

Agenda Item No 5(g)

DERBYSHIRE COUNTY COUNCIL

CABINET

24 January 2017

Joint Report of the Chief Executive and the Director of Finance

**PRUDENTIAL CODE FOR CAPITAL FINANCE, CAPITAL PROGRAMME
APPROVALS & TREASURY MANAGEMENT STRATEGY
(COUNCIL SERVICES)**

1 Purpose of the Report

To obtain approval for proposals for submission to Council relating to The Prudential Code for Capital Finance, including:

- The capital starts programme for 2017-18.
- The Minimum Revenue Provision (MRP) policy for 2017-18.
- A Treasury Management Strategy for 2017-18.
- Compliance with, and set limits under CIPFA's Prudential Code and the Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes

2 Information and Analysis

A CAPITAL PROGRAMME & FINANCING

- 2.1 The Prudential Code for Capital Finance in Local Authorities (the Code) is a professional Code that sets out a framework for self-regulation of capital spending; in effect allowing councils to invest in capital projects which best meet their service delivery objectives as long as they are affordable, prudent and sustainable, subject to Government reserve powers to restrict borrowing for national economic reasons.
- 2.2 To facilitate the decision making process and support capital investment decisions, the Code requires the Council to agree and monitor a number of prudential indicators. The indicators cover affordability, prudence, capital expenditure, debt levels and treasury management. These indicators will also form the basis of in-year monitoring and reporting.

- 2.3 The main limiting factor on the Council's ability to undertake capital expenditure is whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing costs and running costs, after allowing for any support provided by central government, now mainly through capital grants.
- 2.4 The capital programme remains affected by the downward pressure on public expenditure, with lower levels of new schemes, government support and related borrowing going forward.

Schemes are funded by a combination of government grant, capital receipts, use of revenue or reserves with the balance funded from borrowing. Policy on borrowing is to limit new borrowing to no more than the value of existing borrowing repaid. Capital receipts are normally used to support the overall programme but the level of receipts realised has been limited in recent years due to the recession and the current policy on retention of surplus property for development purposes. In cases where a new project is directly dependent on the disposal of an existing asset, eg replacement of a school, then the receipt from disposal of the "old" asset can be earmarked to fund the replacement.

The Council will receive government grant of just under £38m to address key issues in highways maintenance, develop integrated transport schemes and address the most immediate condition problems in schools. Funding for the replacement of Alfreton Park Special School has been proposed, along with funding to invest in the upgrading and refurbishment of a number of our Homes for Older People.

There is also an LED street lighting scheme shown as invest to save; that is they should only proceed if they are shown to generate revenue savings in excess of the annual financing costs of the initial capital investment. A detailed business case is in preparation for the scheme.

The proposed new starts programme for 2017-18, as shown in Appendix 1, has been evaluated and is recommended to proceed with new borrowing at £14.895m (excluding Invest To Save). A change to the calculation of the minimum level of debt repayable each year (MRP) has been identified as a revenue budget saving and will reduce the financing costs by £6.125m.

More details on each scheme are provided in Appendix 2. The proposals for capital expenditure related borrowing and the estimated impact on the Council's revenue accounts in the next three years are shown at 2.5 to 2.10 below.

- 2.5 Details of the actual and estimated figures are shown below. This table incorporates schemes already approved, completed or still in progress

plus the proposed new starts for 2017-18, and estimates for 2018-19 and 2019-20. These figures include existing capital programme proposals with updated forecasts for phasing of expenditure.

	2015-16 Actual £m	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
*Capital Expenditure	94.01	146.01	197.22	99.43	62.62
Funding sources:					
Borrowing	25.71	33.69	109.41	50.54	22.65
Capital receipts	0.64	6.59	25.96	8.89	2.97
Capital grants	56.52	89.71	52.57	36.19	35.50
Revenue	11.14	16.02	9.28	3.81	1.50
*Capital Financing Requirement (CFR) (underlying need to borrow for capital purposes)					
Total CFR at year end	498.59	517.99	613.09	646.79	651.44
Net movement in CFR	6.58	19.40	95.10	33.70	4.65
Minimum Revenue Provision	20.72	14.29	14.31	16.84	18.00
PFI & Leases in CFR	81.60	78.70	75.60	72.28	68.73
PFI & Leases in MRP	2.71	2.90	3.10	3.32	3.55

*(*These are prudential indicators.)*

The above table indicates proposals for capital expenditure and related borrowing. Within the framework of prudential indicators Members are required to assess the affordability of the capital investment plans. Members are asked to note the following indicators, which are designed to assist the consideration of affordability:

- 2.6 Actual and Estimates of the ratio of financing costs to net revenue stream** - This indicator identifies the trend in the cost of capital against the net revenue stream, based on the Capital Programme set out above.

	2015-16 Actual £m	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Financing costs of CFR	45.33	38.79	41.30	47.23	49.47
Net Revenue Stream* Including DSG	937.9	897.0	905.8	898.0	915.1
Percentage	4.9%	4.9%	5.4%	6.1%	6.7%
Net Revenue Stream* Excluding DSG	499.9	476.0	485.8	478.0	495.1
Percentage	9.2%	9.7%	9.9%	11.6%	12.2%

* Estimates of Government grants, Council Tax/Business Rates, including and excluding Dedicated Schools Grant (DSG). DSG is forecast to increase by £13m in 2017-18, should schools become academies the net revenue stream excluding DSG will reduce although financing costs will remain with the Council.

