

**DERBYSHIRE COUNTY COUNCIL**

**COUNCIL**

**1 February 2012**

**Joint Report of the Chief Executive, the Director of Finance and  
the Director of Property**

**PRUDENTIAL CODE FOR CAPITAL FINANCE, CAPITAL PROGRAMME  
APPROVALS & TREASURY MANAGEMENT STRATEGY**

**1 Purpose of the Report**

To obtain approval for proposals relating to:

- The Prudential Code for Capital Finance.
- The capital starts programme for 2012-13.
- The Minimum Revenue Provision (MRP) policy for 2012-13.
- 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
- A Treasury Management Strategy for 2012-13.

**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 is affected by the downward pressure on public expenditure, with lower levels of new schemes, government support and related borrowing going forward.

Although the strategic aim is to reduce long term debt and therefore the ongoing revenue cost, investment into key priorities continues. A long-term investment into care for older adults is planned, aimed at drawing in significant private sector investment which will improve choice and control over care for and by older people, but at the same time reduce the pressure on existing revenue spending. The Council will receive government grant of over £40m to address key issues in highways maintenance, develop integrated transport schemes and address the most immediate condition problem in schools. With the help of a funding contribution from the schools budget the Council has already approved a scheme to provide a new building at Tibshelf School, a project originally a priority within the BSF programme. The borrowing costs associated with this capital expenditure will be reduced by the use for financing of capital receipts from the sale of surplus assets and, in 2012-13, by £7m from the Council Tax freeze grant.

The Council also has a bid submitted into the national Priority School Building Programme to replace three secondary, one special and one primary school. A decision is still awaited but if successful would result in a further £33m of capital investment via a nationally procured PFI contract.

The proposed new starts programme for 2012-13, as shown in detail in Appendix 1, has been evaluated and is recommended to proceed.

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 2012-13, and estimates for 2013-14 and 2014-15. The costs and financing are spread accordingly over future years.

	2010-11 Actual £m	2011-12 Estimate £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
<b>*Capital Expenditure</b>	98.70	115.20	144.70	112.30	73.80
<b>Funding sources:</b>					
Borrowing	11.50	53.30	44.50	48.70	36.30
Capital receipts	5.20	1.70	6.90	16.10	0.70
Capital grants	77.70	55.30	76.50	42.80	31.30
Revenue	4.30	4.90	16.80	4.70	5.50
<b>*Capital Financing Requirement (CFR)</b> (underlying need to borrow for capital purposes)					
Total CFR at year end	528.90	559.10	579.54	603.00	613.30
Net movement in CFR	30.80	30.20	20.40	23.50	10.30
Minimum Revenue Provision	22.00	23.10	24.06	25.24	26.00
PFI & Leases in CFR	93.5	91.5	89.2	86.9	84.3
PFI & Leases in MRP	1.4	2.1	2.2	2.4	2.5

(\*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.

	2010-11 Actual £m	2011-12 Estimate £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
Financing costs of CFR	44.0	51.2	53.9	56.3	58.2
Net Revenue Stream* Including DSG	924.6	1,028.2	990.4	985.0	936.3
Percentage	4.8%	5.0%	5.4%	5.7%	6.2%
Net Revenue Stream* Excluding DSG	509.7	535.0	530.8	525.4	476.7
Percentage	8.6%	9.6%	10.2%	10.7%	12.2%

\* Estimates of Government revenue support grant/Council Tax/Business Rates/Area Based Grant, including and excluding Dedicated Schools Grant (DSG).

- 2.7 The estimates of financing costs include current commitments and the proposed starts programme for 2012-13, together with an estimate through to 2014-15.

- 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 2014-15. In practice, only part of the costs are met from Council Tax.

	2012-13 £	Forward Projection 2013-14 £	Forward Projection 2014-15 £
<b>Council Tax - Band D</b>			
Existing Commitments only	9.86	5.22	-4.73
Implication of new starts 2012-15	0.24	3.90	11.90
Total Commitments	10.10	9.11	7.17

- 2.9 Provision is made in the proposed 2012-13 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.

It is not proposed to change the policy, which is set out below.

To provide 4% of debt outstanding on all debt as at 31 March 2008. On any new debt since this date to provide 4% 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 of 5 year lives are 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 November 2009) 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 2012-13 take into account:

- (a) The estimated amount of the Capital Financing Requirement at 31 March 2012 (£559.1m). This figure takes into account debt which the Council services on behalf of Derby City Council (approx £35.3m), which arose before Local Government Reorganisation. Derby City is recharged the relevant loan charges.
- (b) New borrowing for capital schemes of £44.5m during 2012-13 less the estimated amount for debt redemption within 2012-13 loan charges (£24.1m).
- (c) Short term borrowing from the other organisations. Deposits are taken from the Derbyshire Fire Authority and the Peak District National Park Authority 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 £25m should be used to cover these items.
- (d) PFI liabilities also need to be included at a value of £92m.

Based on the above, it is proposed that the authorised limit should be set at £605m for 2012-13. 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 will be somewhat lower and £555m is suggested as a realistic figure for 2012-13.

