Derby City Council

COUNCIL CABINET
21 FEBRUARY 2012

DOCUMENT 9b

Report of the Strategic Director of Resources

Treasury Management Strategy and Prudential Code Indicators 2012/13

SUMMARY

1.1 The report outlines the Council treasury management strategy for the financial year 2012/13. Specifically it covers all borrowing and investment activity undertaken by the Council.

1.2 It seeks Council approval for the strategy and for the prudential indicators derived from this strategy.

1.3 The report also shows the revenue implications of the Council's capital programme, showing how the costs of debt servicing are increasing as a proportion of the Council's overall revenue budget.

RECOMMENDATION

To approve and recommend to Council each of the following five key elements:

2.1 The Prudential Indicators and Limits for 2012/13 to 2014/15 contained within the Supporting Information of this report and detailed in Appendix 3.

2.2 The Minimum Revenue Provision - MRP - statement shown in section 13 below.

2.3 The Treasury Management Strategy 2012/13 to 2014/15, and the Treasury Management Prudential Indicators.

2.4 The Authorised Limit Prudential Indicator shown in Appendix 3 paragraph 8.4.

2.5 The Investment Strategy 2012/13 contained in the treasury management strategy in section 11 below.

REASONS FOR RECOMMENDATION

3.1 It is considered good treasury management practice for members to monitor performance at least three times a year. This report covers treasury activity, both borrowing and lending, in the forthcoming financial year and thereby provides a benchmark for future activity.

SUPPORTING INFORMATION

4 Background

4.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement - TMSS - and Prudential Indicators - Pis - on an annual basis. The TMSS also includes the Annual Investment Strategy - AIS - that is a requirement of the CLG's Investment Guidance.

4.2 Treasury management is about the management of risk, and no TM activity is without risk. The Council is responsible for its treasury decisions and activity, and setting a strategy helps the Council manage these risks.

4.3 In addition all treasury management activity must comply with relevant statute, guidance and accounting standards.

5 Capital Financing Requirement

5.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement - CFR. The CFR is the core driver of the Authority's Treasury Management activities.

5.2 The Authority's projected level of debt and investments as at 1 April 2012 is set out at Appendix 2.

5.3 The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2014/15. The Council is likely only to borrow in advance of need if it feel that the benefits of borrowing at interest rates now, compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

5.4 However, it has been *de facto* Council policy to not borrow this far ahead, and not even to borrow the full amount required for the current financial year, because of the magnitude of such costs and risks.

5.5 The forecasted movement in the CFR in coming years is one of the key Prudential Indicators - PIs. Table 1 below shows the change in the CFR from year to year:

	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
General Fund CFR	291.9	338.4	393.7	390.8
HRA CFR	202.8	202.8	202.8	202.8
Total CFR	494.7	541.3	596.6	593.6
Less: Profile of Existing Borrowing and Other Long Term Liabilities	370.9	367.9	364.3	360.8
Cumulative Maximum External Borrowing Requirement	123.8	173.4	232.3	232.8

6 Self-Financing of Housing

6.1 The reforms, which central government will implement from 2012/13, involve a removal of the housing subsidy system by offering a one-off reallocation of debt. The settlement of the reallocation is expected to take place on 28 March 2012 and will result in the Authority having an increase in debt to fund the settlement of £29.5m. This is in addition to the HRA figures shown in the table above. The specific borrowing amount and terms will be determined by the Council in conjunction with the advice of its treasury advisers.

6.2 In Appendix 3 the Prudential Indicators for 2011/12 to reflect the increase in borrowing in relation to the self-financing settlement. An additional Indicator, showing the debt cap which will apply to the HRA, is also shown.

