

DERBYSHIRE COUNTY COUNCIL

COUNCIL

4 February 2015

**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, including:

- The capital starts programme for 2015-16.
- The Minimum Revenue Provision (MRP) policy for 2015-16.
- A Treasury Management Strategy for 2015-16.
- 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 is 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. 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 £45m to address key issues in highways maintenance, develop integrated transport schemes and address the most immediate condition problems in schools. Funding for a new school at Hadfield from a combination of grant, capital receipts and borrowing, and 2 other school projects are also proposed.

Other major schemes included are further expansion at MEGZ, largely funded by grant with the potential for further capital receipts and a major re-organisation of accommodation in the Ripley/Alfreton/Belper area funded by a combination of capital receipts and revenue savings.

The proposed new starts programme for 2015-16, as shown in Appendix 1, has been evaluated and is recommended to proceed. 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 2015-16, and estimates for 2016-17 and 2017-18. These figures include existing capital programme proposals with updated forecasts for phasing of expenditure.

	2013-14 Actual £m	2014-15 Estimate £m	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m
*Capital Expenditure	85.95	126.17	185.09	160.84	71.73
Funding sources:					
Borrowing	12.33	33.81	78.18	78.91	32.16
Capital receipts	1.16	0.00	5.91	28.18	10.75
Capital grants	54.19	78.12	80.94	43.03	26.78
Revenue	18.27	14.24	20.06	10.72	2.04
*Capital Financing Requirement (CFR) (underlying need to borrow for capital purposes)					
Total CFR at year end	488.24	501.52	558.61	614.04	620.40
Net movement in CFR	-8.67	13.28	57.09	55.43	6.36
Minimum Revenue Provision	21.01	20.52	21.09	23.47	25.80
PFI & Leases in CFR	86.89	84.31	81.60	78.70	75.60
PFI & Leases in MRP	2.37	2.53	2.71	2.90	3.10

*(*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.

	2013-14 Actual £m	2014-15 Estimate £m	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m
Financing costs of CFR	47.04	45.93	48.16	53.58	57.91
Net Revenue Stream* Including DSG	964.9	941.9	944.9	927.0	928.5
Percentage	4.9	4.8	5.1	5.7	6.2
Net Revenue Stream* Excluding DSG	530.2	511.9	495.9	478.0	479.5
Percentage	8.9	9.0	9.7	11.2	12.1

- * Estimates of Government grants, Council Tax/Business Rates, including and excluding Dedicated Schools Grant (DSG). DSG is forecast to increase by £19m in 2015-16, largely due to national changes/extra funding announced in July 2014, and then will remain stable thereafter. 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 2015-16, together with an estimate through to 2017-18.

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 2015-16. In practice, only part of the costs are met from Council Tax.

	2015-16 £	Forward Projection 2016-17 £	Forward Projection 2017-18 £
Council Tax - Band D			
Existing Commitments only	8.26	17.01	9.86
Implication of new starts 2015-18	1.30	6.14	8.50
Total Commitments	9.56	23.15	18.36

2.9 Provision is made in the proposed 2015-16 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 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 2015-16 take into account:

- (a) The estimated amount of the Capital Financing Requirement at 31 March 2015 (£501.52m). This figure takes into account debt which the Council services on behalf of Derby City Council (approx £31.2m), which arose before Local Government Reorganisation. Derby City is recharged the relevant loan charges. 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 £78.18m during 2015-16 less Minimum Revenue Provision £21.09m.
- (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 £20.0m should be used to cover these items.
- (d) PFI and finance leases totalling £81.6m are included in the CFR. A debt redemption value of £2.71m is calculated on these liabilities.

Based on the above, it is proposed that the authorised limit (including transferred debt & PFI) should be set at £587m for 2015-16. 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. £537m is suggested as a realistic figure for 2015-16.

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

Authorised limit for external debt	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m
Borrowing	505	566	576
PFI liabilities	82	79	76
Total	587	645	652
Operational boundary for external debt	2015-16 Estimate £m	2016-17 Estimate £m	2017-18 Estimate £m
Borrowing	455	516	526
PFI & other long term liabilities	82	79	76
Total	537	595	602

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 2014-15.

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 2015-16, which incorporates these requirements, is attached as Appendix 3. The main changes to the previous strategy are the additional categories of approved borrowers (UK public and private sector pension funds, the Local Capital Finance Company, and the D2N2 Local Economic Partnership) and approved investment categories (secured loans to banks and building societies, Corporate Bonds, Other Pooled Funds, Challenger banks/ unrated building societies and D2N2 LEP). In practice it is expected that the Authority will primarily use existing

borrowers and investors, but the inclusion of these additional categories provides flexibility and resilience.