2.7 The estimates of financing costs include current commitments and the proposed starts programme for 2017-18, together with an estimate through to 2019-20.

2.8 **Estimates of the incremental impact of capital investment decisions on Council Tax** - This indicator illustrates the estimated effect of the Capital Programme set out above, including the provisional programme through to 2017-18. In practice, only part of the costs are met from Council Tax.

	2017-18 £	Forward Projection 2018-19 £	Forward Projection 2019-20 £
Council Tax - Band D			
Existing Commitments only	9.58	20.88	4.48
Implication of new starts 2015-18	0.82	3.40	4.53
Total Commitments	10.40	24.28	9.00

2.9 Provision is made in the proposed 2017-18 revenue budget and in the Forward Financial Plan for debt charges and other costs arising from the programme. The Plan indicates that the proposals in this report are affordable over future years, based on current assumptions on the overall level of resources likely to be available to the Council. The programme will be reviewed in the event of any future change in those assumptions.

2.10 Minimum Revenue Provision

The Local Authorities (Capital Finance and Accounting) (England) Amendment Regulations 2008 require local authorities to agree a policy on the calculation of the Minimum Revenue Provision (MRP) for each financial year. The MRP is the amount the authority has to provide for the repayment of debt.

A revised policy was agreed by Cabinet on 22 November 2016 which is set out below:

- To provide 2.5% of debt outstanding on all debt as at 31 March 2008.
- On any new debt since this date to provide 2.5% of the balance on all borrowing unless any unsupported borrowing relates to any significant assets with a life of less than 20 years. In this case an annual amount based on the expected useful life of the individual assets is used and where those assets are vehicles then an average life of 5 years is used.

The Authority continues to have the option to make voluntary additional provision for debt repayment if it wishes.

The policy meets the requirement to make a prudent calculation of MRP.

B EXTERNAL DEBT

- 2.11 The Prudential Code (revised in 2011) specifies a number of prudential indicators in respect of external debt. These are described below.

Limits to Borrowing Activity

- 2.12 **The authorised limit** - This represents the limit beyond which borrowing is prohibited, and needs to be set and revised if necessary by members.

The figures for the proposed authorised limit for 2017-18 take into account:

- (a) The estimated amount of the Capital Financing Requirement at 31 March 2017 (£517.99m). This figure takes into account net debt of approximately £27m which the Council services on behalf of Derby City Council. This debt arose before Local Government Reorganisation for which Derby City is recharged the relevant loan charges. Derby City are looking to repay this debt in the near future. It is possible that the Council may have to borrow on behalf of the D2N2 Local Economic Partnership (LEP) in the future, although no borrowing is anticipated at present.
- (b) New borrowing for capital schemes of £109.41m during 2017-18 less Minimum Revenue Provision £14.31m.
- (c) Short term borrowing from the other organisations. Deposits are expected to be taken from the D2N2 LEP pending their use. The deposits are treated as loans to the Council and therefore need to be included in its borrowing limits. It is suggested that a figure of £52m should be used to cover these items.
- (d) PFI and finance leases totalling £75.60m are included in the CFR. A debt redemption value of £3.10m is calculated on these liabilities.

Based on the above, it is proposed that the authorised limit (including transferred debt & PFI) should be set at £674m for 2017-18. Proposed limits for future years have been calculated in a similar manner.

- 2.13 **The operational boundary** - This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year.

In practice it is unlikely that all of the potential borrowing requirements included in the authorised limit will materialise at once, therefore the operational boundary requirements (including transferred debt & PFI) will be somewhat lower. £644m is suggested as a realistic figure for 2017-18.

- 2.14 The Cabinet is asked to approve the following authorised and operational limits:

Authorised limit for external debt	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Borrowing	598	639	648
PFI liabilities	76	72	69
Total	674	711	717
Operational boundary for external debt	2017-18 £m	2018-19 £m	2019-20 £m
Borrowing	568	607	615
PFI & other long term Liabilities	76	72	69
Total	644	679	684

These borrowing limits will be subject to monitoring and will be revised annually.

- 2.15 To date, the Council has remained within all of the Prudential Indicators set for 2016-17.

C TREASURY MANAGEMENT

Prudential Indicators

- 2.16 The Prudential Code (revised in 2011) specifies only one prudential indicator in respect of Treasury Management which is that the Council has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes as revised in November 2009, details of which are included in Appendix 3.
- 2.17 In addition, the Council is required to take account of guidance received from Communities and Local Government (CLG) in respect of Investment Strategy.
- 2.18 The proposed Treasury Management Strategy for 2017-18, which incorporates these requirements, is attached as Appendix 3. The main

changes to the previous strategy are the segmentation of the County Fund and Pension Fund counterparty limits. The authority will primarily use existing borrowers and investors, but the availability of other categories provides a flexibility and resilience.

Clauses to be formally adopted

2.19 CIPFA recommends in the revised Treasury Management Code of Practice that councils should amend their financial regulations to adopt four important clauses in respect of treasury management activity. These clauses relate to:

- The creation and maintenance of a treasury management policy statement and treasury management practices.
- Minimum reporting requirements to council on treasury management matters.
- Delegation of responsibility for the implementation, regular monitoring and execution of its treasury management policies and practices
- Delegation of responsibility for the effective scrutiny of those policies and practices.