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

<b>Authorised limit for external debt</b>	<b>2012-13 Estimate £m</b>	<b>2013-14 Estimate £m</b>	<b>2014-15 Estimate £m</b>
Borrowing	513	539	552
PFI liabilities	92	89	87
Total	605	628	639
<b>Operational boundary for external debt</b>	<b>2011-12 £m</b>	<b>2012-13 £m</b>	<b>2013-14 £m</b>
Borrowing	463	489	502
PFI & other long term liabilities	92	89	87
Total	555	578	589

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

- 2.15 The Council has remained within all of the Prudential Indicators set for previous years, including in 2011-12.

## **C TREASURY MANAGEMENT**

### **Prudential Indicators**

- 2.16 The Prudential Code (revised in November 2009) 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 2012-13, which incorporates these requirements, is attached as Appendix 2.

### **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 as Appendix 3 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, property and transport considerations.

### **4 Key Decision**

No.

### **5 Call-in**

Not applicable.

### **6 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, Consensus Economics December 2010, Capital Accounting Working Papers.

## **7 OFFICERS' RECOMMENDATIONS**

Council recommends to Council:

1. The 2012-13 Capital Starts Programme as detailed in Appendix 1, and that further reports on the detailed schemes be brought to Cabinet.
2. The MRP policy for 2012-13 as detailed in paragraph 2.10.
3. The adoption of the Prudential Indicators as described in paragraphs 2.5, 2.6, 2.8 and 2.12-2.16.

4. The Treasury Management Strategy for 2012-13 as described in Appendix 2, and taking into account the guidance issued by the CLG as described in paragraph 9(b).
5. The adoption of CIPFA's Code of Practice on Treasury Management and Cross Sectoral Guidance Notes (revised November 2009), as shown in Appendix 2, and the Treasury Management Policy Statement as specified in the Treasury Management Code of Practice and set out in Appendix 3.

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24 January 2012



## APPENDIX 1

2012 STARTS - Recommended Starts Programme	Gross Cost £000s	Grant £000s	Net Cost £000s	Revenue		Capital Receipts £000s	Borrowing £000s	Score Rating
				Schools £000s	Reserves £000s			
<b>Children and Younger Adults</b>								
Schools Basic Need	3,631	3,631	-	-	-	-	-	67
Schools Capital Maintenance	13,132	13,132	-	-	-	-	-	67
Tibshelf School	14,900	400	14,500	8,000	-	-	6,500	46
Condition Priorities	5,000	-	5,000	2,500	-	-	2,500	52
Devolved Formula Capital	2,560	2,560	-	-	-	-	-	
	<b>39,223</b>	<b>19,723</b>	<b>19,500</b>	<b>10,500</b>	<b>-</b>	<b>-</b>	<b>9,000</b>	
<b>Adult Care</b>								
Adaptations	3,000	-	3,000	-	-	-	3,000	44
Revised Strategy for Accommodation, Care and Support	42,300	-	42,300	-	-	9,000	33,300	58
	<b>45,300</b>	<b>-</b>	<b>45,300</b>	<b>-</b>	<b>-</b>	<b>9,000</b>	<b>36,300</b>	
<b>Corporate Resources</b>								
H & S/EHO/Radon/Depots/Demols	250	-	250	-	-	-	250	41
Risk Management	225	100	125	-	-	-	125	40
Accommodation Project - Interim	375	-	375	-	-	-	375	48
Carbon Reduction	500	-	500	-	-	-	500	50
Fire certificate work	300	-	300	-	-	-	300	39
Access Improvements	250	-	250	-	-	-	250	54
	<b>1,900</b>	<b>100</b>	<b>1,800</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,800</b>	
<b>Corporate</b>								
Big Society Grants	1,000	-	1,000	-	1,000	-	-	45
Vehicle Replacement Programme	500	-	500	-	-	-	500	40
	<b>1,500</b>	<b>-</b>	<b>1,500</b>	<b>-</b>	<b>1,000</b>	<b>-</b>	<b>500</b>	

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2012 STARTS - Recommended Starts Programme	Gross Cost £000s	Grant £000s	Net Cost £000s	Revenue		Capital Receipts £000s	Borrowing £000s	Score Rating
				Schools £000s	Reserves £000s			
<b>Environmental Services</b>								
Local Transport Plan	19,388	19,388	-	-	-	-	-	57
Countryside: Capital Programme	535	535	-	-	-	-	-	85
Land Reclamation Programme	2,804	2,434	370	-	-	45	325	66
Waste Transfer Stations	2,922	-	2,922	-	-	-	2,922	41
Glossop HWRC & WTS	120	-	120	-	-	-	120	41
Cromford Canal Dredging	300	-	300	-	-	-	300	42
Non Classified Highways Programme	140	-	140	-	-	-	140	50
Ilkeston Rail Station	1,000	1,000	-	-	-	-	-	49
Local Flood Defence	300	-	300	-	300		-	39
MEGZ Western Link	800	-	800	-	800		-	39
	<b>28,309</b>	<b>23,357</b>	<b>4,952</b>	<b>-</b>	<b>1,100</b>	<b>45</b>	<b>3,807</b>	
Council Tax Freeze Grant	-	-	-	-	7,000		-7,000	N/A
<b>Total</b>	<b>116,232</b>	<b>43,180</b>	<b>73,052</b>	<b>10,500</b>	<b>9,100</b>	<b>9,045</b>	<b>44,407</b>	