7 Interest Rate Forecast

7.1 The economic and interest rate forecast provided by the Authority’s treasury management advisor is attached at Appendix 4. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

8 Borrowing Strategy

8.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short- and long-term interest rates. The interest rate forecast provided in Appendix 4 indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a “cost of carry” for any new longer term borrowing, where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. Whilst the cost of carry can be assumed to be a reasonably short-term issue since borrowing is often for longer dated periods (anything up to 50 years) it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Council’s wider financial position.

8.2 As indicated in Table 1 (above), the Authority has a positive borrowing requirement and will be required to borrow up to £232.8m by the end 2014/15. The Authority will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability
- Maturity profile of existing debt
- Interest rate and refinancing risk
- Borrowing source.

These risks might well result in the Council deferring a large proportion of its borrowing until 2015/16.

9 Sources of Borrowing and Portfolio Implications

9.1 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the following borrowing sources:

- PWLB
- Local authorities
- Commercial banks
- European Investment Bank
- Money markets
- Capital markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing.

9.2 The cost of carry has resulted in an increased future reliance upon shorter dated and variable rate borrowing. This type of borrowing would inject volatility into the debt portfolio in terms of interest rate risk but would be counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Council's exposure to shorter dated and variable rate borrowing would be kept under regular review by reference to the difference (or 'spread') between variable rate and longer term borrowing costs. Members should note that a significant narrowing in the spread would result in an immediate review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates should be maintained or altered.

9.3 The Authority has £20m exposure to LOBO loans (Lender's Option Borrower's Option), but none of this will be "called" before 2014/15. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion.

9.4 Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted.

10 Debt Rescheduling

10.1 The Authority's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.

10.2 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring, although occasional opportunities arise. The rationale for undertaking any debt rescheduling would be one or more of the following:

- Savings in risk-adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio.

10.3 Borrowing and rescheduling activity undertaken during the year is reported to Cabinet in the Treasury Management Annual Report in July.

11 Annual Investment Strategy

11.1 In accordance with Investment Guidance issued by the CLG and best practice the Council's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yields earned on investments are important but secondary considerations.

11.2 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt it has built up have lead to a sovereign debt crisis and a banking crisis with the outcome still largely unknown. It is against this backdrop of uncertainty that the Council's investment strategy is framed.

11.3 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the CLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

11.4 The types of investments that will be used by the Authority and whether they are specified or non-specified are shown in the table below:

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	✗
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	✗
Commercial Paper	✓	✗
Corporate Bonds	✓	✓

AAA rated Money Market Funds	✓	✗
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	✗

11.5 A number of changes have been implemented to investment strategy for 2012/13 in response to changes in the CLG Guidance and evolving conditions in financial markets. This has resulted in the inclusion of corporate bonds which the CLG have indicated will become an eligible non-capital investment from 1 April 2012. However, the principal amendments are in relation to the individual institutions with which the Authority is prepared to lend its funds.

11.6 The Authority and its advisors, Arlingclose Ltd, select countries and financial institutions after analysis and ongoing monitoring of:

- Published credit ratings for financial institutions (minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns)
- Credit Default Swaps (where quoted)
- Economic fundamentals (for example Net Debt as a percentage of GDP)
- Sovereign support mechanisms
- Share Prices
- Corporate developments, news, articles, markets sentiment and momentum
- Subjective overlay – or, put more simply, common sense.

11.7 The A- long-term rating is lower than the A+ minimum adopted in 2011/12 and is proposed, after consultation with Arlingclose, in response to downgrades in credit ratings below A+ of many institutions – such as Barclays Bank, Lloyds TSB and Nationwide Building Society - considered to be systemically important to the financial system.

11.8 Members should be assured that any institution can be suspended or removed from the Council's lending list should any of the factors identified in paragraph 11.6 give rise to concern, but institutions not meeting the criteria will never be added.

11.9 The Council banks with the Co-operative Bank. At the current time, it does meet the minimum credit criteria of A- (or equivalent) long term. However, even if the credit rating falls below the Council's minimum criteria the Co-operative will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

11.10 With short term interest rates low for even longer, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

11.11 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.

