



## **Treasury Management Strategy and Prudential Code Indicators 2013/14**

### **SUMMARY**

- 1.1 The report outlines the Council's treasury management strategy for the financial year 2013/14. 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 2013/14 to 2015/16 contained within the Supporting Information of this report and detailed in Appendix 3.
- 2.2 The Minimum Revenue Provision - MRP - statement shown in section 13.7 below.
- 2.3 The Treasury Management Strategy 2013/14 to 2015/16, and the Treasury Management Prudential Indicators.
- 2.4 The Authorised Limit Prudential Indicator shown in Appendix 3 paragraph 8.4.
- 2.5 The Annual Investment Strategy 2013/14 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. 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 on an annual basis. The TMSS also includes the Annual Investment Strategy that is a requirement of the Department for Communities for Local Government - CLG - Investment Guidance.
- 4.2 Treasury Management - TM - 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 Capital Financing Requirement - CFR - is the core driver of the Council's Treasury Management activities. The underlying need to borrow for capital purposes is measured by the CFR.
- 5.2 The Council's projected level of debt and investments as at 1 April 2013 is set out at Appendix 2.
- 5.3 The Council is able to borrow funds in excess of the current level of its CFR up to the projected level in 2015/16. 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 is 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.

## **6. Treasury Management Advisors**

- 6.1 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 economic and interest rate forecasts.
- 6.2 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.

## **7. Interest rate forecast**

- 7.1 The interest rate forecast continues its theme of the last few years and the advice from our treasury advisors is that interest rates are not expected to rise in the near future. The economic and interest rate forecast provided by the Council's treasury management advisor is attached at Appendix 4. The Council regularly reappraises 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 paragraph 3.2 in Appendix 3 shows the Council has a positive borrowing requirement and will be required to borrow up to £156m by the end of 2015/16. The Council 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 future years.

## **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:
- Public Works Loans Board - PWLB
  - Local authorities
  - Commercial banks
  - 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 will inject volatility into the debt portfolio in terms of interest rate risk but will be counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Council's exposure to shorter dated and variable rate borrowing will 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 Council has £20m exposure to LOBO loans (Lender's Option Borrower's Option), but none of this is due to be "called" during 2013/14. 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 Council 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 Council'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.

## 11 Annual investment strategy

- 11.1 In accordance with Investment Guidance issued by the Department for Communities and Local Government - DCLG - 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 Council's investments followed by the yields earned on investments is 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 led 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 Council 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 Council and whether they are specified or non-specified are shown in table 1 below:

**Table 1: Types of investment used by the Council**

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 the Council's investment strategy for 2013/14 in response to changes in the DCLG Guidance and evolving conditions in financial markets. This has resulted in the inclusion of corporate bonds which the DCLG has 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 Council is prepared to lend its funds.
- 11.6 Further changes to the investment strategy for 2013/14 relate to the fixed term investments known as the Local Authority Mortgage Scheme - LAMS. These investments represent a new direction in treasury management. As well as making a return, the local authority's investment also assists the property market. Such investments are therefore considered slightly higher risk than the Council's current investments. Therefore a limit of £1m of Council money is being applied to LAMS investment. It is expected that this sum would provide the necessary 20% deposits for up to 40 mortgage applicants.
- 11.7 To accommodate this sort of investment within the Council's treasury management strategy it is proposed to extend both the time limit and the counterparty credit-worthiness criteria for LAMS investments. However, the precise credit-worthiness criteria to be applied to LAMS applicants have still to be determined. It is therefore recommended that: the Council's treasury management strategy be extended to cover LAMS investments for up to 7 years. A £1m total limit will apply to such investments
- 11.8 The 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.
- 11.9 In making investment decisions the Council and its advisors Arlingclose Ltd, select financial institutions after analysis and on-going 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.
- 11.10 The A- long-term rating is lower than the A+ minimum adopted in 2012/13 and is proposed, after consultation with Arlingclose, in response to downgrades in credit ratings below A+ of many institutions. These ratings are considered to be systemically important to the financial system.
- 11.11 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 11.9 give rise to concern and institutions not meeting the criteria will never be added.