## **SUMMARY OF CAPITAL SCHEMES AND COMMENTARY**

### **Children and Younger Adults**

#### **Schools Basic Need**

The DfE has confirmed a capital grant of £3.631m for 2012/13 Basic Need schemes. This is to provide additional school places in areas of population growth. Officers are currently undertaking feasibility studies in relation to a small number of schools which are 'candidates' for this funding.

#### **Capital Maintenance**

Previous years' funding categories including the Capital Modernisation Fund, Primary Capital Programme, and the Schools Access Initiative were replaced by the DfE last year by a new funding category labelled simply 'Capital Maintenance'. This grant allocation of £13.132m is a single year allocation for 2012/13 and is basically free of any ties on what type of work it has to be spent on. This enables the Authority to prioritise educational works, either capital improvements or major maintenance, to keep schools serviceable and functional.

#### **Tibshelf School**

This allocation is to proceed with a new building to replace Tibshelf School, a scheme which was originally to be funded via the BSF Programme. The decision to proceed with the project was taken by Cabinet at its meeting on 11 October 2011. The Schools Forum agreed that £8m should be allocated to the project from unallocated DSG from 2010/11. On 22 November 2011 Cabinet approved an additional allocation of £400,000 from the 2011/12 CAYA Capital Programme to enable ERS provision to be incorporated in the scheme. The balance is expected to be funded by borrowing. If, however, the pressure on the General Reserve from Equal Pay liabilities has eased then it may be used instead, or a combination of the two funding sources.

#### **Condition Priorities**

A number of the most urgent condition related priorities can be funded from the Capital Maintenance allocation referred to above. However, the list of desirable priority schemes far outweighs the level of grant received from the DfE. In recent years schools have been able to tackle further priorities utilising their Devolved Formula Capital (DFC) grant, but this reduced by 80% in 2011/12 and schools are now unable to undertake many priority schemes without funding assistance from the Authority. It is therefore proposed to allocate £2.5m to a 'Joint Funding' initiative whereby, with an equal contribution from schools, a total budget of £5m would be available to address the most serious condition priorities in school buildings.

### **Devolved Formula Capital**

This grant funding of £2.56m 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.

### **Adult Care**

#### **Adaptations**

If a disabled person needs a major adaptation to their accommodation they 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 decision as to whether to approve the grant ultimately lies with the relevant district council, although the County Council as the council with social care responsibility which will initially identify an adaptation as being necessary, based on an assessment of individual needs.

The County Council, as part of its legal duties under the Chronically Sick and Disabled Peoples Act 1970 (2(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.

#### **Revised Strategy for Accommodation, Care and Support**

The Adult Care capital project for 2012-13 will deliver a wide range of fit for purpose facilities to provide choice and control to older people in Derbyshire. The bid will deliver 2 residential and community care centres specialising in dementia care. In addition the project includes the procurement of up to 1400 units of extra care as a viable alternative to residential care over 23 sites. The extra care project will incorporate a substantial commitment from private investors equal to around £140 million over the next 5 years.

This bid also includes the procurement of a number of purpose built day care facilities within some of the extra care sites to deliver day opportunities for people with complex needs. Part of the investment will be used for the procurement and disposal of a number of sites and improvements in some existing older persons homes.

### **Corporate Resources**

#### **Health and Safety/EHO/Vacant Buildings/Radon/Demolitions**

Works in this category are generated from a variety of sources including fire officer reports, environmental health officer reports and health and safety assessments. Failure to comply with such reports or assessments could result in building closures or prosecutions. The category also covers security/risk issues

which officers consider need urgent attention. Security issues may occur when buildings are vacant for sale, or temporarily not in use, where vandalism or other misuse, such as squatters, is regarded as possible.

### **Risk Management**

This funding is requested to support departments in implementing risk management initiatives usually on shared funding basis. Traditionally this has targeted security priorities on a risk ranking basis. It is also intended to promote wider strategic risk management initiatives, as appropriate, in line with the risk management strategy.

The funding is also used to support school security schemes across the county, prioritised on a risk ranking basis. As well as pupil, staff and visitor protection, this funding also helps to protect the Council's assets against arson, theft and vandalism which may not simply be costly but may also cause significant disruption to services.

### **Accommodation Project**

The "Changing the Way Derbyshire Works" (CWDW) initiative will reduce the number of buildings from which the County Council operates. This will mean that some buildings will need minor enhancement, some will be sold and some may need to be demolished. Overall, this initiative is expected to save the Council major sums of money; however, there needs to be a fund set aside to deal with all the potential works, some of which will undoubtedly be necessary to allow this process to progress.

