

**Agenda Item No.8 (d)**

**DERBYSHIRE COUNTY COUNCIL**

**COUNCIL**

**10 February 2016**

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

**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, including:

- The capital starts programme for 2016-17.
- The Minimum Revenue Provision (MRP) policy for 2016-17.
- A Treasury Management Strategy for 2016-17.
- 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 £40m to address key issues in highways maintenance, develop integrated transport schemes and address the most immediate condition problems in schools. Funding for a new primary school in Tibshelf, partly met by capital receipts has been proposed, along with some funding to enable the most urgent work at a number of schools. Discussion is currently taking place with DFE in respect of potential replacement of a number of schools and further funding may be needed, dependent on the outcome of those discussions.

Two major schemes – the Integrated Adult Care scheme at Belper and the LED street lighting scheme are 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. Detailed business cases are in preparation for both schemes.

The proposed new starts programme for 2016-17, as shown in Appendix 1, has been evaluated and is recommended to proceed. New borrowing at £14.095m (excluding Invest To Save) is lower than the estimated debt repayment in 2016/17 which should reduce the cost of borrowing overall and reduce revenue expenditure, albeit marginally. A change to the calculation of the minimum level of debt repayable each year (MRP) has been identified as a revenue budget saving and is expected to reduce the financing costs by £5m.

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 2016-17, and estimates for 2017-18 and 2018-19. These figures include existing capital programme proposals with updated forecasts for phasing of expenditure.

	2014-15 Actual £m	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
<b>*Capital Expenditure</b>	127.02	127.90	186.92	177.14	67.24
<b>Funding sources:</b>					
Borrowing	24.30	31.13	103.79	90.70	24.10
Capital receipts	0.00	0.99	10.23	29.75	3.75
Capital grants	92.63	76.24	46.01	51.19	37.90
Revenue	10.09	19.54	26.90	5.50	1.50
<b>*Capital Financing Requirement (CFR)</b> (underlying need to borrow for capital purposes)					
Total CFR at year end	492.02	502.43	585.65	652.87	650.46
Net movement in CFR	3.78	10.41	83.22	67.22	-2.41
Minimum Revenue Provision	20.52	20.72	20.57	23.48	26.51
PFI & Leases in CFR	84.31	81.60	78.70	75.60	72.28
PFI & Leases in MRP	2.54	2.71	2.90	3.10	3.32

*(\*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.

	2014-15 Actual £m	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m
Financing costs of CFR	45.74	46.35	48.26	55.28	60.51
Net Revenue Stream* Including DSG	955.2	936.7	919.8	906.5	904.7
Percentage	4.8%	4.9%	5.2%	6.0%	6.7%
Net Revenue Stream* Excluding DSG	517.1	498.7	481.8	468.5	466.7
Percentage	8.8%	9.3%	10.0%	11.8%	13.0%

- \* Estimates of Government grants, Council Tax/Business Rates, including and excluding Dedicated Schools Grant (DSG). DSG is forecast to increase by £2m in 2016-17, 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 2016-17, together with an estimate through to 2018-19.

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 2016-17. In practice, only part of the costs are met from Council Tax.

	2016-17 £	Forward Projection 2017-18 £	Forward Projection 2018-19 £
<b>Council Tax - Band D</b>			
Existing Commitments only	4.34	10.61	0.77
Implication of new starts 2015-18	3.71	18.59	20.73
Total Commitments	8.05	29.20	21.50

2.9 Provision is made in the proposed 2016-17 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 proposed to change the policy in the near future, but the current figures have been calculated on the current 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 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 2016-17 take into account:

- (a) The estimated amount of the Capital Financing Requirement at 31 March 2016 (£502.43m). This figure takes into account approximately £30m of debt 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 by 31 March 2016 provided a mutually acceptable figure can be agreed. 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 £103.79m during 2016-17 less Minimum Revenue Provision £20.57m.
- (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 £60m should be used to cover these items.