Clauses to be formally adopted

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

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

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

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity; human resources, environmental, health, 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 2015-16 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 2015-16 as detailed in paragraph 2.10.

4. The Treasury Management Strategy for 2015-16 as described in Appendix 3, and taking into account the guidance issued by the CLG as described in paragraph 9(b) 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

JEREMY GOACHER
Director of Property

22 January 2014

Capital Programme 2015/16 Starts Proposed Approvals		Gross Cost £000s	Grant £000s	Net Cost £000s	RCCO/ Reserves £000s	Capital receipts £000s	Borrowing £000s
CAYA							
	Basic Need	5,240	5,240	-	-	-	-
	Schools Modernisation	12,500	12,500	-	-	-	-
	Glossopdale:Hadfield Scheme	17,000	4,300	12,700		9,000	3,700
	Bingham House	1,200	-	1,200	-	-	1,200
	Breadsall & Bennerley	4,750	-	4,750	-	3,550	1,200
	Schools Access Initiative	800	-	800	-	-	800
	Devolved Formula Capital	2,700	2,700	-	-	-	-
	Sub total	44,190	24,740	19,450	-	12,550	6,900
Adult Care							
	Adaptations	4,000	-	4,000	-	-	4,000
	Sub total	4,000	-	4,000	-	-	4,000
Corporate							
	Replacement vehicles	3,000	-	3,000	-	-	3,000
	Bolsover/Clowne reorganisation	140	-	140		140	-
	County Hall remodelling	340		340			340
	County Hall Reroofing & Refurbishment	2,000	-	2,000	-	-	2,000
	Glossop Reorganisation	40	-	40		40	-
	Ripley/Alfreton/Belper Reorganisation	6,000	-	6,000	-	2,610	3,390
	Buxton Crescent	2,700	-	2,700	-	2,700	-
	Sub total	14,220	-	14,220	-	5,490	8,730
Corporate Resources							
	H & S/EHO/Radon/Depots/Demols	150	-	150	-	-	150
	Risk Management	250	-	250	-	-	250
	Fire certificate work	750	-	750	-	-	750
	Kitchen Ventilation schemes	1,000	-	1,000	-	-	1,000
	Sub total	2,150	-	2,150	-	-	2,150

				Public		
Capital Programme 2015/16 Starts Proposed Approvals	Gross Cost £000s	Grant £000s	Net Cost £000s	RCCO/ Reserves £000s	Capital receipts £000s	Borrowing £000s
Economy, Transport & Environment						
Local Transport Plan	22,624	22,624	-	-	-	-
Land Reclamation	1,165	820	345	-	-	345
MEGZ	8,740	6,540	2,200	-	-	2,200
Sub total	32,529	29,984	2,545	-	-	2,545
Health & Communities						
Belper Library	268	-	268	-	-	268
Contingency	500	-	500		-	500
Total	<u>97,857</u>	<u>54,724</u>	<u>43,133</u>	<u>-</u>	<u>18,040</u>	<u>25,093</u>

New Start Proposals

Children and Younger Adults

Schools Basic Need

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.

Modernisation/Capital Maintenance (level of funding subject to confirmation)

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

Glossopdale: Hadfield Site

Glossopdale is a school with buildings on three separate sites. Overall the school has around 40% spare capacity and the buildings are in very poor condition with a backlog of maintenance of £5.4m. This funding along with previous allocations, land sales and other resources will allow a complete new school to be provided on the school's largest site in nearby Hadfield. A business case has established the benefits of this scheme.

Bingham House

Bingham House is a DCC building situated on the Alfreton Park special school site; it is currently leased to the Health Authority who no longer have a use for the building. The main school has less than 50% of the recommended floor area for a school with the current number of pupils and is in poor condition. Funding would allow the refurbishment of Bingham House for use by Alfreton Park and would nearly double the area available, potentially enable it to take additional students. The increase in capacity created by this development may also create future savings by reducing the likelihood of the need to purchase expensive out of county SEN places.