The budget will also allow for ad-hoc works to other corporate buildings to fund emergency issues which may be necessary to keep a building open or conversely have it boarded up for safety reasons prior to disposal.

The policy of reducing the Council's building stocks should result in considerable capital receipts through the property sales which the CWDW initiative will generate.

### **Carbon Reduction**

This funding is intended to be spent on invest-to-save initiatives which will improve the energy efficiency of the Authority's buildings and reduce CO2 emissions. The Council's Carbon Management team will operate this initiative by identifying poor performing buildings and offering loans for energy improvement schemes. Savings realised from reduced gas and electricity bills will allow establishments to repay the Council on an agreed basis.

Priority will be given to projects which have the shortest payback period and achieve the greatest reduction in CO2 reduction per £ invested.

### **Fire Certificate Work**

Under The Regulatory Reform (Fire Safety) Order 2005 the Authority is required to undertake Fire Risk Assessments on its building stock. These consist of an Operational and Technical Assessment (Operational assessments are undertaken by establishment managers).

The Technical Assessment is of the fabric of a building taking into account such items as means of escape, compartmentation, warning systems and equipment etc. These assessments identify works required to the fabric, both maintenance and improvement, to protect the integrity of the fire precautions on site.

Fire Risk Assessments have been completed from the ongoing survey programme and have identified the need for further funding to address essential fire precautions.

### **Access Improvements**

In previous years, these works have been approved under the heading of Disability Discrimination Act (DDA) works. However, DDA works have now been included within the more recent Equalities Act 2010. This budget covers priority access works to all the Council's non-schools establishments and will allow improvements to continue at a reasonable rate. Funding for access works to schools are included within CAYA budgets.

## **Corporate**

### **Big Society Grants**

To contribute towards major community partnership projects to support sustainable community activities.

### **Vehicle Replacement Programme**

£500,000 - Contribution to corporate vehicle replacement programme to meet overall costs of £4.122m.

## **Environmental Services**

### **Local Transport Plan**

£19,388,000 - Funding allocated through the Local Transport Plan process to implement:

- highways maintenance schemes help to effectively manage and maintain the local highways network, the council's largest asset.
- integrated transport schemes to provide local people with access to services (jobs, education, leisure, health), to reduce social and rural exclusion and to improve road safety.

**Countryside: Capital Programme**

£535,000 - To deliver environmental and community projects to improve access to the countryside and enhance biodiversity in the local countryside. The funding will also be used to help lever external grants.

**Land Reclamation Programme**

£2,804,000 - The funding for land reclamation is predominantly provided through capital grants secured from a range of external funding organisations. This will enable the implementation of major works at Markham Vale and on Grassmoor lagoons; and will support other local works including Chesterfield canal partnership, greenways routes, abandoned mineshaft safety schemes and starting on reclamation schemes (opencast sites).

**Waste Transfer Stations**

£2,922,000 - Work has been completed on the Transfer Stations and the funding for these projects was taken out of the £25 million set aside for the proposed waste treatment plant. This funding returns the budget to the £25 million allocated for the major waste treatment plant.

**Glossop HWRC and Waste Transfer Station**

£120,000 - Contribution towards redevelopment and extension of existing Household Waste Recycling Centre and transfer station. Capital is already in place and committed, but a shortfall has been identified. This bid will meet the shortfall.

**Countryside: Cromford Canal Dredging**

£300,000 - To dredge the canal in order to undertake crucial maintenance of the historic Cromford Canal to reinstate its use and improve facilities for visitors.

**Countryside: Non Classified Highway Programme**

£140,000 - To improve key routes that have been identified as requiring significant maintenance and improvement to increase access and use of popular routes.

**Ilkeston Rail Station**

£1,000,000 - New Growth Point Grant secured as a contribution towards the costs of Ilkeston Station development, the total costs of which will be £4.5 million.

**Local Flood Defence**

£300,000 - To reduce the risk of surface water flooding from County assets and to promote and support local investment (finance and resources) to alleviate surface water flood risk in Derbyshire.

**MEGZ Western Link**

£800,000 - To construct a link road and associated highways infrastructure to improve access to Markham Vale to enable further development to attract more economic growth in the area.



**A. Treasury Management Strategy 2012-13**

1. Cabinet approved the CIPFA Code of Practice on Treasury Management, which included a Treasury Management Policy Statement, on 16 April 2002, and acceptance of the Code is reaffirmed on an annual basis as a prudential indicator.
2. The policy requires an annual strategy to be reported to Cabinet outlining the expected treasury activity for the forthcoming year. Further reports are produced at the half-year stage to monitor progress, and after the year-end to report on actual activity for the year.
3. In accordance with the provisions of CIPFA's Code of Practice, the Director of Finance has assessed the arrangements for the management and control of treasury management risk and is satisfied with their adequacy and suitability. A key requirement of this report is to explain both the risks, and the management of the risks, associated with treasury management. The report will incorporate guidance received from CLG in respect of the investment of temporary surpluses.
4. This strategy report covers:
  - The expected movement in interest rates
  - Current net borrowing and comparisons (prudential indicators)
  - The Council's borrowing and debt strategy
  - The Council's investment strategy (including compliance with DCLG guidance)
  - Treasury performance indicators
5. Treasury Management activities will be subject to regular review to reflect changing circumstances, and further application and development of existing and emerging guidance.

