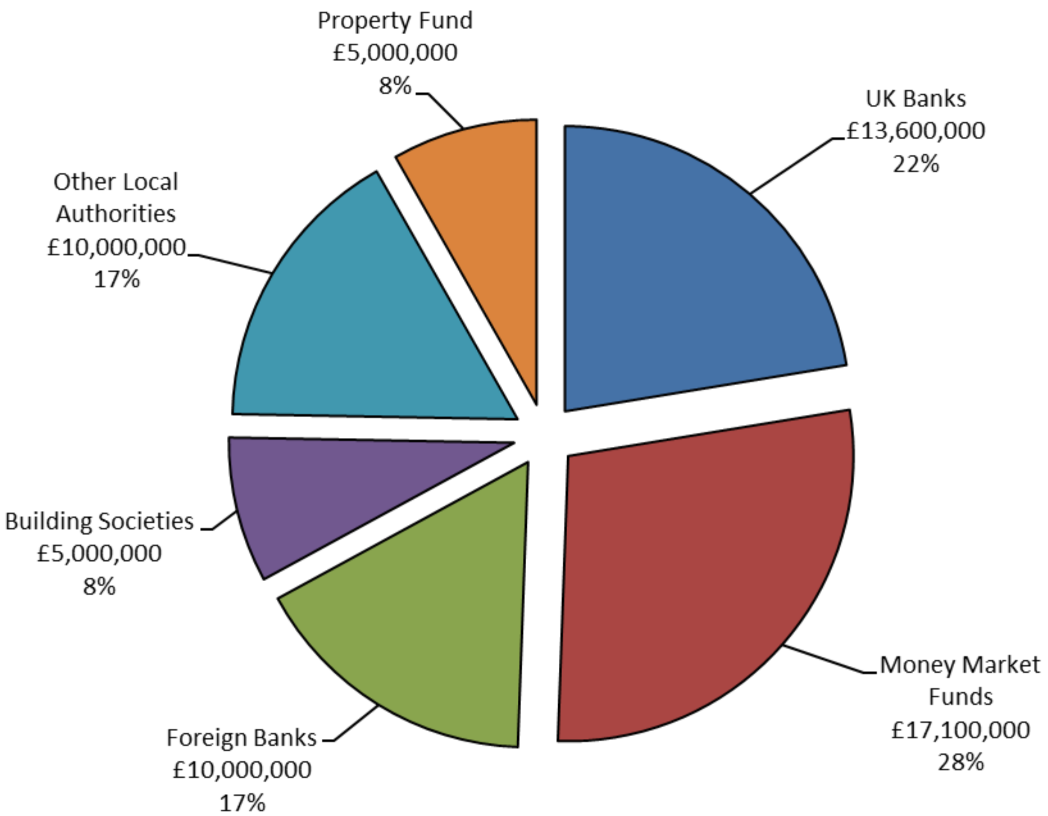


Chart 2: Council Investments as at 30th September 2019 - £61.2m

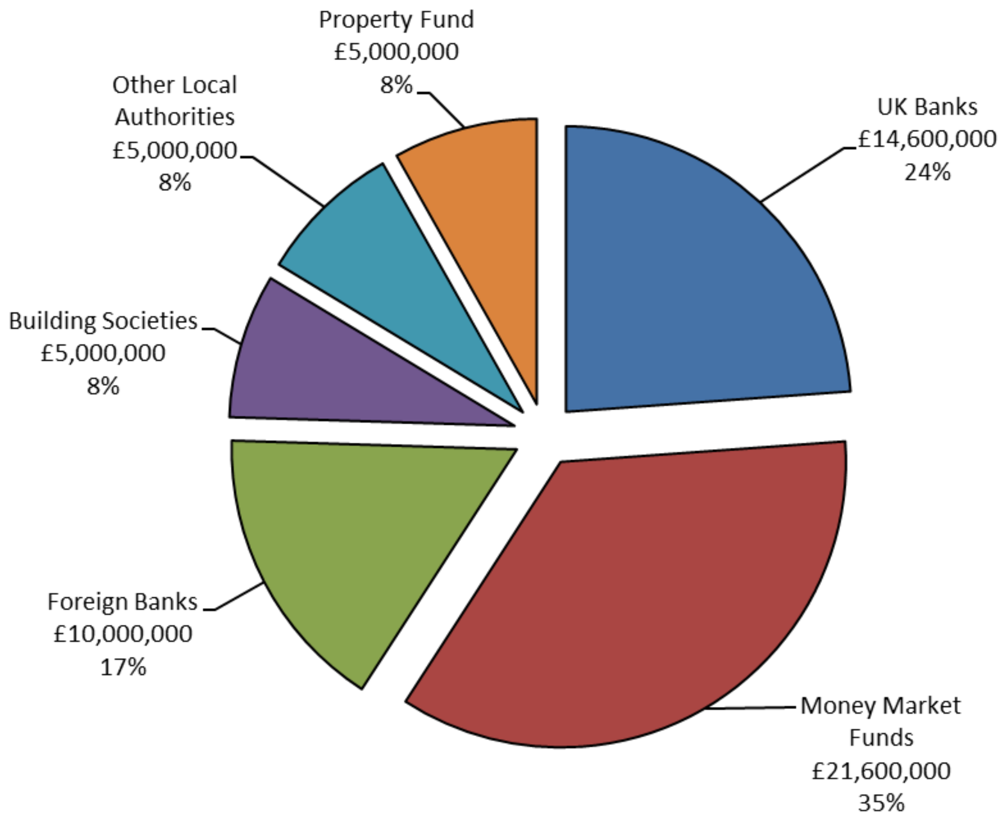