- (d) PFI and finance leases totalling £78.70m are included in the CFR. A debt redemption value of £2.90m is calculated on these liabilities.

Based on the above, it is proposed that the authorised limit (including transferred debt & PFI) should be set at £615m for 2016-17. 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. £565m is suggested as a realistic figure for 2016-17.

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

<b>Authorised limit for external debt</b>	<b>2016-17 Estimate £m</b>	<b>2017-18 Estimate £m</b>	<b>2018-19 Estimate £m</b>
Borrowing	536	609	611
PFI liabilities	79	76	72
Total	615	685	683
<b>Operational boundary for external debt</b>	<b>2016-17 £m</b>	<b>2017-18 £m</b>	<b>2018-19 £m</b>
Borrowing	486	559	561
PFI & other long term Liabilities	79	76	72
Total	565	635	633

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 2015-16.

## **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 2016-17, 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.

The Prudential Code, Capital Programme, Treasury Management Strategy and Code of Practice on Treasury Management were considered by Cabinet on 26 January 2016 and commended to the Council.

## **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 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**

That Council approves:

- 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 2016-17 Capital Starts Programme as detailed in Appendix 1, and that further reports on the detailed schemes be brought to Council.
- 3 The MRP policy for 2016-17 as detailed in paragraph 2.10.
- 4 The Treasury Management Strategy for 2016-17 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

27 January 2016



## APPENDIX 1

## CAPITAL PROGRAMME 2016-17 NEW START PROPOSALS

Scheme	Funding arrangements						2016-17 £'000	2017-18 £'000	2018-19 £'000	Total £'000
	Total Gross Bid £'000	Grant £'000	Capital Receipts £'000	Other (eg S106) £'000	Invest to Save (borrowing funded from Rev Budget) £'000	Borrowing Requirement £'000				
<b>Children's Services</b>										
Basic need 16-17	5,503	5,503				0	1,376	3,302	825	5,503
Devolved Formula Capital	2,500	2,500				0	625	1,500	375	2,500
Schools Modernisation	9,000	9,000				0	2,250	5,400	1,350	9,000
Tibshelf Primary	7,000		3,900			3,100	1,050	3,800	2,150	7,000
Schools Capital Investment Programme	1,700					1,700	850	850	0	1,700
Schools Access initiative	800					800	480	240	80	800
Spire Lodge	1,900		100			1,800	285	1,425	190	1,900
<b>Children's Services Total</b>	<b>28,403</b>	<b>17,003</b>	<b>4,000</b>	<b>0</b>	<b>0</b>	<b>7,400</b>	<b>6,916</b>	<b>16,517</b>	<b>4,970</b>	<b>28,403</b>
<b>Adult Care</b>										
Belper Integrated Scheme	14,500				14,500	0	7,975	5,075	1,450	14,500
Adaptations	4,000					4,000	3,400	600		4,000
<b>Adult Care Total</b>	<b>18,500</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>14,500</b>	<b>4,000</b>	<b>11,375</b>	<b>5,675</b>	<b>1,450</b>	<b>18,500</b>
<b>Corporate Resources</b>										
Health & Safety/Radon/Risk Mgt/Fire Cert work/Kitchen Ventilation Schemes/Preventative work	500					500	100	250	150	500
Preventative Maintenance	600					600	300	300		600
Buxton Crescent	400		400					400		400
<b>Corporate Resources Total</b>	<b>1,500</b>	<b>0</b>	<b>400</b>	<b>0</b>	<b>0</b>	<b>1,100</b>	<b>400</b>	<b>950</b>	<b>150</b>	<b>1,500</b>