**6. The expected movement in interest rates**

The Bank of England base rate has been 0.5% since March 2009. The next move in interest rates will depend on economic and financial market conditions and the level of inflation. The position remains uncertain, but forecasters are suggesting that the base rate will be held at 0.5% until the third quarter of 2013.

Base rates, or shorter-term interest rates, determine the level of interest receivable on the Council's temporary investments. A cautious approach is adopted in treasury management activity, to minimise the risk of loss. In

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line with policy, security and liquidity are treated as the most important considerations, ahead of yield. In current market conditions the return on short term investments (for less than 6 months) is likely to be between 0.25%pa and 0.5% pa.

Longer-term fixed interest rates are more relevant for borrowing to fund the Capital Programme. These have fallen over the year. Long term borrowing rates from the Public Works Loan Board ("PWLB") change in line with the gilt market, and currently range from 3.10% for 10 years to 4.04% for 25 years. The gilt market has benefitted from its perceived status as a safe haven, keeping rates low. The Bank of England's quantitative easing programme of gilt purchases has had a similar effect. If circumstances change, however, markets could quickly reverse and rates increase. Forecasts are mixed in respect of the next move in long-term rates. Interest rates on shorter term borrowing are very much lower (e.g. 1.3% for 2 year PWLB loans).

### 7. (i) Current Net Borrowing

	31/3/11 Actual £m	31/3/12 Estimate £m
<b>Fixed Rate Debt - PWLB</b>	361.0	357.6
<b>Market</b>	-	-
<b>Short term</b>	10.0	3.4
<b>Variable Rate Debt - PWLB</b>	-	-
<b>Market</b>	28.0	28.0
<b>Short term</b>	11.5	20.0
<b>Total Debt</b>	410.5	409.0
<b>Fixed Investments</b>	-	-
<b>Variable Investments</b>	(255.5)	(250.0)
<b>Total Investments</b>	(255.5)	(250.0)
<b>Net Borrowing</b>	155.0	159.0

### (ii) Net Borrowing and Capital Financing Requirements

	2012-13 Estimate (year end) £m	2013-14 Estimate (year end) £m	2014-15 Estimate (year end) £m
Gross Borrowing*	415	460	491
Investments	250	220	220
Net Borrowing	165	240	271
CFR	579.5	603	613.3

\* For this indicator, debt managed on behalf of others (Derby City) is required to be excluded.

The above figures show that the Council's net borrowing is less than its forecast CFR in accordance with the requirements of the Prudential Code.

## **8. The Council's borrowing and debt strategy**

### **(a) Approved sources of borrowing/raising capital finance**

The main source of new external loans is likely to be the Public Works Loans Board, which it is estimated could provide all of the Council's requirement. Historically the PWLB has offered the lowest fixed rates, although the banking sector may be competitive from time to time. However, over the short term it would also be possible to finance a part of the capital programme through the use of internal resources that are temporarily available (cashflow and reserves). These are currently invested in short term deposits through the money market. The use of internal resources in this way would reduce the Council's interest receipts, but in current market conditions this would be more than offset by savings in interest payments by deferring or repaying external borrowing. However, it would be necessary to replace the funds in the future by raising long term loans, dependent upon market conditions. It would be necessary to take care that such actions would not be detrimental to the Council in the longer term. Use of internal resources will be limited to 25% of the Capital Finance Requirement (CFR) and will be regularly reviewed.

A number of larger public organisations have issued their own bonds instead of taking substantial long-term borrowing from the PWLB or other sources. This process involves the need to apply for an individual credit rating for the organisation concerned, and incurs considerable legal and financial advisory costs. Nevertheless it is assumed that they believe there are significant cost savings to be made when sufficiently large sums are involved.

Some banks are now offering a service whereby they combine the financing requirements of a number of smaller authorities in order to make a bond issue more viable. Whilst it is not intended that Derbyshire County Council should adopt this approach at the present time, it is a further potential source of funding which will be kept under review.

Accordingly it is recommended that the approved sources of borrowing for 2012-13 should be PWLB loans, the banking sector and internal resources, according to market conditions. Short-term deposits will be taken from the Peak District National Park Authority

(PDNPA) and the Derbyshire Fire Authority (DFA) to assist their Treasury Management activities. Other short term requirements will be taken from the banking sector. No other form of borrowing will be used. Leasing will be considered, should this prove to be advantageous relative to borrowing when all costs are taken into account.

**(b) Debt Rescheduling/Repayment**

Rescheduling opportunities will be sought as part of the day to day management of the Council's borrowing and lending activities. However, under the current PWLB interest structure for borrowing, opportunities for rescheduling are greatly restricted. It is proposed that rescheduling should be subject to the following limits:

- No more than £80m will be rescheduled without the prior approval of Cabinet.
- Any rescheduling exercise will leave the average maturity of the total debt between 10 and 35 years. Average maturity is currently 22 years.
- Any rescheduling exercise will produce an overall benefit to the Council by either reducing total interest charges or providing an early redemption discount.