Breadsall and Bennerley

This is a complex scheme involving two related projects. Breadsall Primary School has significant condition issues as well as no hall and no on site playing fields. It is proposed to transfer this school into the building currently occupied by the Erewash PRU. This will give it good quality accommodation

with on-site playing fields. The PRU will move to the site of the former Bennerley School in Ilkeston. The main building and playing fields will be retained. A significant investment will take place that will provide good quality accommodation for the PRU as well as supporting some co-location of DCC services such as the MAT team and the Support Service Special Educational Needs team (SSSN). The building will include in a hall which will be available to the community for lettings/performances etc. At both locations there will be land disposals of parts of the sites to help fund the schemes.

Schools Access Initiative (SAI)

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.

Devolved Formula Capital

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.

Adult Care

Adaptations

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

Vehicle Replacement Programme

The programme has been developed based mainly on the age factor of the fleet. Decisions taken over the last 5 or so years to delay replacements based on service re-design and lower than expected annual mileages are taking their toll, resulting in the vehicles becoming less economical to maintain, more unreliable and expensive to operate when based on the benefits of new vehicles with their new technologies. In some cases the older vehicles are becoming less fit for purpose. The investment will bring the Council's vehicle fleet back to a standard that minimises inefficient maintenance costs.

Office Rationalisation in Bolsover and Clowne

This scheme involves rationalising office space in Bolsover and North East Derbyshire in order to improve service delivery and generate revenue savings. This capital bid is for the initial one off set up costs required to bring the scheme to fruition. The proposal to rationalise office accommodation in Bolsover and Clowne by leasing in space at the Ark, Clowne (owned by Bolsover District Council) to enable the vacation of Oxcroft House, Bolsover and Southgate House, Eckington was approved at Cabinet on 20 January 2015.

County Hall Accommodation Remodelling

This scheme involves implementing new ways of working with employees based at County Hall, Matlock, in order to maximise the use of space at County Hall to facilitate the vacation and demolition of the Adult Care Block by 31 December 2015 in order to comply with the conditions of the temporary planning permission. This capital bid is for the initial one off set up costs required to bring the scheme to fruition. The revenue expenditure associated with the implementation of the scheme was approved by Cabinet on 20 January 2015.

County Hall re-roofing and remodelling

The pitched and flat roof coverings over the south east corner of the main building of County Hall currently occupied by Legal, Pensions and CAYA are in poor condition exhibiting structural problems and showing numerous areas

of water penetration. The ornate timber roof lanterns are also in urgent need of attention.

In addition, the electrical wiring within the area occupied by Legal is in poor condition and requires replacement. This issue has been picked up by the Council's building insurers who have deemed the standard unacceptable and asked for this work as part of an ongoing phased re-wire throughout County Hall. Included as part of the rewiring project is a small amount of internal refurbishment/rationalisation intended to achieve improved occupancy. This work can be co-ordinated with the renewal of the roof coverings.

The planning permission for the temporary building occupied by Adult Care expires at the end of 2015 when the building has to be demolished. The re-roofing and refurbishment of the south east area will create additional accommodation to help facilitate this relocation of staff.

Office Rationalisation in Glossop

This scheme involves rationalising office space and some front line service delivery space in Glossop in order to improve service delivery and generate revenue savings. This capital bid is for the initial one-off set up costs required to bring the scheme to fruition. The proposal to rationalise office accommodation and front line service delivery space in Glossop by leasing in space at Municipal Buildings in Glossop (owned by High Peak Borough Council) to enable the vacation of the High Peak Social Services Area Sub-Office on Talbot Street and the existing Register Office on High Street East in Glossop was approved at Cabinet on 20 January 2015.

Office Rationalisation in Alfreton, Belper and Ripley

This scheme involves rationalising office space and some front line service delivery space in Alfreton, Belper and Ripley in order to improve service delivery and generate revenue savings. This capital bid is for the initial one-off set up costs required to bring the scheme to fruition; financing costs will be met from savings generated.

Buxton Crescent

Cabinet agreed, in principle, in January 2014 to identify £8 million in the Council's capital programme to enable a loan to be made to the developers of the Buxton Crescent Project in the event that the developers were unable to secure private sector debt financing. (Minute number 34/14 refers.) The developers have since confirmed the unavailability of bank finance. As a result of the increased costs of the proposed project, the spa and hotel development works have increased to £17.7 million. BCHTS Co have requested that the value of the loan from the County Council is increased to £10.7 million with the remaining £7 million being funded by private equity from CP Holdings and the Trevor Osborne Property Group.

A full update report on Buxton Crescent was considered by Cabinet on 20 January 2015.

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, 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. In some cases, the budget may cover urgent demolition work.