## APPENDIX 1

Scheme	Total Gross Bid £'000	Grant £'000	Capital Receipts £'000	Other (eg S106) £'000	Invest to Save (borrowing funded from Rev Budget) £'000	Borrowing Requirement £'000	2016-17 £'000	2017-18 £'000	2018-19 £'000	Total £'000
<b>Environment, Transport and Economy</b>										
Local Transport Plan	21,045	21,045				0	16,836	3,157	1,052	21,045
Land Reclamation	1,092		480	287		325	819	273		1,092
Countryside flood management	425	425				0	319	106		425
Countryside sites	370					370	278	92		370
LED street lights	16,500				16,500	0	6,100	5,775	4,625	16,500
Vehicle Replacement Programme	530				530	0	398	132		530
Elvaston Castle repairs	900					900	675	225		900
<b>Environment, Transport and Economy Total</b>	<b>40,862</b>	<b>21,470</b>	<b>480</b>	<b>287</b>	<b>17,030</b>	<b>1,595</b>	<b>25,425</b>	<b>9,760</b>	<b>5,677</b>	<b>40,862</b>
<b>Contingency</b>						0				0
<b>Total</b>	<b>89,265</b>	<b>38,473</b>	<b>4,880</b>	<b>287</b>	<b>31,530</b>	<b>14,095</b>	<b>44,116</b>	<b>32,902</b>	<b>12,247</b>	<b>89,265</b>

## **New Start Proposals**

### **Children's Services**

#### **Schools Basic Need - £5.503m**

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 - £2.5m**

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.

#### **Modernisation/Capital Maintenance (level of funding subject to confirmation) - £9.0m**

This grant allocation is to address urgent condition and suitability issues in educational properties, including projects relating to essential re-roofing, reheating, re-wiring, replacement windows, and replacement of 'buildings at risk'. A priority list of potential projects is being finalised.

#### **Tibshelf Primary - £7.0m**

At primary level, Tibshelf is served by Tibshelf Infant School, which is located on a small site adjacent to the former site of the secondary school, and Tibshelf Town End junior school which is located over half a mile away on the edge of the town. The former site of Tibshelf Secondary school is now largely surplus to the Authority's requirements. The approval of the Secretary of State is required if the Authority is proposing to sell this site. It is proposed to retain part of the site to allow Tibshelf Town End and Tibshelf Infants to be replaced by a new school on this location. Capital receipts of £3.9m from the sale of part of the secondary site and Town End school are estimated. Tibshelf Town End itself is valued at £900,000, which will need Secretary of State approval for disposal. An allocation of £3.1m gives the Authority sufficient funds to be able to propose these changes and undertake the necessary statutory consultations.

#### **Schools Capital Investment Programme - £1.7m**

There are a number of schemes that may require funding during the year. This allocation particularly relates to situations where the Authority may need to

negotiate a contribution to a school scheme being managed by an external body.

### **Schools Access Initiative (SAI) - £0.8m**

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

### **Spire Lodge - £1.9m**

Spire lodge is the poorest facility the Authority has that houses children with Disabilities. It has a backlog of maintenance in excess of £150,000. Further improvements would be required to meet current standards but there would remain fundamental deficiencies. This project is to provide a purpose built facility on a new site.

### **Adult Care**

#### **Belper Integrated Scheme - £14.5m**

This Adult Care scheme in Belper is a combined Extra Care, Specialist Residential Care, Health Centre (which is subject to consultation), Library and Adult Education scheme on Derwent Street. This development is part of the revised strategy for accommodation, care and support for older people and additionally will deliver opportunities for integrated working with health service partners, as well as interdepartmental co-operation within the Council. This scheme is due to start early in 2017.

### **Adaptations - £4.0m**

Disabled people requiring major adaptation 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**

### **Property Maintenance - £0.6m**

This allocation is required for the formation and implementation of a programme of preventative maintenance for non-schools premises with the aim of reducing future the Council's maintenance liability and running costs. Items of preventative maintenance that will be included in the programme will include:

- Replacement heating boilers and associated heating infrastructure
- Replacement of single glazed windows
- Replacement roof coverings

The Council has an estimated future maintenance liability, over the next five years, of £63.5million for its non-schools premises. The total maintenance budget allocated for expenditure on non-schools premises this financial year (2014/2015) is £8.1million. This budget amount is likely to be similar or slightly less in future years, whilst the future maintenance liability is going to increase. Pump-priming the budget for property maintenance will enable a programme of preventative maintenance to be implemented that will result in a reduction in the pressure on Council's future maintenance budget and the Council's future maintenance liability.