**(c) Variable v Fixed Rate loans**

Longer term borrowing to fund the Capital Programme may be taken at either fixed or variable rates of interest. The Council is required to approve limits for its fixed and its variable rate debt, and these limits now form treasury indicators within the Treasury Management Code. Control of this is important because of the risk or potential benefit which would accrue to variable rate debt as interest rates change. At present the vast majority of the Council's long-term loan debt is held at fixed rates, to provide protection from increases in interest rates. A 0.5% change on say £25m of new borrowing is equivalent to £125,000 per annum. Short term deposits from the DFA and PDNPA are at variable rates.

Should new long term loans be taken, the proposed strategy is to take new long-term borrowing at fixed rates of interest, provided that long term interest rates remain at relatively low levels. If rates were to increase significantly, variable rate borrowing would be considered with a view to converting to fixed rates in the future.

Investments consist mainly of the investment of temporarily surplus funds, which are therefore subject to variations in short-term interest rates.

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	<b>2012-13 Upper</b>	<b>2013-14 Upper</b>	<b>2014-15 Upper</b>
	%	%	%
<b>Borrowing</b>			
Limits on fixed interest rates	100	100	100
Limits on variable interest rates	40	40	40
<b>Investments</b>			
Limits on fixed interest rates	25	25	25
Limits on variable interest rates	100	100	100

*For investments, fixed interest rates are deemed to apply to loans for more than one year.*

Limits set at these levels will provide for efficient debt management, within an acceptable degree of risk. For the purposes of the Code, investments are to be deducted from borrowing to produce adjusted limits, but within the above parameters.

**(d) Maturity Profile**

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 in any one year, thus a spread of redemptions is desirable. The Council's debt profile at 31 March 2012 is expected to be as follows:

<b>Years</b>	<b>£'m</b>	<b>%</b>
0 – 10	79.2	20.4
10 – 20	74.0	19.0
20 – 30	118.5	30.5
30 – 40	97.5	25.1
Over 40	19.8	5.0
	389.0	100

The average redemption per year is 4.6% of the total debt, with a maximum redemption in any one year of approximately 9%. The average maturity period for all loans is approximately 22 years. The maturity structure is a treasury indicator under the Code, with lower and upper limits recommended as shown in the table below. These are set quite widely to ensure that full advantage can be taken of

interest rate movements and debt rescheduling opportunities, within an acceptable degree of risk.

<b>Maturity Structure limits - fixed borrowing</b>		<b>2012-13</b>
Under 12 months	Lower – Upper	0% - 15%
12 months to 2 years	Lower – Upper	0% - 15%
2 years to 5 years	Lower – Upper	0% - 45%
5 years to 10 years	Lower – Upper	0% - 40%
10 years to 20 years	Lower – Upper	10% - 40%
20 years to 30 years	Lower – Upper	10% - 40%
30 years and above	Lower – Upper	10% - 40%

## 9. The Council's Investment Strategy

Under CIPFA's Treasury Management Code of Practice, the Council is required to formulate a strategy each year regarding the investment of its revenue funds/capital receipts pending their use. The Treasury Management Code is supplemented by guidance from CLG and Authorities are required to take this guidance into account under the terms of section 12 of the Local Government Act 2003.

The proposed investment strategy, the counterparty list and limits are designed to accommodate Pension Fund monies as well as those of the County Council. Under the terms of the Local Authorities (Functions & Responsibilities) (England) Regulations 2000, the Cabinet is not permitted to take decisions relating to the Pension Fund. Responsibility for Pension Fund investments has been delegated to the Investment Committee and relevant extracts from this report, insofar as they apply to the Pension Fund, will be submitted to the Investment Committee for approval.

The investment strategy is subject to regular review and monitoring to reflect changing circumstances and external guidance.

### (a) Strategy under CIPFA's Treasury Management Code of Practice

The income and expenditure flow of the Council is such that funds are temporarily available for investment. Interest receipts are highly sensitive to both changes in interest rates and cash flows. For example, on investments of £200 million a 0.5% change in interest rates results in £1m p.a. change in receipts, and a £20m change in the amount invested at 0.5% impacts receipts by £100,000 p.a.

The recent credit rating reviews by the credit rating agencies Moody's, Fitch and Standard & Poor's have led to numerous credit downgrades to both sovereigns and individual financial institutions. These downgrades have resulted in a £54m reduction of limits and

the shortening of loan durations within the Council's approved list. Accordingly approval is requested to extend the lending list by adding Certificates of Deposit and an additional Money Market Fund.

The proposed policy is to limit investment to eight categories. The following seven categories have previously been approved :

- Main High Street Banks and their wholly owned subsidiaries, with their own credit rating.
- Subsidiaries (of Main High Street Banks) with no separate credit rating
- Leading Building Societies
- Local Authorities
- AAA rated Money Market Funds
- The Government's Debt Management Office
- UK Treasury Bills

Approval is requested to add Certificates of Deposit to the above list. These are tradeable time deposits purchased at a discount and redeemable at their full nominal value if held to maturity. It is proposed that these should be for a term no longer than 3 months and should be issued by a bank with a minimum credit rating of F1/A1/P1. This would allow access to some of the approved higher-rated counterparties which do not accept short term deposits.