11.12 Money Market Funds - MMFs - will be utilised, but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Council will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF.

11.13 The countries and institutions that meet the criteria for term deposits and call accounts are included in Appendix 5. It remains the Council's current policy, however, to restrict investments only to UK institutions.

12 The Use of Financial Instruments for the Management of Risks

12.1 Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the 2011 Localism Act is not sufficiently explicit. Consequently, the Council does not intend to use derivatives.

12.2 Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

13 2012/13 MRP Statement

13.1 The Capital Finance Regulations place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

13.2 The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

NB This does not preclude other prudent methods.

13.3 Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported (ie. prudential) non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

13.4 The Council's MRP Statement is shown in paragraph 13.5 and 13.6 below. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Cabinet at that time.

13.5 The Authority will apply Option 2 in respect of supported non-HRA capital expenditure funded from borrowing and Option 3 in respect of unsupported non-HRA capital expenditure funded from borrowing. This means that, for supported capital expenditure, 4% of the financial year's opening capital financing requirement will be charged to revenue in order to provide for the repayment of debt. For prudential borrowing, the charge to revenue will be based on the principal element of an annuity calculation over the life of the asset ultimately being financed.

13.6 MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

14 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

14.1 The Strategic Director of Finance will report to Cabinet on treasury management activity / performance and Performance Indicators twice yearly against the strategy approved for the year. The first of these will be the Progress Report, which is taken to the November Cabinet; the second is the Annual Report on treasury management activity, which must be received by Cabinet no later than 30 September after the financial year end.

14.2 The Audit & Accounts Committee will be responsible for the scrutiny of the Council's treasury management activity and practices.

15 Treasury Management advisors

15.1 The Council retains the services of Arlingclose Ltd to advise on treasury management issues. In particular Arlingclose provides the Council with a list of investment counterparties which satisfy the criteria determined by Cabinet as part of this report, as well as advising on other issues, such as interest rate forecasts.

15.2 Arlingclose won a competitive tendering process in 2011 to provide such a service for the three years commencing 1 April 2011. The Council has the option to extend the contract by a further two years if it so desires.

16 Training

16.1 CIPFA's Code of Practice requires the Strategic Director of Resources to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

16.2 The training needs of staff working in treasury management are decided as part of the Managing Individual Performance - MIP - interviews, which trickle down the organisation from the Chief Executive. Where necessary, TM staff are trained on the job by more experienced staff, or by making use of courses and conferences provided by CIPFA or Arlingclose, the Council's treasury management advisors.

16.3 Arlingclose can also provide treasury management training for Council members and this is particularly directed at Audit and Accounts Committee members, although any member is welcome to attend organised sessions.

OTHER OPTIONS CONSIDERED

17.1 The Council is required by Regulation to have regard to the Prudential Code when carrying out its duties, and so there is no choice in whether to consider the prudential indicators contained in this report.

17.2 The Council is free to set its prudential indicators as it likes. However, the indicators in this report have been set in accordance from guidance received from the Council's treasury management advisors. To stray from this would mean running additional risks.

17.3 Therefore, to exercise its decision-making competence most effectively the Council must focus its attention on the proposed 2012/13 capital programme, the costs of which drive the prudential indicators reported here.

This report has been approved by the following officers:

Legal officer **Financial officer** **Human Resources officer** **Service Director(s)** **Other(s)**	Martyn Marples, Director of Finance and Procurement

For more information contact: **Background papers:** **List of appendices:**	Name 01332 643362 e-mail ciaran.guilfoyle@derby.gov.uk The Prudential Code for Capital Finance in Local Authorities, CIPFA Appendix 1 – Implications Appendix 2 – Projected Investment and Debt Portfolio Appendix 3 – Prudential Indicators 2012/13 to 2014/15 Appendix 4 – Economic and Interest Rate Forecast Appendix 5 – Recommended Counterparty List

IMPLICATIONS

Financial and Value for Money

1.1 As detailed in the report.

Legal

2.1 The Council is obliged to set and review prudential indicators in order to comply with the Local Government Act 2003. The Local Government Act 2003 states that the Council must adopt the Prudential Code, which, in turn, requires local authorities to adopt the CIPFA Treasury Management Code of Practice. Unless the government uses its powers under section 4 of that Act, the Council is free to set any reasonable indicators consistent with its other policies.