### **Property Health And Safety Issues - £0.5m**

#### **Health and Safety/EHO/Radon**

Works in this category are generated from a variety of sources including fire officer reports, environmental health officer reports, health and safety assessments and any other urgent safety works which may arise. Failure to comply with such reports or assessments could result in building closures or prosecutions. The category may also covers security/risk issues which occur when buildings are vacant for sale, temporarily not in use, or where

vandalism/misuse - such as squatters - is regarded as possible.

## **Risk Management**

This funding supports departments in implementing risk management initiatives usually on a 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 bulk of this funding tends to be spent on school security schemes to help protect pupils, staff and visitors. It is also used to assist in the protection of the council's assets against arson, theft and vandalism which can cause significant disruption to services.

## **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 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.

## **Kitchen Ventilation Schemes**

Following an oven back-blast, the 2010-11 Capital programme approved £3.00m to fund the first tranche of safety works to kitchens; continuing these works, a further £1.00m was approved in each of the 2011-12 and 2014-15 programmes bringing the current overall commitment to £5.00m. The aim of this budget is to upgrade kitchens to be compliant with current legislation. Engineers have already replaced most Flame Failure Devices (FFD) and installed over 60 canopies with a further 19 currently approved for installation in the near future. The 2010-11 report noted that overall the costs of completing this work programme would be in the region of £8.00m - £9.00m. The current bids to allow for this important work to continue, however, members need to be mindful that there may be future bids to continue this process.

### **Buxton Crescent - £0.400m**

Revised tenders have now been received by the developer from the main contractor. Despite intensive efforts from the developer to drive out costs, although the current figure is significantly below the previous figure it remains above the current budget. There is little likelihood of any further major reductions and any delay to start on site will only lead to further cost increases as the construction sector is currently undergoing inflationary pressure. A further contribution of £400,000 is needed, which together with contributions from the developer and HPBC, will allow the scheme to commence.

## **Economy, Transport & Environment**

### **Local Transport Plan - £21.045m**

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.

### **Land Reclamation and Markham Vale - £1.092m**

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. 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. Many hours of volunteer time are also contributed to this programme.

Funding for Markham Vale is predominantly provided through capital grants secured from a variety of external sources including D2N2 and Sheffield City Region Local Enterprise Partnerships, with the Council providing some investment.

### **Countryside flood management - £425k**

Work to Chesterfield Canal and Cromford Canal, Stockley Pond, Sett Valley Trail and Gamesley woodlands in relation to flood management. Bids to be submitted for Flood grant funding but may need borrowing if these are not successful.

### **Countryside sites, trails and facilities - £370k**

Projects at a number of sites to make the sites more desirable for recreational and visitor use, including the generation of increased revenue income.

### **LED Street Lighting - £16.5m**

A business case is currently being developed to install LED on the strategic network and using the same assumptions as the current LED programme on the non strategic network. An average monthly implementation of 600 units/month could achieve additional energy savings along the following lines assuming work can start on both projects at the same time (i.e. April 2016).

£210k by March 2017

£430k by March 2018 (£220k for the year)

£570k by March 2019 (£140k for the year)

### **Vehicle Replacement Programme - £530k**

The bid is for Winter Maintenance vehicles that are due for replacement. The investment will bring the fleet back to a standard that minimises inefficient maintenance costs.