### **(b) CLG Guidance**

Guidance from CLG requires councils to give priority to the security and liquidity of investments over yield whilst still aiming to provide good returns. This is in line with the Council's current practice and it is recommended that the policy should be reaffirmed.

The guidance also requires councils to categorise their investments as either "specified" or "non-specified" investments.

#### **(i) Specified Investments**

Specified investments are deemed as "safer" investments and must meet certain conditions, i.e. they must

- be denominated in sterling
- have less than 12 months' duration
- not constitute the acquisition of share or loan capital
- either be invested in the government, a local authority, or in a body or investment scheme with a "high" credit quality

The Council is required to specify what constitutes a high credit quality for each type of investment and how frequently these should be monitored. It must also specify the minimum level of such investments.

Of the investments currently authorised by the Council, deposits with other local authorities, with the Government's Debt Management Office and investment in Treasury Bills, automatically qualify as specified investments provided that they are of less than 12 months' duration and are denominated in sterling. The classification of the other investments is dependent on the counterparty being of a high credit quality. It is suggested that high credit quality should be defined as:-

Moody's:	long term A; short term P1
Fitch:	long term A; short term F1
Standard & Poor's:	long term A; short term A1

It is recommended that, in order to be classified as specified investments, approved counterparties should have credit ratings no lower than those shown above, with the lending limit for banks and Nationwide Building Society set at £27m. Following recent downgrading of a number of building societies there are currently no building societies, other than Nationwide, which meet the Council's higher credit criteria.

It is also recommended that there should be a further category of specified investments with higher lending limits (£32m) being allocated to those counterparties with credit ratings higher than those shown above. It is suggested that the minimum credit ratings for this category of specified investments should be defined as:-

Moody's:	long term Aa; short term P1
Fitch:	long term AA; short term F1
Standard & Poor's:	long term AA; short term A1

For money market funds a Fitch AAA rating would be required.

A summary of Moody's, Fitch's and Standard & Poor's credit ratings are included in this Appendix, as a general indication of what the ratings represent.

The Council receives information relating to counterparties' credit ratings from its treasury management consultant as changes occur.



It is recommended that in the event of a counterparty losing its F1/A1/P1 status, that no further investment should be made pending a report to the Cabinet Member for Finance and Management.

The Council receives a fully updated list of counterparty credit ratings every month from its treasury management advisers. However, credit ratings should not be relied upon in isolation. Supplementary information will also be considered (eg financial press, positive/negative ratings watches, other market information). The status of all approved counterparties will be kept under regular review.

It is also recommended that the minimum level for short-term specified investments for the coming year be fixed at £150m, the same as for 2011-12.

### **(ii) Non Specified Investments**

The Council is required to look at non-specified investments in more detail. It must set out:

- procedures for determining which categories of non-specified investments should be used
- the categories deemed to be prudent
- the maximum amount to be held in each category

The Strategy must also set out procedures for determining the maximum period for committing funds.

It is recommended that the following procedure be adopted for determining which categories of non-specified investments should be used:

- the Cabinet should approve categories on an annual basis
- advice should be provided by the Director of Finance
- priority should be given to security and liquidity ahead of yield

On this basis, the following categories of non-specified investments, and relevant limits are currently considered as prudent and are recommended for use:

- (a) short-term investments with counterparties on the Council's list provided that they have a short term P2/F2/A2 rating. It is recommended that the limit for this category be fixed at £10m

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for each counterparty, subject to an overall total maximum of £70m, except for the Co-operative bank (£20m) which acts as the Council's banker.

Loan duration will depend on the counterparties' long-term ratings as shown below:

	Fitch	Moody's	S&P
Up to 3 months	A/BBB+	A/Baa1	A/BBB+
Up to 1 month	BBB	Baa2	BBB

- (b) investments in excess of 364 days but for not more than 2 years' duration with counterparties on the Council's list provided that they have a both short & long term ratings of at least the following:-

	Short term	Long term
Moody's	P1	Aa
Fitch	F1	AA
S&P	A1	AA

In addition, loans to Lloyds Banking Group and Royal Bank of Scotland have a maximum duration of 18 months, provided that they retain their current credit rating.

It is recommended that for category (b) the overall limit should be £75m, being a maximum of £15m per counterparty (as part of the total counterparty limit), of which a maximum of £10m has over 364 days to maturity at any point in time.

Whilst most of the Council's surpluses are of a temporary nature, others, for example the insurance fund reserve, could reasonably be invested for periods in excess of one year.

A limit for lending for more than one year is set out below:

Prudential Indicator	2012-13	2013-14	2014-15
Maximum principal sums invested for more than 364 days	£75m	£75m	£75m

**10. Performance Indicators**

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the Prudential Indicators which are predominantly forward looking.

The results of these indicators will be reported in the Treasury Management Annual Review following the end of the financial year.