- 11.12 The Council has historically banked 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 to ensure business continuity arrangements.
- 11.13 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.
- 11.14 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 counter party will be set to ensure prudent diversification is achieved.
- 11.15 Money Market Funds - MMFs, will be utilised, but good treasury management practice prevails and whilst MMFs provide good diversification the Council 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.

## **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 2013/14 Minimum Revenue Provision 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 - MRP - 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 (i.e. prudential) non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Council 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 13.7 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 Council 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.
- 13.7 In December 2012, Council Cabinet approved the following revised MRP statement:
- For capital expenditure incurred before 1 April 2008 or which in the future is Supported Capital Expenditure, the MRP policy will be to set aside a provision equal to 4% of the previous year's Capital Financing Requirement.
  - From 1 April 2008 for all unsupported borrowing, excluding PFI and finance leases, the MRP policy will use the Asset Life Method on an annuity basis; i.e. MRP will be based on the estimated life of the assets, with MRP being equal to the principal element of an annuity calculation based on a cost of capital deemed reasonable by the Corporate Director of Resources. The provision will be set aside in the year following the capital expenditure.
  - For all PFI schemes and finance leases, the MRP will be equal to the element of the actual unitary charge or actual finance lease repayment that reduces the on-going balance sheet liability, ie. the principal element of the charge or repayment, in line with CLG guidance.
  - For all secured loans made to external organisations, the MRP will be based on the life of the loan, with MRP being equal to the principal element of an annuity calculation based on a cost of capital deemed reasonable by the Strategic Director of Resources. The provision will be set aside in the year following the draw down of the loan.



#### **14. Monitoring and reporting on the treasury outturn and prudential indicators**

- 14.1 The Strategic Director of Resources 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 and Accounts Committee will be responsible for the scrutiny of the Council's treasury management activity and practices and receive regular reports.

#### **15 Training**

- 15.1 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.
- 15.2 The training needs of staff working in treasury management are decided as part of the Managing Individual Performance - MIP - interviews, which cascade 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.
- 15.3 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.

<b>OTHER OPTIONS CONSIDERED</b>
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- 16.1 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.
- 16.2 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.
- 16.3 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:**

<b>Legal officer</b> <b>Financial officer</b> <b>Human Resources officer</b> <b>Service Director(s)</b> <b>Other(s)</b>	Chloe Kenny, Head of Corporate Finance
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<b>For more information contact:</b> <b>Background papers:</b> <b>List of appendices:</b>	Ciaran Guilfoyle 01332 643362 e-mail <a href="mailto:ciaran.guilfoyle@derby.gov.uk">ciaran.guilfoyle@derby.gov.uk</a> 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
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**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 council 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.

## Projected Investment and Debt Portfolio Position 1 April 2013

	<b>£000</b>
<b>External Borrowing:</b>	
- Fixed Rate PWLB	265,295
- Fixed Rate PWLB (HRA self-financing loan)	28,164
- Fixed Rate Market	20,000
- Variable Rate PWLB	0
- Variable Rate Market	0
Other Long-term Liabilities:	
- Transferred Debt	35,031
- PFI	47,565
<b>Total Gross External Debt</b>	<b>396,055</b>
<b>Investments:</b>	
- Short-term	20,000
- Long-term	0
<b>Total Investments</b>	<b>376,055</b>
<b>Total Net External Debt</b>	<b>376,055</b>

## Prudential Indicators 2013/14 to 2015/16

### 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 Gross borrowing and the capital financing requirement

- 2.1 This is a new indicator of prudence, replacing the previous 'net borrowing' indicator. In order to ensure that over the medium-term net borrowing will only be for a capital purpose, the local authority should ensure that its gross 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 Resources reports that the authority had no difficulty meeting this requirement in 2012/13, 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.