### **Elvaston Castle - £900k**

Capital repair works to address major health and safety concerns for the public and to facilitate economic development through regeneration and help move us towards the target of economic sustainability at Elvaston Castle. Repairing the historic garden walls would free up the areas in question to be used for weddings and other events and the revenue potential here is considerable. ETE are in the process of inviting tenders for these services but the wall safety issues and the temporary fencing are likely to cause major problems in marketing this successfully. In the case of the failing top stable yard roofs, repair of these would render the existing accommodation economically viable for mixed office/retail development conversion thus kick-starting regeneration of the Elvaston core area. This would also provide the basis for developing DCC's track record necessary in resubmitting a major HLF funding bid for repair and conversion of the currently unoccupied Grade II\* listed castle.

## **Corporate**

### **Development Company**

Cabinet has approved, subject to the production of a satisfactory business case, the establishment of a Development Company.



Initially the company will develop housing for sale or rent on land currently owned by the County Council. The business case will consider how the company, and therefore, the developments will be funded, and whilst as yet nothing has been incorporated in the new starts for 2016-17 the intention would be to bid for funding once the business case is approved.

**DERBYSHIRE COUNTY COUNCIL**

**TREASURY MANAGEMENT  
STRATEGY 2016-17**

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## 1 Introduction

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.

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.

## 2 External Context

### External Context

**Economic background:** Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in November. Wages are growing at 2.4% a year, and the unemployment rate has dropped to 5.2%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 82nd consecutive month at its meeting in December 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.

The outcome of the UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. In December 2015, the Federal Reserve finally raised US policy rates by 0.25%. The accompanying statement emphasised that money tightening would be gradual and data dependent. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

**Credit outlook:** The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

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 UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. 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 remain stubbornly low.

**Interest rate forecast:** The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.

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 0.75% and that new long-term loans will be borrowed at an average rate of 3.5%.

### 3 Local Context

The Authority currently has £385m of external borrowing and £319m of investments. The Authority's net debt position is detailed in Table 1.

**Table 1 – Existing Borrowing & Investment Portfolio**

	<b>31.12.15 Actual Portfolio £m</b>	<b>31.12.15 Average Rate %</b>
<b>External Borrowing:</b>		
PWLB – Fixed Rate	332	4.79
LOBO Loans	28	4.69
Temporary Loans (D2N2)	25	0.75
<b>Total External Borrowing</b>	<b>385</b>	<b>4.52</b>
<b>Investments:</b>		
Managed in-house:		
Short-term investments	248	0.71
Long-term investments	36	1.61
Managed externally:		
Money market funds	30	0.59
Pooled Funds	5	4.72
<b>Total Investments</b>	<b>319</b>	<b>0.87</b>
<b>External Borrowing less Investments</b>	<b>66</b>	
<b>Other Long Term Liabilities:</b>		
PFI	80	
Finance Leases	5	
Transferred Debt In (Derby City)	4	
<b>Total Other Long Term Liabilities</b>	<b>89</b>	
Less Transferred Debt (Derby City)	(33)	
<b>Net Debt Position</b>	<b>122</b>	

**Table 2 - Balance Sheet Summary and Forecast**

	<b>31.3.15 Actual £m</b>	<b>31.3.16 Estimate £m</b>	<b>31.3.17 Estimate £m</b>	<b>31.3.18 Estimate £m</b>	<b>31.3.19 Estimate £m</b>
<b>Capital Financing Requirement (CFR)</b>	492	502	586	653	650
Less: Other debt liabilities * (Excludes D2N2)	-89	-86	-83	-80	-76
<b>Borrowing CFR</b>	<b>403</b>	<b>416</b>	<b>503</b>	<b>573</b>	<b>574</b>
Less: External borrowing **	365	350	337	332	324
<b>Internal borrowing***</b>	<b>38</b>	<b>66</b>	<b>166</b>	<b>241</b>	<b>250</b>
Less: Usable reserves	-260	-195	-152	-101	-90
Less: Working capital	-33	-33	-33	-33	-33
<b>Investments (Borrowing)</b>	<b>255</b>	<b>162</b>	<b>19</b>	<b>-107</b>	<b>-127</b>

\* Other debt liabilities comprise of PFI liabilities (£80m), Finance Leases (£5m) and Transferred Debt (£4m).