These clauses are reproduced in the Treasury Management Strategy statement together with the policy statement recommended by CIPFA.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity; human resources, environmental, health, social value, property and transport considerations.

4 Background Papers

Local Government Act 2003, Prudential Code, Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes, Guidance issued by CLG, Capital Accounting Working Papers.

5 Officers' Recommendations

Cabinet recommends to Council:

- 1 The adoption of the Prudential Code including the Prudential Indicators as described in paragraphs 2.5, 2.6, 2.8 and 2.12-2.16.
- 2 The 2017-18 Capital Starts Programme as detailed in Appendix 1, and that further reports on the detailed schemes be brought to Cabinet.

- 3 The MRP policy for 2017-18 as detailed in paragraph 2.10.
- 4 The Treasury Management Strategy for 2017-18 as described in Appendix 3, and taking into account the guidance issued by the CLG and noting the changes in 2.18.
- 5 The adoption of CIPFA's Code of Practice on Treasury Management and Cross Sectoral Guidance Notes (revised 2011), as shown in Appendix 3, and the Treasury Management Policy Statement as specified in the Treasury Management Code of Practice and set out in Appendix 3.

IAN STEPHENSON

Chief Executive

PETER HANDFORD

Director of Finance

APPENDIX 1

CAPITAL PROGRAMME 2017-18 - BIDS

Scheme	FUNDING STREAM						Total £'000
	Grant £'000	Capital Receipts £'000	Borrowing £'000	Invest to save (borrowing funded from Rev Budget) £'000	Revenue Contributions £'000	Other £'000	
Environment, Transport and Communities							
Local Transport Plan	21,581					-2,400	19,181
Derelict Land Reclamation and Regeneration Prog.			325			50	375
LED street lighting				8,688		2,400	11,088
Flood Defence works	1,518				33	96	1,647
Elvaston Castle enabling works			270				270
	<u>23,099</u>	<u>0</u>	<u>595</u>	<u>8,688</u>	<u>33</u>	<u>146</u>	<u>32,561</u>
Children's Services							
Devolved Formula Capital	2,450						2,450
Schools Access initiative			800				800
Alfreton Park Citty special school replacement			6,500				6,500
Basic Need	2,148						2,148
School Condition	9,850						9,850
	<u>14,448</u>		<u>7,300</u>				<u>21,748</u>
Adult Care							
HOPS refurbishment			2,000				2,000
Disabled Facilities			4,000				4,000
	<u>0</u>	<u>0</u>	<u>6,000</u>			<u>0</u>	<u>6,000</u>
Corporate							
Fire Risk Assessment			500				500
Contingency			500				500
	<u>0</u>	<u>0</u>	<u>1,000</u>	<u>0</u>		<u>0</u>	<u>1,000</u>
TOTAL	<u>37,547</u>	<u>0</u>	<u>14,895</u>	<u>8,688</u>		<u>146</u>	<u>61,309</u>

The adjustment in 'Other' represents the funding for the LED scheme from the LTP grant

APPENDIX 2**New Starts Proposals****Economy, Transport and Communities****Local Transport Plan - £21.581m**

Direct grant allocation for highway maintenance and integrated transport. The Highway Maintenance grant funds a programme of work that is key to effectively managing and maintaining the local highways network, the Council's largest and most visible asset. The Integrated Transport grant provides funding which is vital in providing local people with access to jobs, education, healthcare, shopping, leisure and other services, while reducing the impact of social and rural exclusion and improving safety. £2.4m of the LTP has been earmarked for the LED scheme, giving a net figure of £19.181m.

Land Reclamation - £375k

Funding for land reclamation programme is predominantly provided through capital grants secured from a variety of external funding organisations, with the Council providing some pump-prime investment. External bids are currently being developed for Chesterfield canal and Clowne branchline where the land reclamation funding forms part of the funding structure. Many hours of volunteer time and monies are contributed to the work on Chesterfield canal as a result of the county's investment in the restoration work.

The funding is also required to enable the Council to meet statutory obligations on land in its ownership, particularly around physical and environmental work on mines, tips and quarries to deal with hazards and contamination.

Street Lighting - £8.688m

A business case has been developed to install LED on the strategic network using the same assumptions as the current LED programme on the non-strategic network. The programme will replace existing street lighting on columns 8m and above with LED energy saving technology to include replacement of columns and private service connection where these are evaluated to have a residual life less than 5 years.

Overall funding of £11.088m is proposed to include £2.4m from the Local Transport Plan at a rate of £800k/year over three years with an additional £2.9m in each of the first two years and £2.888m in the final year funded from borrowing. This would allow an overall improvement in the asset and slow its decline, sustaining a reduced maintenance regime and delivering a payback period of between 8 years 2 months (10% energy inflation) and 10 years 2 months (0% energy inflation).

The annual energy savings, before debt charges, are predicted to be:

- £210k pa by March 2018
- £430k pa by March 2019 (£220k for the year)
- £570k pa by March 2020 (£140k for the year)

Elvaston Castle - £270k

Enabling works to ground floor of castle to bring large reception rooms up to the required standard to facilitate letting out for conferences, functions, education, hospitality, and weddings to external operators/customers. The works include new finishes, decorations and required technical upgrades (e.g. heating, fire escape, lighting, broadband etc). This is the minimum necessary to facilitate letting out of three large rooms to generate much-needed revenue in the short to medium term.