<b>Capital Expenditure</b>	<b>2012/13 Revised £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>
General Fund	103.8	92.8	94.4	48
HRA	11.3	11.7	9.0	8.6
<b>Total</b>	<b>115.1</b>	<b>104.5</b>	<b>103.4</b>	<b>56.6</b>

- 3.2 Capital expenditure will be financed or funded as follows:

<b>Capital Financing</b>	<b>2012/13 Revised £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>
Capital receipts	7.2	0.9	0.2	0.2
Government Grants	33.6	20.8	31.1	10.5
Major Repairs Allowance	8.2	8.9	8.5	8.5
Revenue contributions	11.2	14.4	4.6	0.3
<b>Total Funded</b>	<b>60.2</b>	<b>45.0</b>	<b>44.4</b>	<b>19.6</b>
Supported borrowing	3.1	1.0	0	0
Unsupported borrowing	51.8	58.5	59.0	37.0
<b>Total To Be Financed</b>	<b>54.9</b>	<b>59.5</b>	<b>59.0</b>	<b>37.0</b>
<b>Total Funded and To Be Financed</b>	<b>115.1</b>	<b>104.5</b>	<b>103.4</b>	<b>56.6</b>

#### 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.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2012/13 Revised %</b>	<b>2013/14 Estimate %</b>	<b>2014/15 Estimate %</b>	<b>2015/16 Estimate %</b>
Non-HRA	7.45	10.30	12.19	14.29
HRA	17.54	17.97	17.65	16.88

#### 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.

<b>Capital Financing Requirement</b>	<b>2012/13 Revised £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>
Non-HRA	315.4	362.9	410.9	361.5
HRA	229.7	231.5	231.5	231.5
<b>Total CFR</b>	<b>545.2</b>	<b>594.4</b>	<b>642.4</b>	<b>593.0</b>

## 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.

<b>Forecast External Debt as at 31/03/2013</b>	<b>£m</b>
Borrowing	293,459
Transferred Debt (managed by Derbyshire County Council)	36,081
Other Long-term Liabilities (PFI)	47,523
<b>Total</b>	<b>377,063</b>

## 7 Incremental impact of capital investment decisions

- 7.1 This is an indicator of affordability that shows the notional impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is derived from the proposed 2013/14 capital programme, and adding together the costs of the proposed level of borrowing (both interest and MRP) and the proposed use of revenue resources. General Fund costs are divided by the council tax base. HRA costs are divided by the number of housing stock rent-weeks.
- 7.2 The increase in Band D council tax over the next few years reflects the increase in financing costs of £10.869m which is needed to undertake additional borrowing of £153.5m arising from the proposed capital programme (see total 'to be financed' costs, years 2013/14 onwards, paragraph 3.2 above). The actual council tax rate will not increase by this amount, however, because of savings made elsewhere within the revenue budget, some savings stemming from the capital programme itself. The indicator is required to be reported to members as part of the Prudential Code.
- 7.3 The full revenue impact of the capital programme is not felt until the year following capital expenditure, because the Council's MRP policy stipulates that the provision for debt repayment need not be made until the year following actual expenditure. An estimate for 2016/17 of the full cost of the proposed capital programme is therefore included for information in the table below.



<b>Incremental Impact of Capital Investment Decisions</b>	<b>2013/14 Estimate £</b>	<b>2014/15 Estimate £</b>	<b>2015/16 Estimate £</b>
Impact on Band D Council Tax	17.40	67.43	109.08
Increase in Average Weekly Housing Rents	0.13	0.40	0.67

## **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).

<b>Authorised Limit for External Debt</b>	<b>2012/13 Revised £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>
Borrowing	562	615	663	721
Other long-term liabilities	48	46	44	41
<b>Total</b>	<b>610</b>	<b>661</b>	<b>707</b>	<b>762</b>

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	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Borrowing	492	545	593	663
Other long-term liabilities	48	46	44	41
Total	540	591	637	704