2.2 The Prudential Code states that the Prudential indicators for treasury management should be considered together with the local authority's treasury management strategy and the annual report on treasury management activities.

Personnel

3.1 None.

Equalities Impact

4.1 None.

Health and Safety

5.1 None.

Environmental Sustainability

6.1 None.

Asset Management

7.1 Any assets held for investment purposes are not considered within the Council's treasury management strategy. However, all assets are potentially available for sale, which could generate a receipt and thereby reduce the need for the Council to borrow. This process is managed as part of the Council's overall asset management strategy.

Risk Management

8.1 Counterparty risk and interest rate risk remain key risks to the Council, and these are actively managed as part of the treasury management strategy.

Corporate objectives and priorities for change

9.1 The priorities of the Council's Treasury Management Strategy contribute to minimising Council Tax and providing value for money.

Appendix 2

Projected Investment and Debt Portfolio Position 1 April 2012

	£000
External Borrowing:	
- Fixed Rate PWLB	265,295
- Fixed Rate PWLB (HRA self-financing loan)	29,492
- Fixed Rate Market	20,000
- Variable Rate PWLB	0
- Variable Rate Market	0
Other Long-term Liabilities:	
- Transferred Debt	36,489
- PFI	49,077
Total Gross External Debt	**400,353**
Investments:	
- Short-term	36,711
- Long-term	0
Total Investments	**36,711**
Total Net External Debt	**363,642**

Appendix 3

Prudential Indicators 2012/13 to 2014/15

1 Background

1.1 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2 Net Borrowing and the Capital Financing Requirement

2.1 This is a key indicator of prudence. In order to ensure that over the medium-term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

2.2 The Strategic Director of Finance reports that the authority had no difficulty meeting this requirement in 2011/12, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3 Estimates of Capital Expenditure

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
General Fund	102.4	78.8	101.9	90.7	27.3
HRA	17.4	21.8	11.2	9.5	8.6
Total	**119.8**	**100.6**	**113.1**	**100.2**	**35.9**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Capital receipts	10.7	9.1	4.3	7.3	1.8
Government Grants*	48.0	34.0	34.6	14.5	14.2
Major Repairs Allowance		4.9	8.1	8.7	8.6
Revenue contributions	11.6	11.1	3.6	0.0	0.0
Total Funding	**70.3**	**59.1**	**50.6**	**30.5**	**24.6**
Supported borrowing	7.4	2.3	5.6	0.0	0.0
Unsupported borrowing	42.1	39.2	56.9	69.7	11.3
Total Financing	**49.5**	**41.5**	**62.5**	**69.7**	**11.3**
Total Financing and Funding	**119.8**	**100.6**	**113.1**	**100.2**	**35.9**

* 2011/12 approved figure includes Major Repairs Allowance

4 Ratio of Financing Costs to Net Revenue Stream

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2011/12 Approved %	2011/12 Revised %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
Non-HRA	7.40	7.14	8.35	12.09	13.04
HRA	21.99	19.91	17.63	17.64	16.82

5 Capital Financing Requirement

5.1 The Capital Financing Requirement - CFR - measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

Capital Financing Requirement	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Non-HRA	307.8	291.9	338.4	393.7	390.8
HRA	188.7	202.8	202.8	202.8	202.8
Total CFR	**496.5**	**494.7**	**541.3**	**596.6**	**593.6**

6 Actual External Debt

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2011	£m
Borrowing	265.295
Transferred Debt (managed by Derbyshire County Council)	38.009
Other Long-term Liabilities (PFI)	46.180
Total	**349.484**

7 Incremental Impact of Capital Investment Decisions

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Increase in Band D Council Tax	66.85	89.72	105.68
Increase in Average Weekly Housing Rents	2.16	1.50	0.77

7.2 The increase in Band D council tax/average weekly rents reflects the increases in running costs and/or increases in the provision for capital financing charges of £10.8m to undertake additional borrowing of £143.5m arising from the proposed capital programme.