Chart 3: Council Investments Per Lowest Equivalent Long Term Credit Rating as at 31st December 2019 - £60.7m

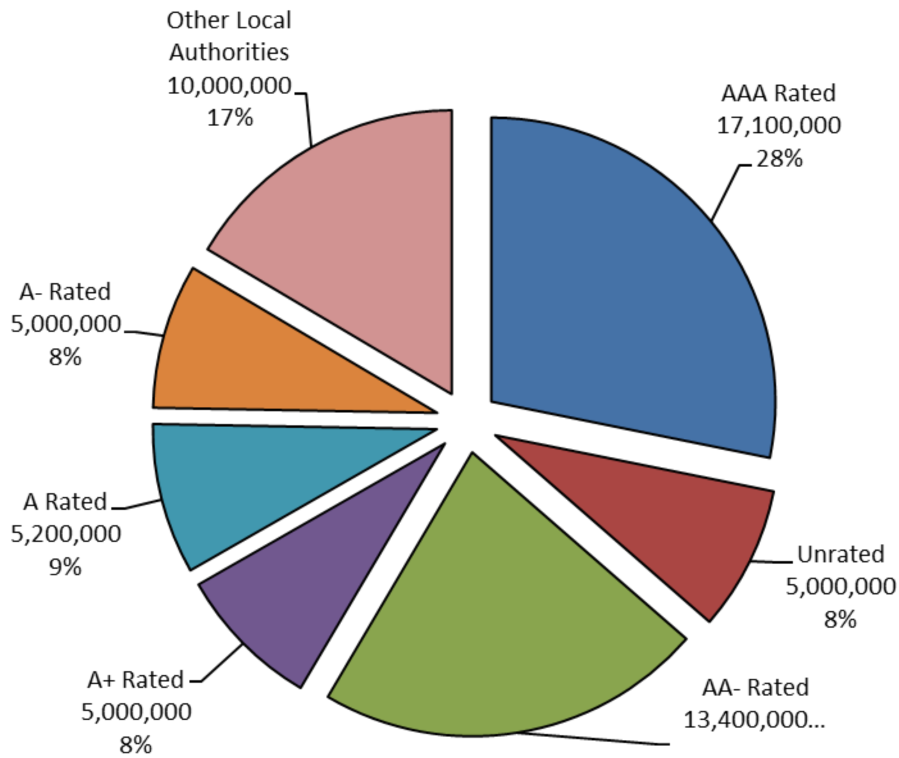
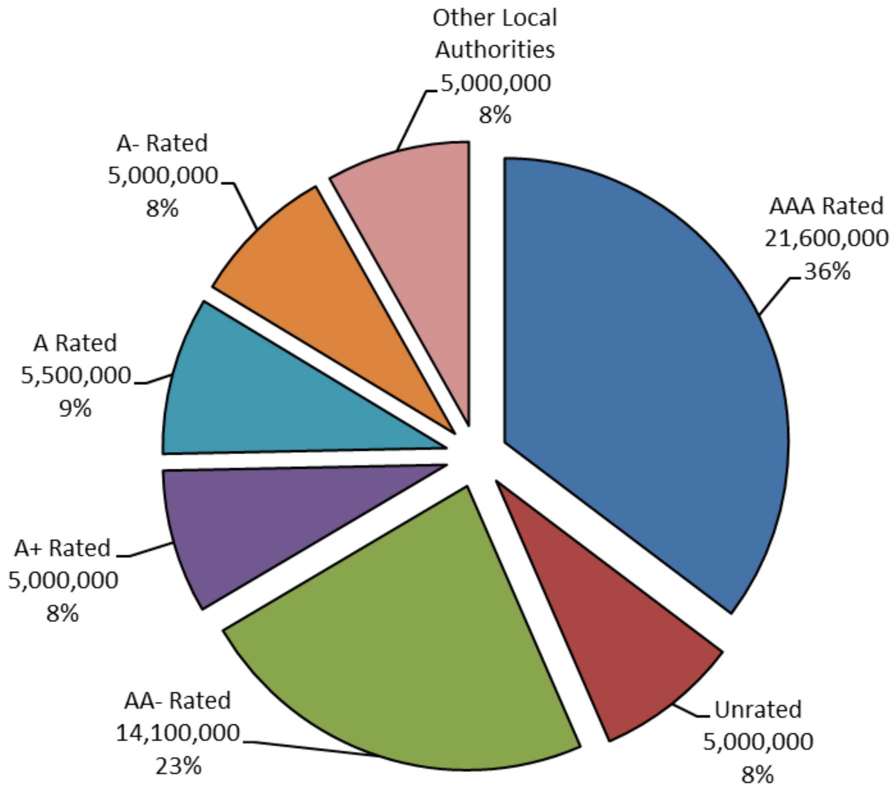