An updated Conservation Plan for the Castle is essential to inform future restoration works necessary as part of the long-term sustainable regeneration of the castle. Completion of this will save time in the longer term as this work can be completed ahead of the major Heritage Lottery Fund bid planned for 2017-18 which will include conversion of the upper floors to residential use.

Flood management - £1.647m

Flood risk management schemes use a combination funding streams, such as Local Flood Levy, ETC earmarked reserves, National Flood Risk Management Grant in Aid (GiA), and other public and private funding. The five schemes – Breadsall, Renishaw, Ockbrook, Lower Hartshay and Scropton - will impact on around 200 residential and over 20 non-residential properties.

Children's Services

Schools Basic Need - £2.148m

The DfE grant allocation for Basic Need schemes is to provide additional school places in areas of population growth. There are a number of primary sector schools which are 'candidates' for this funding for which feasibility studies have been undertaken. A priority list of potential projects is being finalised.

Devolved Formula Capital - £2.45m

This grant funding is devolved directly to schools by the DfE to spend on their Asset Management Plan priorities, or to contribute to capital projects funded by the Authority in accordance with approved policies.

School Condition - £9.85m

This grant allocation is to address urgent condition and suitability issues in educational properties, including projects relating to essential re-roofing, re-heating, re-wiring, replacement windows, and replacement of 'buildings at risk'. A priority list of potential projects will be finalised once the actual grant figure is known.

Schools Access Initiative - £800k

This is used to address disabled access needs in mainstream schools. This helps to enable disabled pupils to attend their local mainstream schools where appropriate.

Alfreton Park Community School replacement - £6.50m

Alfreton Park Special school has significant condition problems and falls short of national guidelines for the area. It is a school for children with severe and complex learning difficulties. The present facilities are unsuitable. In recent years the Authority started the replacement of the School providing a Hydrotherapy pool and a new 16+ block. This scheme will allow the first phase of the main building replacement.

Adult Care**Older persons homes improvements - £2.00m**

This investment will support a number of homes that require works to be able to meet minimum Care Quality Commission standards, infection control and health and safety requirements. The work includes improvements to bathrooms, kitchens, sluice rooms, and call systems. This proposal will improve the infrastructure of the homes, thereby improving the quality of life for residents within Adult Care's own residential establishments. Furthermore, it will protect against market failure in this sector and address some of the issues in relation to top up fees for clients in the private sector. This investment will also support the health integration agenda to prevent hospital admissions and support delayed transfer of care some of which is underpinned by the £30 million Adult Care received through the Better Care Fund from the 5 Clinical Commissioning Groups within the County.

Adaptations - £4.00m

Disabled people requiring major adaptations to their accommodation are able to apply for a Disabled Facilities Grant (DFG) administered by district councils. The DFG is mandatory if the applicant is unable to access essential facilities within their home. The County Council has a duty to identifying suitable works based upon an assessment of individual needs; however, the decision to approve the grant lies with the relevant District Council.

The DFG process is prescribed by legislation and regulations and requires that applicants are subject to a Test of Resources (means test). The Test of Resources only looks at an applicant's income and does not take account of their outgoings or personal circumstances. There are three possible outcomes for applicants:

- a grant to cover the cost of all the work (up to a maximum of £30,000)
- a grant to cover part of the work with the requirement that the applicant meets the remaining costs (subsequently referred to as their assessed contribution)
- the grant application is deemed ineligible as the applicant is assessed to be able to meet all the costs of the work.

The decision on DFG funding is the responsibility of the relevant District Council. However, the County Council, as part of its legal duties under the Chronically Sick and Disabled Peoples Act (1970) s2(1)(e), is required to consider providing financial assistance where 1) the applicant requests assistance towards his/her assessed contribution due to financial hardship and/or 2) that the costs of the work assessed as being necessary are above the current £30,000 DFG limit and the applicant appears to be unable to meet the additional costs.

Corporate Resources

Fire Certificate Work - £500k

Under The Regulatory Reform (Fire Safety) Order 2005 the Authority is required to undertake Fire Risk Assessments on its building stock. These consist of Operational assessments by establishment managers and Technical Assessment by survey teams. Technical Assessments consider the building components, the means of escape, the suitability of compartmentation, warning systems and equipment etc. Assessments are carried out on an on-going basis, agreed with the Fire service, to identify and improve the building form/fabric to a suitable standard. The Council's ongoing survey programme has identified the need for further funding to address these works.

Corporate

There are a number of initiatives that have developed which will potentially need some form of finance from the Council in the near future:

Drakelow Developments Limited

Cabinet on 26 July 2016 considered a report in respect of Walton-upon-Trent Bypass and Bridge. The project requires financial support in order to progress which will comprise a loan being made to Drakelow Developments for the purposes of constructing the bypass and river crossing. This would be

payable over a period up to ten years and secured through a charge against Drakelow Development's assets.

Derby Teaching Hospitals NHS Foundation Trust

The Council has been approached by Derby Teaching Hospitals to help in two ways. Due to the way NHS trusts are funded it would be beneficial to both the Council and the trust for the Council to lend the trust up to £25m each financial year repayable on the 31 March of each year. It is estimated this would generate around £90,000 per year in additional interest for the Council. The second proposition would be for the Council to use its Public Works Loan Board borrowing powers to help the trust improve Accident and Emergency services in the Royal Derby Hospital. The total loan value is not yet known but is estimated at around £10m. This would be revenue neutral to the Council.