8 Authorised Limit and Operational Boundary for External Debt

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Borrowing	517	562	667	665
Other long-term liabilities	50	48	46	44
Total	567	610	713	709

8.5 The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Strategic Director of Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to Cabinet.

Operational Boundary for External Debt	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Borrowing	447	492	597	595
Other long-term liabilities	50	48	46	44
Total	497	540	643	639

9 Adoption of the CIPFA Treasury Management Code

9.1 This indicator demonstrates that the Council has adopted the principles of best practice. The CIPFA Code of Practice outlines a number of principles cover treasury management, the most important being "In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns". It also lists 12 Treasury management Practices, covering:

- Risk management
- Performance measurement
- Decision-making and analysis
- Approved instruments, methods and techniques
- Organisation, clarity, segregation of responsibilities, and dealing arrangements
- Reporting requirements and management information arrangements
- Budgeting, accounting and audit arrangements
- Cash and cashflow management
- Money laundering
- Training and qualifications
- Use of external service providers
- Corporate governance.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 1 March 2010. The Council has also incorporated the changes from the revised Code of Practice (issued November 2011) into its treasury policies, procedures and practices.

10 Gross and Net Debt

10.1 The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need.

Gross and Net Debt	**2011/12 Estimated £m**	**2012/13 Estimated £m**	**2013/14 Estimated £m**	**2014/15 Estimated £m**
Outstanding Borrowing (at nominal value)	314.8	437.8	496.8	496.8
Other Long-term Liabilities (at nominal value)	85.6	82.6	79.0	75.5
Gross Debt	400.4	520.4	575.8	572.3
Less: Investments	36.7	30.0	30.0	30.0
Net Debt	363.7	490.4	545.8	542.3

10.2 Members should note that CIPFA has acknowledged that the upper limit does not work as was intended and is working on a revised indicator. This indicator will be amended once revised guidance has been received from CIPFA.

11 Maturity Structure of Fixed Rate Borrowing

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Existing level at 31/03/11 %	Upper Limit for 2012/13 %
under 12 months	0	10
under 24 months	0	15
under 5 years	7.5	20
under 10 years	11.3	50
under 20 years	19.5	70
under 30 years	33.7	80
under 40 years	52.9	90
under 50 years	100	100
50 years and above	0	0

12 Credit Risk

12.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

12.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

12.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

12.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

13 Upper Limit for total principal sums invested over 364 days

13.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. This limit was reduced to nil after 2010/11, in line with the policy of maintaining very low cash balances and minimising risk.

	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Upper Limit for total principal sums invested over 364 days	0	0	0	0	0

14 HRA Limit on Indebtedness

14.1 This is a new prudential indicator that stems from new legislation allowing the HRA subsidy scheme to be abolished by central government. From 1 April 2012 the Council's HRA will no longer have to pay subsidy over to DCLG, and this will be achieved through the HRA borrowing £29.5m in order to buy itself out of the subsidy scheme. Consequently, HRA borrowing will need to be separately monitored, as shown in the table below:

HRA Limit on Indebtedness	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
HRA CFR	188.7	202.8	202.8	202.8	202.8
Self-financing loan			29.5	29.5	29.5
HRA CFR under self-financing	188.7	202.8	232.3	232.3	232.3
HRA Debt Cap (as prescribed by CLG)			239.6	239.6	239.6
Difference			7.3	7.3	7.3

Appendix 4

Economic and Interest Rate Forecast

1.1 Stress in financial markets continues to build. Rates within Interbank markets (where banks fund the majority of their day to day operations) continue to climb. This dynamic was a feature of the banking crisis that occurred in 2008 and whilst the authorities have flooded the markets with liquidity still provides a key barometer of rising risk within markets.