## 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.

<b>Gross and Net Debt</b>	<b>2012/13 Estimated £m</b>	<b>2013/14 Estimated £m</b>	<b>2014/15 Estimated £m</b>	<b>2015/16 Estimated £m</b>
Outstanding Borrowing (at nominal value)	459	510	560	557
Other Long-term Liabilities (at nominal value)	35	33	32	31
Gross Debt	494	543	592	588
Less: Investments	20	20	20	20
Net Debt	474	522	571	568

## 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.

<b>Maturity structure of fixed rate borrowing</b>	<b>Existing level at 31/03/12 %</b>	<b>Upper Limit for 2013/14 %</b>
under 12 months	0	10
under 24 months	0	15
under 5 years	6.82	20
under 10 years	12.27	50
under 20 years	24.29	70
under 30 years	32.13	80
under 40 years	57.52	90
under 50 years	100.00	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.

### 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. Since 1 April 2012 the Council's HRA has no longer had to pay subsidy over to DCLG, and this was achieved through the HRA borrowing £28.2m in March 2012 in order to buy itself out of the subsidy scheme. HRA borrowing is now separately monitored, as shown in the table below:

HRA Limit on Indebtedness	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
HRA CFR	229.7	230.5	230.5	230.5
HRA Debt Cap (as prescribed by DCLG)	238.6	238.6	238.6	238.6
Headroom	8.9	8.1	8.1	8.1

## Economic and Interest Rate Forecast

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

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
<b>Official Bank Rate</b>													
Upside risk				0.25	0.25	0.25	0.25	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	-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
<b>3-month LIBID</b>													
Upside 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
Central case	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
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
<b>1-yr LIBID</b>													
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	1.50	1.40	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.80
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
<b>5-yr gilt</b>													
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	0.60	0.60	0.70	0.70	0.70	0.80	0.80	0.90	0.90	0.90	0.90	0.90	0.90
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
<b>10-yr gilt</b>													
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	1.50	1.40	1.50	1.60	1.60	1.70	1.70	1.80	1.80	1.80	1.90	1.90	1.90
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
<b>20-yr gilt</b>													
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	2.50	2.40	2.40	2.40	2.50	2.50	2.60	2.50	2.50	2.60	2.60	2.60	2.60
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
<b>50-yr gilt</b>													
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	3.00	2.90	2.90	3.00	3.10	3.10	3.20	3.20	3.20	3.20	3.20	3.30	3.30
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

## Underlying Assumptions:

- Consumer Price Inflation is 2.5% having fallen from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated.
- The third consecutive quarterly contraction in Q2 of 0.4% left the UK economy lagging behind its main competitors. There is renewed optimism for Q3 supported by strong employment data and declining inflation that should feed through some stability in real incomes. Underlying growth will probably remain soft in the near term whilst uncertainty over Europe persists.
- Having voted to increase asset purchases (QE) by £50bn in July, the MPC will wait to assess its effectiveness and that of the Funding for Lending Scheme (FLS) which started in August. We do not expect a further monetary policy response until the final quarter of 2012.
- Despite poor growth resulting in much weaker public finances than forecast and a slower pace of fiscal consolidation, the Chancellor is expected to maintain the deficit-cutting strategy in the Autumn Statement.
- The US Federal Reserve has responded to the slowdown in growth and employment with QE3 with large scale asset purchases of \$40bn a month until the outlook for the labour market improves substantially. The US public finance 'fiscal cliff' nevertheless remains a serious risk unless a political solution is reached soon.

- The optimism after the announcement of the ECB's Outright Monetary Transactions (OMT) initiative has eroded after Germany and other core Eurozone countries scuppered a deal that would have allowed Spain's banks to recapitalise. Contagion risk remains high; a solution to the Eurozone crisis is some way off as there is little appetite for fiscal reform and mutualisation of Eurozone sovereign debt liabilities remains politically unpalatable.

**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