It is recommended that the performance indicators used should be as described below:

Long Term Borrowing:

Comparison of the Council's cost of borrowing for the latest financial year with:

- the average interest rate for 25 year PWLB maturity loans for the latest financial year
- the average rate of interest for county councils for the latest financial year (taken from the CIPFA publication - Capital Expenditure and Borrowing Statistics)

Investments:

Comparison of the Council's return for the year with the average local authority 7 day deposit rate for the year, which is in line with the low risk strategy taken by the Council in the investment of its funds.

Treasury Management Advisers

The Council has appointed treasury management consultants who provide a range of services. This service is subject to regular review.

Whilst the advisers provide support to the internal treasury function, the final decision on treasury matters remains with the Council.

**B. Approved Borrowers**

1. Approval is requested to lend to the following main high street banks (including 100% subsidiaries with their own credit rating). Standard Chartered Bank has been re-instated to facilitate dealing in Certificates of Deposit.

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Group	Short term			Long term			Limit
	Fitch	Moody's	S&P	Fitch	Moody's	S&P	£m
<b>Banco Santander</b>							
Santander UK plc (formerly Abbey)	F1	P1	A1+	A+	A1	AA-	27
<b>Barclays Bank Group</b>	F1	P1	A1	A	Aa3	A+	27
<b>Co-operative Bank</b>	F2	P2	n/a	A-	A3	n/a	20
<b>HSBC Group</b>	F1+	P1	A1+	AA	Aa2	AA-	32
<b>Lloyds TSB Group</b>							27
Bank of Scotland Plc	F1	P1	A1	A	A1	A	
Lloyds TSB Bank	F1	P1	A1	A	A1	A	
<b>Northern Rock</b>	n/a	n/a	A2	n/a	n/a	BBB+	0
<b>Royal Bank of Scotland</b>							27
Royal Bank of Scotland	F1	P1	A1	A	A2	A	
Nat West	F1	P1	A1	A	A2	A	
<b>National Australia Bank</b>							
Clydesdale Bank t/a Yorkshire Bank	F1	P1	A2	A+	A2	BBB+	10
<b>Standard Chartered Bank</b>	F1+	P1	A1+	AA-	A1	AA-	27

### 2. Main building societies.

Building Society	Short term			Long term			Limit
	Fitch	Moody's	S&P	Fitch	Moody's	S&P	£m
Coventry	F1	P2	n/a	A	A3	n/a	10
Leeds	F2	P2	n/a	A-	A3	n/a	10
Nationwide	F1	P1	A1	A+	A2	A+	27
Yorkshire	F2	P2	A2	BBB+	Baa2	A-	10

Skipton and Principality Building Societies have been removed from the list as they no longer meet the minimum credit criteria.

- 3 All UK local authorities including Police and Fire Authorities.  
Lending Limit £17m for each authority
- 4 AAA credit rated Money Market Funds  
Lending Limit £20m per individual fund and £100m in total, (County Fund/Pension Fund combined). This represents an increase of £20m, to accommodate an additional Money Market Fund.

- 5 Debt Management Office  
(Lending Limit £160m.)
- 6 UK Treasury Bills  
(Lending limit £50m for DCC and £70m for the Pension Fund)
- 7 Certificates of Deposit – maximum term 3 months  
(Lending limit £20m for DCC and Pension Fund combined)

## **C. Credit Ratings**

### **Moody's Credit Ratings**

#### **Long-Term Obligation Ratings**

##### **Aaa**

Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.

##### **Aa**

Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

##### **A**

Obligations rated A are considered upper-medium grade and are subject to low credit risk.

#### **Short-Term Obligation Ratings**

##### **P-1**

Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations.

##### **P-2**

Issuers (or supporting institutions) rated Prime-2 have a strong ability to repay short-term debt obligations.

### **Fitch Credit Ratings**

#### **Long-Term Ratings**

##### **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.

### **Short-Term Ratings**

#### **F1 – Highest short-term credit quality**

Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added “+” to denote any exceptionally strong credit feature.

#### **F2 – Good short-term credit quality**

Good intrinsic capacity for timely payment of financial commitments.

### **Standard & Poor’s Credit Ratings**

#### **Long-Term Ratings**

##### **AAA**

An obligation rated AAA has the highest rating assigned by Standard & Poor’s. The obligor’s capacity to meet its financial commitment on the obligation is extremely strong.

##### **AA**

An obligation rated AA differs from the highest rated obligations only to a small degree. The obligor’s capacity to meet its financial commitment on the obligation is very strong.

##### **A**

An obligation rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor’s capacity to meet its financial commitment on the obligation is still strong.

#### **Short-Term Ratings**

##### **A1**

A short term obligation rated ‘A-1’ is rated in the highest category by Standard & Poor’s. The obligor’s capacity to meet its financial commitment on the obligation is strong. Within this category certain obligations are designated with a (+) sign.

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This indicates that the obligor's capacity to meet its financial commitment is extremely strong.

### **A2**

A short term obligation rated 'A-2' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.

**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.



## 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.

## 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.