1.2 The Bank of England's Monetary Policy Committee's decision to embark on the unconventional monetary policy of providing a further £75 billion of Quantitative Easing (QE) – which the Minutes showed was unanimously supported – is likely to be expanded in the coming months as some members of the MPC had voted for £100bn of QE.

1.3 Inflation moderated back to 5% from what is considered to be its peak of 5.2% reached in October. The Bank of England expects domestic inflation to subside markedly in 2012 as the twin effects of the VAT increase and surge in oil prices fall out of the twelve month series.

1.4 Economic growth meanwhile remains largely illusive, and is not helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone. Even if a credible and effective policy is implemented, the scale of the problems means that there is likely to be a prolonged period of subdued growth within the Euro area. A failure to meet these challenges would almost certainly have significant implications for the global economy.

1.5 Recent data and surveys suggest that the UK economy has lost the admittedly fragile momentum since the summer. Business and consumer surveys point to continued weakness in coming months and the situation in the Euro area is likely to further undermine confidence and lead to tighter credit conditions for households and firms.

1.6 Against this uncertain backdrop the ability of the economy (government, companies and individual consumers) to accommodate an increase in the cost of money through higher interest rates – in the absence of a deterioration in the high credit standing that the UK enjoys – is highly unlikely.

1.7 Arlingclose's forecast for interest rates over the coming period is shown in the table below:

	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Official Bank Rate													
Upside risk						0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk													
1-yr LIBID													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**1.75**	**1.75**	**1.75**	**1.75**	**1.75**	**1.80**	**1.85**	**1.95**	**2.00**	**2.10**	**2.20**	**2.30**	**2.40**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**1.25**	**1.30**	**1.35**	**1.40**	**1.50**	**1.60**	**1.70**	**1.80**	**2.00**	**2.10**	**2.30**	**2.40**	**2.50**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**2.20**	**2.30**	**2.40**	**2.45**	**2.50**	**2.55**	**2.60**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**3.00**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**3.00**	**3.05**	**3.05**	**3.10**	**3.20**	**3.25**	**3.30**	**3.35**	**3.40**	**3.45**	**3.50**	**3.60**	**3.75**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**3.25**	**3.40**	**3.50**	**3.60**	**3.70**	**3.80**	**3.90**	**4.00**	**4.00**	**4.00**	**4.10**	**4.20**	**4.25**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

1.8 Arlingclose believes that it could be as late at 2016 before official interest rates rise.

Appendix 5

Recommended Counterparty List

1 Recommended Counterparties and Limits

1.1 Derby City Council continues to prudently restrict its investments to UK-based institutions, and within this further restrictions apply as in the table below.

1.2 The limit for the Co-operative Bank of £15m is recommended by Arlingclose, despite the bank currently not meeting the short-term minimum criterion of F1. Its position as the Council's current bank means that there could be a balance of up to £15m during the course of a business day, particularly prior to a monthly payroll run. It would therefore be inconsistent to set a lower limit than this to apply to overnight/weekend balances. However, longer-term investments with the Co-op Bank are still not permitted by these limits.

Counterparty		Max period	Limit
Short term: F1/P-1/A-1	Long term: A-/A3/A-	1 year	£15m
Bank of England Debt Management Office		6 months	n/a
AAA rated Money Market Funds		n/a	0.50% of fund size to a max of £8m
Other Local Authorities		1 year	£15m
Co-operative Bank (see paragraph 1.2 above)		Overnight	£15m
Treasury Bills		1 year	n/a