\*\* Derby City Council is considering repayment of £30m of transferred debt.

\*\*\* 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 use internal borrowing to maintain borrowing and investments below their underlying levels, subject to holding a minimum investment balance of £30m (1 month's salaries).

The Authority has an increasing CFR due to the capital programme. Investments are forecast to reduce to £19m by 31 March 2017, as capital receipts are used to finance capital expenditure and usable reserves are utilised to finance the revenue budget.

The Authority may need to increase the internal borrowing limit or alternatively take additional external borrowing to fund the CFR by 31 March 2017.

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 2016-17.



## 4 Borrowing Strategy

At 31 December 2015, the Authority held £360m of fixed term loans, with a further £10m to be repaid on 31 March 2016 (£365m 31 March 2015) as part of its strategy for funding previous years' capital programmes (a temporary revenue loan of £25m from D2N2 is excluded). The balance sheet forecast in Table 2 shows that the Authority will require additional borrowing (external or internal) in 2016-17. The Authority may also borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £615m.

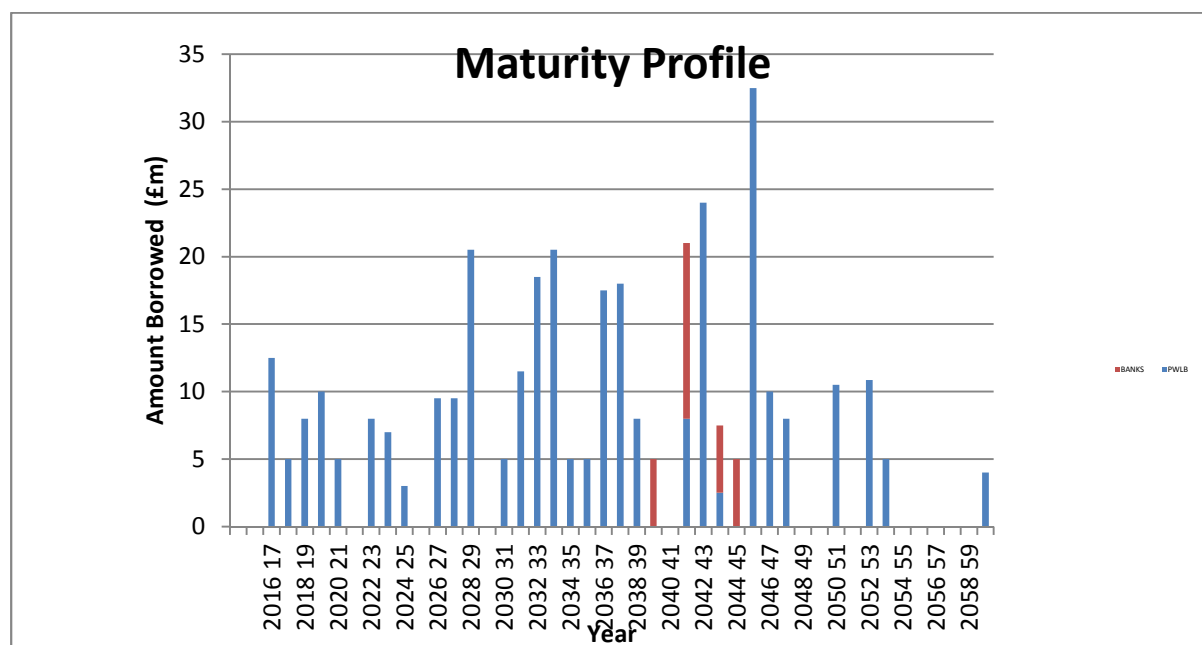
**Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans 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. 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 2016-17 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Authority may borrow short-term loans (normally for up to 35 days) to cover unexpected cash flow shortages.

The Authority's maturity profile at 31 March 2016 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 redemptions is desirable.