Derbyshire Developments Limited

On 26 July 2016, Cabinet considered a report regarding the establishment of Derbyshire Developments Limited. Initially, the company will develop residential housing to sell (or let) in the open market with affordable housing as required to satisfy local planning requirements.

Coalite Chemical site

Cabinet on 11 October 2016 approved a grant to Bolsover Land Ltd of £2.0022m towards the £21.8m scheme to secure the reclamation and regeneration of the Coalite Chemicals site to provide much needed jobs and housing in northern Derbyshire

DERBYSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT STRATEGY 2017-18

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1 Introduction

In April 2002 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code last revised in 2011) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

Revised strategy: In accordance with the CLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of its investment balance.

2 External Context

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia

and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.86%, and that new long-term loans will be borrowed at an average rate of 2.86% (20 Year Maturity Loan – Certainty Rate Discount)

3 Local Context

The Authority currently (31/12/16) has £380m of external borrowing and £298m of investments.

The Authority's net debt position is detailed in Table 1.

Forecast changes are shown in the balance sheet analysis Table 2.

Table 1 – Existing Borrowing & Investment Portfolio

	31.12.16 Actual Portfolio £m	31.12.16 Average Rate %
External Borrowing:		
Public Works Loans Board (PWLB)	310	4.71
Banks Loans (including LOBO's)	28	4.69
Local Authority Loans (D2N2)	42	0.25
Total External Borrowing	380	4.21
Investments:		
Managed in-house:		
Short-term investments	162	0.63
Long-term investments	56	1.40
Managed externally:		
Money market funds	70	0.43
Pooled Funds	10	4.86
Total Investments	298	0.86
External Borrowing less Investments	82	
Other Long Term Liabilities:		
PFI	77	
Finance Leases	5	
Total Other Long Term Liabilities	82	
Less Net Transferred Debt (Derby City)	(27)	
Net Debt Position	137	

Table 2 - Balance Sheet Summary and Forecast

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m
Capital Financing Requirement (CFR)	499	518	613	647	651
Less: Other debt liabilities * (Excludes D2N2)	-82	-79	-76	-72	-69
Borrowing CFR	417	439	537	575	582
Less: External borrowing **	350	337	332	324	314
Internal borrowing***	67	102	205	251	268
Less: Usable reserves	-254	-186	-130	-115	-107
Less: Working capital	-33	-33	-33	-33	-33
Investments (Borrowing)	220	117	-42	-103	-128

* comprised of PFI liabilities (£77m) and finance leases (£5m).

** Derby City Council to repay net transferred debt of £27m in 2017-18.

*** The Authority's internal borrowing limit is currently 25% of the CFR

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme. Investments are forecast to reduce to £Nil by 31 March 2018, as capital receipts are used to finance capital expenditure and usable reserves are utilised to finance the revenue budget.

It is recommended that the Authority increase the internal borrowing limit from 25% to 40%. This limit will be kept under review. Research confirms a number of Local Authorities do not have internal borrowing limits.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 2 shows that the Authority expects to comply with this recommendation during 2017-18.

4 Borrowing Strategy

At 31 December 2016, the Authority held £338m of fixed term loans, a decrease of £12.5m on the previous year as part of its strategy for funding previous years' capital programmes (a temporary revenue loan of £42m from D2N2 is excluded). The balance sheet forecast in Table 2 predicts that the Authority will require additional borrowing in 2017-18. The Authority may also borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £674m.

Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

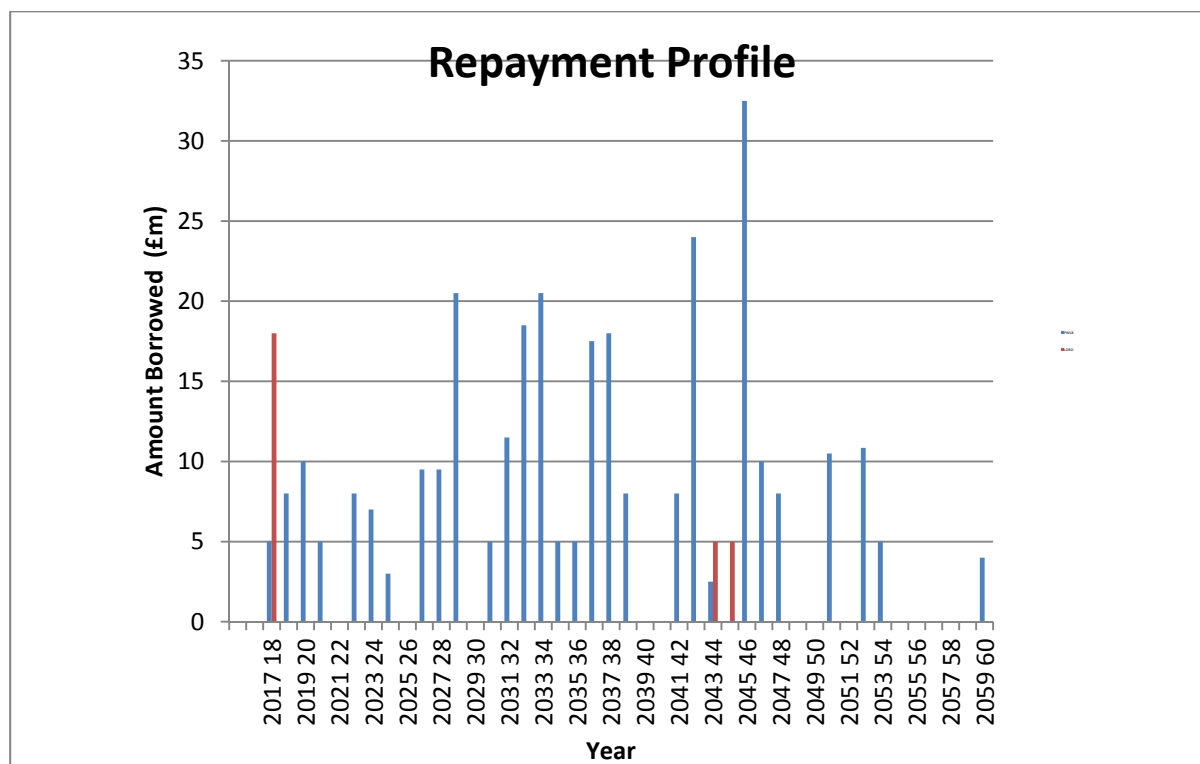
By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The Authority will monitor this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2017-18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2017-18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