Chart 4: Council Investments Per Lowest Equivalent Long Term Credit Rating as at 30th September 2019 - £61.2m



APPENDIX 3
Average rate of return on investments for 2019/20

	Apr. %	May %	Jun. %	Jul. %	Aug. %	Sep. %
Average rate of interest earned	0.83%	1.01%	1.02%	0.97%	1.07%	1.04%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.62%	0.62%	0.62%	0.61%	0.61%	0.62%
Performance against Benchmark %	+0.21%	+0.39%	+0.40%	+0.36%	+0.46%	+0.42%

	Oct. %	Nov. %	Dec. %	Average for Period
Average rate of interest earned	1.07%	1.07%	1.05%	**1.03%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.62%	0.62%	0.62%	**0.62%**
Performance against Benchmark %	+0.50%	+0.51%	+0.43%	**+0.41%**

APPENDIX 4

Council's External Borrowing at 31st December 2019

	Amount Outstanding (£)	Start Date	Maturity Date	Interest Rate
LONG TERM				
PWLB	10,000,000	15/10/04	15/10/34	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/02/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
PWLB	5,300,000	29/01/15	08/04/34	2.62%
PWLB	5,000,000	29/01/15	08/10/64	2.92%
PWLB	17,854,459	20/06/16	20/06/41	2.36%
PWLB	9,123,689	24/02/17	16/02/40	2.28%
PWLB	9,233,416	04/04/17	16/02/43	2.26%
PWLB	7,847,604	08/05/17	15/02/42	2.25%
PWLB	6,825,039	10/08/17	10/04/67	2.64%
PWLB	9,397,038	13/12/17	10/10/42	2.35%
PWLB	9,409,808	06/03/18	10/10/42	2.52%
PWLB	9,704,754	10/09/18	20/07/43	2.42%
PWLB	9,548,442	06/03/18	10/10/47	2.62%
PWLB	9,552,155	06/12/18	20/06/43	2.38%
PWLB	9,849,833	12/12/18	20/06/68	2.59%
PWLB	4,772,323	13/12/18	20/06/43	2.25%
PWLB	19,897,321	11/02/19	20/07/68	2.52%
PWLB	10,000,000	04/09/19	20/07/44	1.40%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
Sub Total - Long Term	**223,315,881**			
MEDIUM TERM				
Gloucestershire C C	5,000,000	25/11/19	25/11/21	1.50%
Portsmouth City Council	5,000,000	19/12/19	19/12/22	1.65%
Sub Total - Medium Term	**10,000,000**			
TOTAL BORROWING	**233,315,881**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for October 2019 to December 2019

Economic background: The headline rate of UK Consumer Price Inflation remained unchanged in November 2019 at 1.5% year-on-year, the same as October 2019, as accommodation services and transport continued to pull the level of inflation below the Bank of England target of 2%. Labour market data remained positive. The ILO unemployment rate continued to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9%.

The Quarterly National Accounts for Q3 GDP showed the UK economy expanded by 0.4% following the 0.2% contraction in Q1. Construction rebounded by 1.2%, reversing the fall of the same magnitude in the previous quarter, while growth in the services sector was up 0.5%, beating the 0.1% gain in Q2. Production increased by a more modest 0.1% and agriculture fell 0.1%. On an annual basis, GDP growth continued to fall further below its trend rate, slipping to 1.1% from 1.2%.