The average redemption per year is £8.0m (2.3%) of the total debt, with a maximum redemption of £32.5m (9.3%) 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
- Other UK Local Authorities
- Banks or Building Societies 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)

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**

In December 2014, the CLG announced HM Treasury would take the necessary steps to abolish the PWLB. The CLG have stated it 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.

**LGA 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 £28m 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 5 LOBOs have options during 2016-17, 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.

**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 past 12 months, the Authority's investment balance has ranged between £270 million and £394 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.

**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 2016-17. 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 substantial change in strategy over the coming year, although remaining within the current Treasury Management approvals.

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

**Table 3: Approved Investment Counterparties and Limits**

<b>Credit Rating*</b>	<b>UK Banks**</b>	<b>Non UK Banks***</b>	<b>Government Other LA's</b>	<b>Corporates</b>	<b>Registered Providers</b>
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£30m + £10m 5 years	£10m + £10m 5 years	£50m + £10m 25 years	£10m + £10m 5 years	£10m + £10m 5 years
AA+	£30m + £10m 5 years	£10m + £10m 5 years	£50m + £10m 20 years	£10m + £10m 5 years	£10m + £10m 5 years
AA	£30m + £10m 4 years	£10m + £10m 4 years	£50m + £10m 15 years	£10m + £10m 4 years	£10m + £10m 4 years
AA-	£30m + £10m 3 years	£10m + £10m 3 years	£50m + £10m 10 years	£10m + £10m 3 years	£10m + £10m 3 years
A+	£30m + £10m 2 years	£10m + £10m 2 years	£25m + £10m 5 years	£10m + £10m 2 years	£10m + £10m 2 years
A	£30m + £10m 13 months	£10m + £10m 13 months	£25m + £10m 5 years	£10m + £10m 13 months	£10m + £10m 13 months
A-	£30m + £10m 6 months	£10m + £10m 6 months	£25m + £10m 5 years	£10m + £10m 6 months	£10m + £10m 6 months
BBB+	£10m + £10m 100 days	n/a	£10m + £5m 13 months	£5m + £5m 100 days	£5m + £5m 100 days
BBB or BBB-	£10m + £10m next day only	n/a	n/a	n/a	n/a
None (Challenger Banks & Unrated Building Societies	£1m 6 months	n/a	n/a	n/a	n/a
Pooled funds	£20m + £10m per fund				

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

The proposed Treasury Management strategy is also designed to accommodate the requirements of the Pension Fund (£10m per counterparty). The counterparty limits will be segmented into County and Pension fund. This may require a period of transition until the individual cash requirements of the Pension Fund are ascertained.

Approval to adopt this strategy is obtained from the Pensions and Investments Committee.

- \* **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.

The credit ratings in the table above are based upon Fitch's Credit Ratings (as an example). These ratings are explained in further detail in Appendix A.

The current credit ratings of the main UK High Street banks and building societies for all 3 credit rating agencies are shown in Appendix B.

**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. Unsecured investments with banks rated BBB or lower are restricted to overnight deposits at the Authority's current account banks (Lloyds Bank (main) and Barclays Bank (contingency)).

**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+). Unsecured investment with banks rated BBB+ or lower are restricted to overnight deposits at the Pension Funds custodian banks (BNP Paribas/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. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- \*\* Lloyds Bank covered bond (secured by collateral) is rated at AAA by Fitch, whilst an unsecured bank deposit is rated as A+ (5 notches below).
- \*\*\* Bank of Nova Scotia (Canadian) covered bond (secured by collateral) is rated at AAA by Fitch, whilst an unsecured bank deposit is rated as AA- (4 notches below).

**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 (£118m at 31 December 2015). The Authority will distinguish between Upper Tier (Counties, Unitaries, London Boroughs, Scottish, Welsh & Northern Irish) and Lower Tier (Boroughs & Districts) Authorities. Investments to Fire, Police, Transport and Local Authority Pension funds will also be considered.