Maturity Profile

The Authority's maturity profile at 31 March 2017 is shown below. The maturity profile is the rate at which long term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments due in any particular year, thus a good spread of maturities is desirable. The Authority currently has no short-term borrowing < 364 days (except D2N2). The £18m of LOBO's are technically callable every 6 months.



The average redemption is £9.0m per year over the next 37 years. The maximum redemption is £32.5m in 2045-46. The average duration of all the Authority's loans is approximately 20 years. Any new borrowing would be targeted for maturity in those years with nil/low repayments.

Sources of Borrowing: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body (HM Treasury)
- Other UK Local Authorities
- Any other bank or building society authorised to operate in the UK (including non UK banks)
- UK public and private sector pension funds (except for the Derbyshire Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues
- D2N2 Local Economic Partnership
- Internal borrowing (see above)
- Any institution approved for investments (see below)

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Authority has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans, bank loans, that may be available at more favourable rates.

PWLB/HM Treasury: In November 2016, the government announced it would take the necessary steps to abolish the PWLB and transfer its functions to HM Treasury. This process will have no impact on existing loans held by Local Authorities or the government's policy on local authority borrowing. HM Treasury clarified that local authorities will continue to have access to an identical range of borrowing facilities and terms that currently exist with the PWLB albeit under a different body so that local authorities will continue to access borrowing at rates which offer good value for money.

Municipal Bond Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Cabinet.

LOBOs: The Authority holds £18m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All 3 LOBOS have options during 2017-18, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Barclays Bank converted £10m of LOBO's to fixed rate term loans during the current financial year.

Short-term and Variable Rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5 Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the current year, the Authority's investment balance has ranged between £298 million and £395 million, although these levels are expected to fall significantly as reserves are utilised in the forthcoming year.

Objectives: Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative Interest Rates: If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Base rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2017-18. This is especially the case for the estimated £20m (of reserves) that are available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will therefore represent a continuation of the new strategy adopted in 2016/17.

Approved Counterparties: The Authority may invest its surplus funds with any of the counterparty types in Table 3a below, subject to the cash limits (per counterparty) and the time limits shown.

The Pension Fund limits are detailed in Table 3b below. Approval to adopt this strategy is obtained from the Pensions and Investments Committee.

Table 3a: Approved Investment Counterparties and Limits (County Fund)

Credit Rating*	Banks Unsecured	Banks Secured	Government Other LA's	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£30m 5 years	£30m 20 years	£30m 50 years	£10m 20 years	£10m 20 years
AA+	£30m 5 years	£30m 10 years	£30m 25 years	£10m 10 years	£10m 10 years
AA	£30m 4 years	£30m 5 years	£30m 15 years	£10m 5 years	£10m 10 years
AA-	£30m 3 years	£30m 4 years	£30m 10 years	£10m 4 years	£10m 10 years
A+	£30m 2 years	£30m 3 years	£30m 5 years	£10m 3 years	£10m 5 years
A	£30m 13 months	£30m 2 years	£30m 5 years	£10m 2 years	£10m 5 years
A-	£30m 6 months	£30m 13 months	£30m 5 years	£10m 13 months	£10m 5 years
BBB+	£10m 100 days	£10m 6 months	£10m 2 years	£5m 6 months	£5m 2 years
None	£1m 6 months	n/a	£30m 25 years	n/a	£10m 5 years
Pooled funds	£30m per fund				
Other Unrated Bodies	Individual Cabinet Approval				

NB: An excess of the counterparty limit due to accrued interest is permitted.

The Council's Main Bank Account - Lloyds Bank

It is requested that the existing additional overnight limit for operational and transactional purposes of £20m is maintained.

It is requested that an overnight limit for operational and transactional purposes of £1m for D2N2 is established.

It is requested that an overnight limit for operational and transactional purposes of £1m for Derbyshire Developments Ltd is established.