Politics continued to play a major role in financial markets over the period as the UK's progress negotiating its exit from the European Union together with its future trading arrangements has driven volatility, particularly in foreign exchange markets. The General Election has removed some uncertainty, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

The Bank of England maintained Bank Rate to 0.75% in December following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report (formerly the Quarterly Inflation Report) suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

The fallout from the US-China trade war continued and is likely to drag on global growth in 2020, however it has been reported that Phase I of the deal will be signed at the White House on 15th January. The US economy continued to perform relatively well compared to other developed nations; however, the Federal Reserve started to unwind its monetary tightening through 2019. The Fed has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP continued to slow.

Slow economic growth in Europe continued and Christine Lagarde took control as the head of the European Central Bank. In her first announcement as ECB chief, Ms Lagarde confirmed that the bank would continue to provide the monetary support needed to bring euro area inflation back towards target.

Financial markets: Financial markets adopted a more risk-on approach over the quarter as equities rallied in expectation of ongoing monetary stimulus from central banks. The Dow Jones ended the 2019 calendar year up 22%, while the FTSE 100 and FTSE 250 jumped on the UK general election result with the former gaining 12% during 2019 and the latter around 25%.

Gilt yields remained volatile over the period. From 0.28% at the end of September, the 5-year benchmark gilt rose to 0.60% by the end of December. There were rises in the 10-

year and 20-year gilts over the same period, with the former climbing from 0.48% to 0.82% and the latter from 0.88% to 1.24%. 1-month, 3-month and 12-month SONIA (Sterling Overnight Index Average) bid rates averaged 0.63%, 0.76% and 0.93% respectively over the period.

The US yield curve returned to 'normal' over the period with 2-year ending 2019 at 1.56% and the 10-year at 1.91%. German bunds continued to remain firmly negative with the 10-year ending 2019 at -0.19% with 2 and 5-year securities ending at -0.61% and -0.46% respectively.

Credit background: Credit Default Swap (CDS) spreads fell over the quarter. Non-ringfenced bank NatWest Markets plc CDS fell to 50 basis points at the end of December from over 80bp in September, while for the ringfenced entity, National Westminster Bank plc, the spread fell to around 30bp. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 29 and 50bp at the end of the quarter.

Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative.

Moody's revised HSBC Bank's outlook to negative from stable as it expects restructuring costs to negatively impact net income over the next year or two.

The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2019/20

April 2019 to March 2020	YEAR END POSITION Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	9,106	7,290	(1,816)	FAV
- Internal Repayment of Loan Charges	(11,271)	(9,492)	1,779	ADV
- Ex Avon Debt Costs	1,100	1,100	0	
- Minimum Revenue Provision (MRP)	8,403	6,145	(2,258)	FAV
- Interest on Balances	(620)	(720)	(100)	FAV
Total	**6,718**	**4,323**	**(2,395)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

APPENDIX 8

Extract from Treasury Management Risk Register – Top 5 Market Risks

			Current Risk Score										
	Risk Nr	Description	Likelihood					Impact					Management Action
			1	2	3	4	5	1	2	3	4	5	
			L		M	H		L		M	H		
1	R01	Liquidity Risk - The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.		2						3			Obtain approval of annual Treasury Management Strategy by February Council. Carry out weekly reviews of investment portfolio and planned actions. Carry out monthly 'dashboard' meeting with DD Finance. Consider short and medium term cash balances and cashflows following recent debt repayment to inform any short - medium term borrowing requirement.
2	R02	Interest Rate Risk - The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately		2					2				Monitor interest rates on a monthly basis and compare with budget to determine impact on Council finances and report through Monthly Finance Dashboard. Report implication of interest rate changes to Cabinet Member for Resources as part of quarterly Treasury Management Performance Report. Explore alternative potential investment products following new freedoms - including corporate bonds, gilts, Certificate of Deposits etc.
3	R03	Exchange Rate Risk - The risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.	1						2				Treasury Management Policies clearly record the need to eliminate currency exchange rate risks .
4	R04	Inflation Risk - The risk that prevailing levels of inflation cause an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.		2					2				Liaise with S151 Officer to ensure Inflation both current and projected forms part of the medium term financial planning framework.
5	R05	Credit and Counterparty Risk - The risk of failure by a third party to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the third party's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.			3						4		Complete annual review of Counterparty List with external advisors to feed into Treasury Management Strategy. Regular review of counterparty financial standing through use of credit ratings, credit default swap rates and national press coverage and liaison with S151 Officer and external advisors to consider any issues / change in circumstances of counterparties.