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 bid of £1.00m is to allow for this important work to continue, however, members need to be mindful that there may be future bids to continue this process.

Economy, Transport & Environment

Local Transport Plan

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

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. It is anticipated that the Council contribution of £325,000 will lever in an additional £820,000 to fund projects. 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.

Markham Vale

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. It is anticipated that the Council contribution of £2.22m, some of which is likely to be reimbursed through land sales, will lever in an additional £6.54m to fund projects.

Health and Communities

Belper Library

Shortfall in funding from the previously approved Belper Library capital programme allocation, part of which was used towards funding the replacement Heanor Library as approved by Cabinet on 15 April 2014.

Contingency

The contingency sum is for unforeseen, essential works which may arise during the year.

DERBYSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT STRATEGY 2015-16

1	Introduction	1
2	External Context	2
3	Local Context	4
4	Borrowing Strategy	5
5	Investment Strategy	10
6	Treasury Management Indicators	17
7	Other Items	19
Appendix A	Credit Ratings	21
Appendix B	UK High St Banks & Building Societies Long Term Ratings	22
Appendix C	Clauses to be Adopted	23
Appendix D	Treasury Management Practices	24
Appendix E	Treasury Management Policy Statement	25

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 2011 Edition* (the CIPFA Code) 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

Economic background: There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of Gross Domestic Product (GDP). However, inflationary pressure is benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

The Monetary Policy Committee (MPC)'s focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings August 2014 onwards, some Committee members have become more concerned that the economic outlook is less optimistic than at the time of the August *Inflation Report*.

Credit outlook: The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The *Bank Recovery and Resolution Directive* promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast *Deposit Guarantee Schemes Directive* includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, **the credit risk associated with making unsecured bank deposits will increase** relative to the risk of other investment options available to the Authority.

Interest rate forecast: The Authority's treasury management advisor Arlingclose forecasts the first rise in official interest rates in Q3 2015 and a gradual pace of increases thereafter, with the average for 2015-16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.50%, and that new long-term loans will be borrowed at an average rate of 3.25%.

3 Local Context

The Authority currently has £370m of external borrowing and £280m of investments. This is set out in further detail in Table 1 below.

Table 1 – Existing Borrowing & Investment Portfolio

	31.12.14 Actual Portfolio £m	31.12.14 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	342	4.82
LOBO Loans	28	4.63
Total External Borrowing	370	4.81
Other Long Term Liabilities:		
PFI	79	
Finance Leases	5	
Total Gross External Debt	454	
Total Investments	280	0.68
Net Debt Outstanding	174	
Less Transferred Debt Out	-33	
Plus Transferred Debt In	4	
Net Debt Actual	145	

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

4 Borrowing Strategy

At 31 December 2014, the Authority held £370m of loans (a decrease of £25m from 31 March 2014) as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 2 shows that the Authority does not expect to borrow in 2015-16. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £587m.

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 2015-16 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 one month) to cover unexpected cash flow shortages.

Table 2 - Balance Sheet Summary and Forecast

	31.3.14 Actual £m	31.3.15 Estimate £m	31.3.16 Estimate £m	31.3.17 Estimate £m	31.3.18 Estimate £m
General Fund CFR	488	502	559	614	620
Less: Other debt liabilities *	-87	-84	-82	-79	-76
Borrowing CFR	401	418	477	535	544
Less: External borrowing	395	365	350	338	333
Internal borrowing	6	53	127	197	211
Less: Usable reserves	-172	-151	-125	-103	-97
Less: Working capital	-49	-49	-49	-49	-49
Investments	215	147	47	-45	-65

* Finance leases and PFI liabilities that form part of the Authority's debt

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 £100m (approximately 20% of CFR). Table 2 forecasts internal borrowing in excess of the 25% internal borrowing limit by 2016-17. This may require the Authority to either take external debt or amend the internal borrowing limit.

The Authority has an increasing CFR due to the capital programme. Investments are forecast to fall to £0 as capital receipts are used to finance capital expenditure and the various reserves are utilised for the purpose for which they were established.

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 2015-16.