Table 3b: Approved Investment Counterparties and Limits (Pension Fund)

Credit Rating*	Banks Unsecured	Banks Secured	Government Other LA's
UK Govt	n/a	n/a	Unlimited 13 months
AAA	£10m 13 months	£20m 13 months	£20m 13 months
AA+	£10m 13 months	£20m 13 months	£20m 13 months
AA	£10m 13 months	£20m 13 months	£20m 13 months
AA-	£10m 13 months	£20m 13 months	£20m 13 months
A+	£10m 13 months	£20m 13 months	£20m 13 months
A	£10m 13 months	£20m 13 months	£20m 13 months
A-	£10m 6 months	£20m 13 months	£20m 13 months
BBB+	£5m 100 days	£10m 6 months	£10m 6 months
None	£1m 6 months	n/a	£20m 13 months
Money Market funds	£20m per fund		

NB: An excess of the counterparty limit due to accrued interest is permitted.

The Pension Fund's Main Bank Account - Lloyds Bank

It is requested that the existing additional overnight limit for operational and transactional purposes of £10m is maintained.

The Pension Fund's Custodian Account - BNP Paribas

It is requested that the existing additional overnight limit for operational and transactional purposes of £30m is maintained for the In House account.

It is requested that the existing additional overnight limit for operational and transactional purposes of the US\$ equivalent of £20m be maintained for the Wellington account.

It is requested to maintain a £1m limit for deposits at BNY Mellon until all outstanding transitional arrangements are concluded.

- * **Credit Rating:** Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. **Where available, the credit rating relevant to the specific investment or class of investment is used**, otherwise the counterparty credit rating is used. Investment decisions are never solely made based on credit ratings alone, as all other relevant factors including external advice will be taken into account.
See Appendix B – credit rating definitions (Fitch)
See Appendix C – UK High St banks/building societies

UK Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. No unsecured investments with banks rated BBB+ or lower are permitted except for overnight deposits with the Council's main bank account (Lloyds) and contingency bank account (Barclays).

Non-UK Banks: Non UK Banks have an additional requirement that the sovereign rating of its country of domicile must be a minimum of AA+ (The UK has a sovereign rating of AA+). No unsecured investment with banks rated BBB+ or lower are permitted except for overnight deposits at the Pension Funds custodian banks (BNP Paribas) and (/BNY Mellon).

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits (e.g. a Lloyds Bank covered bond secured by collateral is rated at AAA by Fitch, whilst an unsecured Lloyds bank deposit is rated at A+, 5 notches below). The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Repo/Reverse Repo is accepted as a form of securitised lending and should be based on the GMRA 2000 (Global Master Repo Agreement). Should the counterparty not meet our senior unsecured rating then a 102% collateralisation would be required. Acceptable collateral includes index linked gilts, conventional gilts, UK Treasury Bills and DBV (Delivery by Value – a mix of the above).

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years. Investments with Other Local Authorities are significant (£120m at 31 December 2016). The Authority will distinguish between Upper Tier (Counties, Unitaries, London Boroughs and Lower Tier (Boroughs & Districts) Authorities. Investments to Scottish, Welsh, Northern Irish, Fire, Police, Transport and Local Authority Pension funds will also be permitted.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. **Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term.** These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the minimum approved investment criteria (BBB+) then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the Authority's minimum approved rating criteria (BBB+), then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments: The CLG Guidance defines specified investments as:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 4a County and 4b Pension Fund below.

Table 4a: Non-Specified Investment Limits (County Fund)

	Cash limit
Total long-term investments	£100m
Total investments without credit ratings or rated below A-	£50m
Total non-specified investments	£150m

Table 4b: Non-Specified Investment Limits (Pension Fund)

	Cash limit
The Pension Fund’s Custodian Bank (BNP Paribas) In House £20m, Wellington US\$ 20m	£30m + £20m US\$ equivalent
Total non-specified investments	£50m

Investment Limits (County Fund): The Authority's revenue reserves available to cover investment losses are forecast to be £186m on 31 March 2017. In order that no more than approximately 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (except for the UK Government or Lloyds Bank as the Council's main bankers) will be £30m (plus accrued interest).

A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 5a: Investment Limits (County Fund)

	Cash limit
UK Central Government	Unlimited
Any single organisation, except the UK Central Government	£30m each
Any group of organisations under the same ownership	£30m per group
Any group of pooled funds under the same management	£30m per manager
Negotiable instruments held in a broker's nominee account	£100m per broker
Foreign countries	£100m in total
Registered Providers	£50m in total
Unsecured investments with Building Societies	£100m in total
Loans to unrated bodies	£100m in total
Money Market Funds	£150m in total

Investment Limits (Pension Fund): The Pension Fund's cash balance is forecast to be £100m at 31 March 2017. In order that no more than approximately 20% of available cash will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (except for the UK Government or Lloyds Bank as the Pension Funds main bankers) will be £20m (plus accrued interest).

A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, and foreign countries. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 5b: Investment Limits (Pension Fund)

	Cash limit
UK Central Government	Unlimited
Any single organisation, except the UK Central Government	£20m each
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Foreign countries	£50m in total
Unsecured investments with Building Societies	£100m in total
Money Market Funds	£100m in total

Liquidity Management: The Authority uses purpose-built cash flow forecasting software (Logotech PSTM) to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

6 Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target
Portfolio average credit rating	A

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one month period, without additional borrowing.