**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. Money Market Funds that offer same-day liquidity and aim for a constant net asset value 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.

### **The Council's Main Bank Account - Lloyds Bank**

It is requested that the additional limit of £20m for operational and transactional purposes at the Council's main bank should be increased to £30m to cover D2N2 LEP. These deposits are to the next banking day only.



## **The Pension Fund's Custodian Account - BNP Paribas (formerly BNY Mellon)**

It is requested that the limit of £20m for operational and transactional requirements at BNP Paribas be increased by £10m to £30m (overnight).

It is requested that the additional limit of US\$20m for Wellington (the US Fund Manager) at BNP Paribas be amended to the US\$ equivalent of £20 million (overnight).

It is requested to maintain the £1m limit at BNY Mellon until the Pension Fund's account with the previous custodian is closed.

## **D2N2 Local Economic Partnership**

The Council has successfully tendered to be the accountable body for the D2N2 LEP. It is recommended that the £20m deposit limit with the Council be increased to £60m. This limit will be kept under review as the role of accounting body develops.

**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 approved investment criteria 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 those:

- 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 4 below.

**Table 4: Non-Specified Investment Limits**

	<b>Cash limit</b>
Total long-term investments	£100m
Total investments without credit ratings or rated below A-	£50m
The Pension Fund's Custodian Bank (BNP Paribas) In House £20m, Wellington US\$ 20m	£30m + £20m US\$ equivalent
Total non-specified investments	£200m

**Investment Limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £195m on 31 March 2016. 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 (other than the UK Government) will be £30m County fund plus £10m Pension fund and accrued interest.

- \* The Council's principle bankers (Lloyds) have an additional £20m available (overnight) for operational and liquidity purposes. A further £10m limit is requested for the operational and liquidity purposes of D2N2 (overnight).

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:

**Table 5: Investment Limits**

	<b>Cash limit</b>
UK Central Government	Unlimited
Any single organisation, except the UK Central Government	£30m + £10m each
Any group of organisations under the same ownership	£30m + £10m per group
Any group of pooled funds under the same management	£20m + £10m per manager
Negotiable instruments held in a broker's nominee account	£100m per broker
Foreign countries	£100m + £100m in total
Registered Providers	£50m in total
Unsecured investments with Building Societies	£100m + £50m in total
Loans to unrated bodies	£10m in total
Money Market Funds	£100m + £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	2015-16	2016-17	2017-18
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	40%	40%	40%

Investments	2015-16	2016-17	2017-18
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 the whole financial year. Instruments that mature during the financial year 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 date when repayment of the loan is due. The Authority £28m of LOBO loans mature between 2039 and 2045. The Authority will repay this borrowing early if the opportunity to do so at no additional cost arises.

**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:

	2016-17	2017-18	2018-19
Limit on principal invested beyond year end	£100m	£100m	£100m

## 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 regularly.

**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 £615m. 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 2016-17 is £1.3m, based on an average investment portfolio of £175m at an interest rate of 0.75%. The forecast for debt interest paid in 2016-17 is £16.3m, based on an average debt portfolio of £350m at an average interest rate of 4.65%. 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

## Interest Rate Forecast - Arlingclose (November 2015)

## Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
<b>Official Bank Rate</b>													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
<b>3-month LIBID rate</b>													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
<b>1-yr LIBID rate</b>													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
<b>5-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
<b>10-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
<b>20-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
<b>50-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

**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 &amp; Building Societies

## Long Term Ratings

## a) UK Banks

Counterparty	Credit Rating Agency			Limit
	Fitch	Moody's	S&P	£m
Barclays	A	A2	A-	30
Close Brothers	A	AA3	n/a	30
HSBC	AA-	Aa2	AA-	30
Lloyds	A+	A1	A	30
Nat West	BBB+	A3	BBB+	10
Santander UK	A	A1	A	30
Standard Chartered	A+	AA2	A+	30
Yorkshire	A	Baa1	BBB+	10

## 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	A1	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.