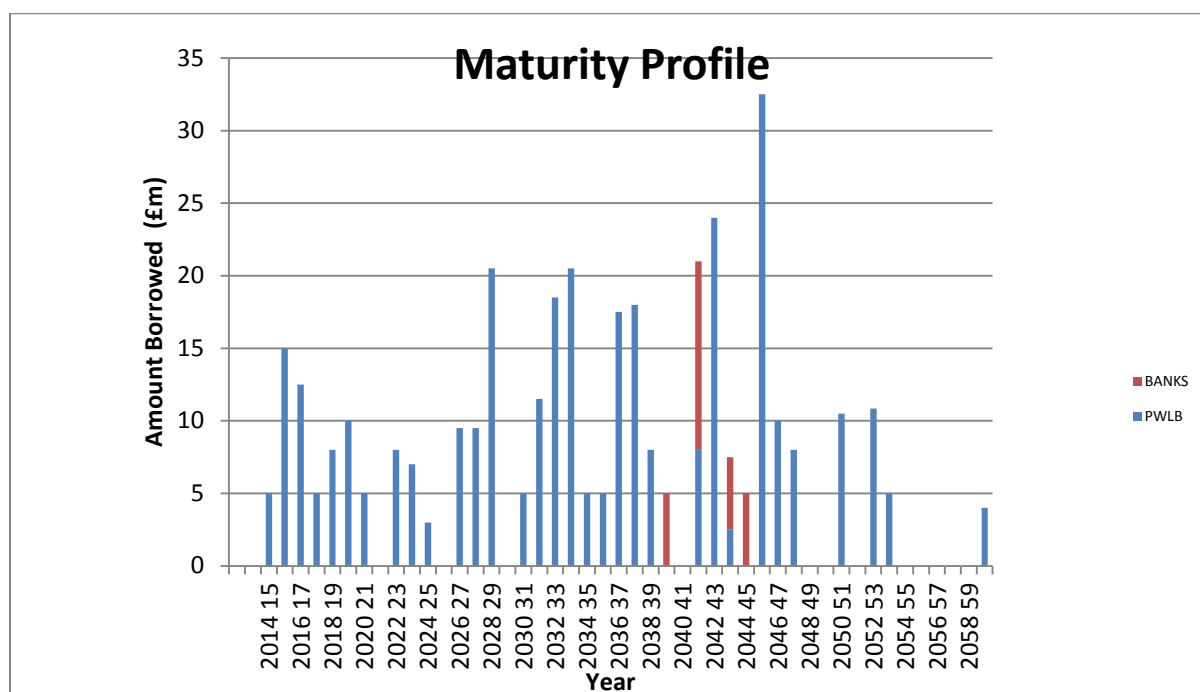
To assist with its long-term treasury management strategy, the Authority and its advisers have created a liability benchmark, which forecasts the Authority's need to borrow over a 50 year period. Following on from the medium term forecasts in table 2 above, the benchmark assumes:

- capital expenditure funded by borrowing of £25m a year
- minimum revenue provision on new capital expenditure based on a 25 year asset life
- income and expenditure increase by 2.5% inflation a year

- reserves reduce by £150 million as they are utilised then increase with inflation

The Authority has scope to continue to finance new capital expenditure from internal resources for the immediate future. The strategy to do so will be tempered by assumptions regarding the relative costs of internal/external borrowing, which will fluctuate during the time frame (see below).

The Authority's maturity profile at 31 March 2015 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 £8.3m (2.3%) of the total debt, with a maximum redemption of £32.5m (8.9%) 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)
- Other 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
- **Local Capital Finance Company** and other special purpose companies created to enable local authority bond issues

- **D2N2 Local Economic Partnership**
- Internal borrowing (as described above)

NB: The newly proposed sources of finance are highlighted in bold.

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: Local Capital Finance Company 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 three 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; and up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency's capital strength instead. 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 of these LOBOS have options during 2015-16, 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 £277 million and £440 million, and similar levels are expected to be maintained 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 2015-16. This is especially the case for the estimated £100m that is available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will therefore represent a substantial change in strategy over the coming year, although remaining within the current Treasury Management approvals.

The proposed Treasury Management strategy is also designed to accommodate the requirements of the Pension Fund. Approval to adopt this strategy is obtained from the Pensions and Investments Committee.