	Target
Total cash available within 35 days	£30m

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

Borrowing	2016-17	2017-18	2018-19
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	40%	40%	40%

Investments	2016-17	2017-18	2018-19
Upper limit on fixed interest rate exposure	25%	25%	25%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	15%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	40%	10%
20 years and within 30 years	40%	10%
30 years & above	40%	10%

Time periods start on the first day of each financial year. The maturity date of the borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017-18	2018-19	2019-20
Limit on principal invested beyond year end	£100m	£80m	£60m

7 Other Items

There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Investment Training: The needs of the Authority's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment Advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is reviewed annually.

Investment of Money Borrowed in Advance of Need: The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of

loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £674m. The maximum period between borrowing and expenditure is expected to be 3 years, although the Authority is not required to link particular loans with particular items of expenditure.

Financial Implications

The forecast for investment income in 2017-18 is £1.5m, based on an average investment portfolio of £180m at an interest rate of 0.85%. The forecast for debt interest paid in 2017-18 is £15.7m, based on an average debt portfolio of £335m at an average interest rate of 4.69%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Appendix A**Arlingclose Economic & Interest Rate Forecast November 2016****Underlying assumptions:**

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.
- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.
- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.
- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.
- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely.

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.
- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	Dec -16	Mar- 17	Jun -17	Sep- 17	Dec -17	Mar- 18	Jun -18	Sep- 18	Dec -18	Mar- 19	Jun -19	Sep- 19	Dec -19	Ave rag e
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.1 2
Arlingclose Central Case	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5	0.2 5
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.4 0
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.1 8
Arlingclose Central Case	0.2 5	0.2 5	0.2 5	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.3 0	0.2 9
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.3 4
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.2 3
Arlingclose Central Case	0.6 0	0.5 0	0.5 0	0.5 0	0.5 0	0.5 0	0.5 0	0.6 0	0.7 0	0.8 5	0.9 0	0.9 0	0.9 0	0.6 5
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.2 4
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.3 9
Arlingclose Central Case	0.5 0	0.4 0	0.3 5	0.3 5	0.3 5	0.4 0	0.4 0	0.4 0	0.4 5	0.5 0	0.5 5	0.6 0	0.6 5	0.4 5
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.4 7
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.3 9
Arlingclose Central Case	1.1 5	0.9 5	0.8 5	0.8 5	0.8 5	0.8 5	0.8 5	0.9 0	0.9 5	1.0 0	1.0 5	1.1 0	1.1 5	0.9 6
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.4 7
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.3 9
Arlingclose Central Case	1.7 0	1.5 0	1.4 0	1.4 0	1.4 0	1.4 0	1.4 0	1.4 5	1.5 0	1.5 5	1.6 0	1.6 5	1.7 0	1.7 5
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.5 7
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.3 9
Arlingclose Central Case	1.6 0	1.4 0	1.3 0	1.3 0	1.3 0	1.3 0	1.3 0	1.3 5	1.4 0	1.4 5	1.5 0	1.5 5	1.6 0	1.4 1
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.5 7

Appendix B**Credit Rating Definitions - Long Term (Fitch's)****AAA - Highest credit quality.**

'AAA' ratings denote the lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA - Very high credit quality

'AA' ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A - High credit quality

'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB - Good credit quality.

'BBB' ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.

Appendix C

UK High St Banks & Building Societies

Long Term Ratings

a) UK Banks

Counterparty	Credit Rating Agency			Limit
	Fitch	Moody's	S&P	£m
Barclays	A	A1	A-	30
Close Brothers	A	AA3	n/a	30
Goldman Sachs	A	A1	A+	30
Handelsbank	AA	AA2	AA-	10
HSBC	AA-	Aa2	AA-	30
Lloyds (HBOS)	A+	A1	A	30
RBS (Nat West)	BBB+	A3	BBB+	10
Santander UK	A	AA3	A	30
Standard Chartered	A+	AA3	A	30

b) UK Building Societies

Building Society	Long term			Limit
	Fitch	Moody's	S&P	£m
Coventry	A	A2	n/a	30
Leeds	A-	A2	n/a	30
Nationwide	A	AA3	A	30
Yorkshire	A-	Baa1	n/a	10

Appendix D**Clauses to be formally adopted**

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses:

1. 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 (TMPs) 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.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Treasury Management Code of Practice, subject only to amendment where necessary to reflect the particular circumstances of this Council. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. This Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
3. This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
4. This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix E**Treasury Management Practices (TMPs)**

CIPFA recommends that an organisation's treasury management practices (TMPs) include those of the following that are relevant to its treasury management powers and the scope of its treasury management activities.

TMP1	Risk management
TMP2	Performance measurement
TMP3	Decision-making and analysis
TMP4	Approved instruments, methods and techniques
TMP5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP6	Reporting requirements and management information arrangements
TMP7	Budgeting, accounting and audit arrangements
TMP8	Cash and cash flow management
TMP9	Money laundering
TMP10	Training and qualifications
TMP11	Use of external service providers
TMP12	Corporate governance

Note

TMPs are the detailed procedures which are held by the Director of Finance and are subject to regular review.

Appendix F**The Treasury Management Policy Statement**

CIPFA recommends that the Council's treasury management policy statement adopts the following forms of words to define the policies and objectives of its treasury management activities:

1. This organisation defines its treasury management activities as:

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