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

Credit Rating*	UK Banks Unsecured	UK Banks Secured	Non UK Banks	Government Other LA's	Corporates	Registered Providers
UK Govt	n/a	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£30m 5 years	£30m 20 years	£10m 5 years	£50m 25 years	£10m 20 years	£10m 20 years
AA+	£30m 5 years	£30m 10 years	£10m 5 years	£50m 20 years	£10m 10 years	£10m 10 years
AA	£30m 4 years	£30m 5 years	£10m 4 years	£50m 15 years	£10m 5 years	£10m 10 years
AA-	£30m 3 years	£30m 4 years	£10m 3 years	£50m 10 years	£10m 4 years	£10m 10 years
A+	£30m 2 years	£30m 3 years	£10m 2 years	£25m 5 years	£10m 3 years	£10m 5 years
A	£30m 13 months	£30m 2 years	£10m 13 months	£25m 5 years	£10m 2 years	£10m 5 years
A-	£30m 6 months	£30m 12 months	£10m 6 months	£25m 5 years	£10m 12 months	£10m 5 years
BBB+	£10m 100 days	£10m 6 months	n/a	n/a	n/a	n/a
BBB or BBB-	£10m next day only	£10m 100 days	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	n/a
Pooled funds		£20m per fund				

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

***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 investment with banks rated

BBB or lower are restricted to overnight deposits at the Authority's current account banks (Lloyds Bank/Co-op Bank).

UK 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.

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. Unsecured investment with banks rated BBB or lower are restricted to overnight deposits at the Pension Funds custodian banks (BNP Paribas/BNY Mellon).

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 (£239m at 31 December 2014). 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, Waste 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 (formerly Co-op Bank)

It is requested that the additional limit of £10m for operational and transactional purposes at the Council's main bank should be increased to £20m for overnight deposits only.

It is requested that a £1m limit for the Co-op Bank for operational and transactional purposes remains until the Council's accounts are closed.

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

The limit of £20m for overnight deposits at the Pension Fund's In House custodian account should be maintained for operational and transactional purposes only.

It is requested that an additional limit of US\$20m is approved at BNP Paribas for the operational and transactional requirements of Wellington (the US Fund Manager) for overnight deposits only.

It is requested that a £1m limit for BNY Mellon for operational and transactional purposes remains until the Pension Fund's account is closed.

D2N2 Local Economic Partnership

The Council has successfully tendered to be the accountable body for the D2N2 LEP. It is recommended that a limit of £20m be approved for deposits placed with the Council. 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 approved rating criteria, 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

	Cash limit
Total long-term investments	£100m
Total investments without credit ratings or rated below A-	£100m
The Pension Fund's Custodian Bank (BNP Paribas) In House £20m, Wellington US\$ 20m	£20m + US\$ 20m
Total non-specified investments	£220m + US\$ 20m

Investment Limits: The Authority's revenue reserves available to cover investment losses are forecast to be £276m on 31 March 2015. In order that no more than approximately 10% 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 +accrued interest.

* The Council's principle bankers (Lloyds) have an additional £20m limit available (overnight) for operational and liquidity purposes.

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

	Cash limit
UK Central Government	Unlimited
Any single organisation, except the UK Central Government	£30m each
Any group of organisations under the same ownership	£30m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£200m per broker
Foreign countries	£100m in total
Registered Providers	£50m in total
Unsecured investments with Building Societies	£50m in total
Loans to unrated bodies	£10m in total
Money Market Funds	£200m 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 1 month	£50m

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 borrowing is the earliest date on which the lender can demand repayment.

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

	2015-16	2016-17	2017-18
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, 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 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.

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 £587 million. 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 2015-16 is £1.5 million, based on an average investment portfolio of £300m at an interest rate of 0.50%. The forecast for debt interest paid in 2015-16 is £17.5 million, based on an average debt portfolio of £365 million at an average interest rate of 4.80%. 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

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.

UK High St Banks & Building Societies Long Term Ratings

a) UK Banks

Counterparty	Credit Rating Agency			Limit
	Fitch	Moody's	S&P	£m
Barclays	A	A2	A	30
Co-operative Bank	B	Caa2	n/a	1
HSBC	AA-	Aa3	AA-	30
Lloyds				30
Bank of Scotland	A	A1	A	
Lloyds Bank	A	A1	A	
National Australia Bank				
Clydesdale Bank Yorkshire Bank	Baa2	A	BBB +	10
Royal Bank of Scotland				30
Royal Bank of Scotland	A	Baa1	A-	
Nat West	A	Baa1	A-	
Santander UK	A	A2	A	30
Standard Chartered Bank	AA-	A1	A+	30

b) UK Building Societies

Building Society	Long term			Limit
	Fitch	Moody's	S&P	£m
Coventry	A	A3	n/a	10
Leeds	A-	A3	n/a	10
Nationwide	A	A2	A	30
Yorkshire	A-	Baa1	n/a	10

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.