COUNCIL CABINET
22 January 2014

ITEM 14

Report of the Cabinet Member for Business, Finance and Democracy

Treasury Management Strategy and Prudential Code Indicators 2014/15

SUMMARY

1.1 This report outlines and seeks approval of the Council's Treasury Management Strategy for the financial year 2014/15 and the Prudential Indicators derived from this strategy. Specifically, the report includes:

- Economic and Interest Rate Forecast
- Banking Services Update
- Capital Financing Requirement
- The Annual Borrowing Strategy
- The Annual Investment Strategy
- Prudential Code Indicators and limits.

RECOMMENDATION

2.1 To approve and recommend to Council the Treasury Management Strategy for 2014/15.

2.2 To approve and recommend to Council the Prudential Indicators and limits for 2014/15 to 2016/17.

REASONS FOR RECOMMENDATION

3.1 Under the Local Government Act 2003 and Chartered Institute of Public Finance and Accountancy – CIPFA - Code of Practice, and the Prudential Code for Capital Finance, the Council is required to approve an annual treasury management strategy before the start of each financial year.

3.2 The Council has borrowed and invested significant sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. It is therefore important for Members to understand the risks identified, and how they are mitigated and controlled, as set out in this Treasury

Management Strategy.

COUNCIL CABINET
22 January 2014

Report of the Strategic Director for Resources

SUPPORTING INFORMATION

4. Background

4.1 Treasury Management - TM – is about the management of the Council's cash flows, its banking, money market and capital market transactions; and the effective control of the risks associated with those activities in pursuit of optimum performance.

4.2 In addition all treasury management activity must comply with relevant Statute, guidance and accounting standards in accordance with the CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code and associated Indicators. The Prudential Code requires local authorities to produce a Treasury Management Strategy – covering borrowing and investments and a set of Prudential Indicators on an annual basis.

4.3 The Council procures the services of Arlingclose Ltd to advise on treasury management issues. In particular Arlingclose Ltd 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. Arlingclose Ltd won a competitive tendering process to provide such a service for the three years commencing 1 April 2011 with an option to extend for a further two years. The Council has exercised this option to extend the contract. Arlingclose Ltd also provide information for treasury management staff and provide training workshop to staff to ensure that they keep up to date with treasury management principles as required through the CIPFA TM Code.

5. Economic and Interest Rate Forecast

5.1 The information relating to the overall global position of the UK financial markets is provided by Arlingclose Ltd, who continue to update the Council with on-going market activity.

5.2 Growth in the UK economy has strengthened in the first half of 2013/14 and currently shows a slight improvement over forecast. Growth is mainly driven by a significant contribution from construction with government initiatives to boost mortgage funding. However, growth is expected to continue to be gradual, with slow improvements in the jobs market linked to pressures in real earnings growth and household consumption.

5.3 The credit risk of banking failures has diminished, but not depleted altogether. Regulatory changes are underway in the UK to move away from the bank bail-outs (whereby a loan can be given to a company to avoid bankruptcy) of previous years to bank resolution regimes, in which shareholders, bond holders and unsecured creditors are “bailed-in” (this is an alternative to bankruptcy, and regulators can have the power to impose losses on bondholders) to participate in any recovery process. This “bail-in” has already occurred in relation to holders of debt issued by the Co-op Bank.

5.4 The Bank of England Base Rate has remained at 0.5% since March 2009 and Arlingclose Ltd, are forecasting that, it may be 2016 before rates increase.

6. Banking Services

6.1 The Council has historically banked with the Co-operative Bank, however members should be aware that this banking contract is due for renewal and the Co-operative Bank have stated that they will not be retendering for the contract. This will therefore mean that from 1 April 2014 the Council will be under contract with a new bank for all the banking services for the whole of the Council and for short term liquidity requirements (overnight and weekend investments).

6.2 To ensure business continuity arrangements, the Co-operative Bank have confirmed that they will work in parallel with the Council and the new appointed bank, for a further nine months after 1 April 2014, to ensure a smooth transition process.

7. Capital Financing Requirement

7.1 The Council’s underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR represents the cumulative capital expenditure by a local authority that has not been financed from other sources. The borrowing raised to finance this capital expenditure is therefore a key element of the Treasury Management Strategy and is the core driver of the Council’s treasury management activities. For 2014/15, the Council’s CFR is expected to be £589.8m as set out in Appendix 5, Section 5.

7.2 The Council’s projected level of debt and investments as at 1 April 2014 is set out at Appendix 2

7.3 Under the Prudential Code, the Council is also able to borrow funds in excess of the current level of its CFR up to the projected level in 2016/17. However the Council is likely only to borrow in advance of need if it feels 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.

8. Borrowing Strategy

8.1 The Council's chief objective when borrowing money is to strike an appropriate balance in terms of risk between securing low interest costs and achieving cost certainty over the period which funds are required. The Council's borrowing strategy is also designed to address the key issue of affordability, especially given current restrictions to local authority funding, without comprising the longer-term stability of the debt portfolio. Borrowing decisions are also influenced not only by the absolute level of borrowing rates but also the relationship between short- and long-term interest rates in order to achieve best value for money for the Council.

8.2 Other factors, such as the "cost of carry" are also taken into account when making borrowing decisions. 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.

8.3 The interest rate forecast provided by Arlingclose Ltd, in Appendix 4 indicates that the significant difference between short and longer term interest rates is expected to continue over the next few years. This will be taken into consideration in making any decisions.

8.4 As at December 2013, the Council holds £337.5m of loans. This is made up of Public Works Loans Board - PWLB - loans of £273.5m, £20m of loans from Royal Bank of Scotland and £44m borrowed from other local authorities. Council forecasts show a further need to borrow of £186m to meet the capital programme in future years. However, any amounts borrowed will not exceed the limit for authorised borrowing, of £710m in 2014/15, as set out in Appendix 5, paragraph 8.6.

8.5 In addition to borrowing from the Public Works Loans Board - PWLB - and other local authorities, the £20m loans from the Royal Bank of Scotland, are classed as LOBO loans (Lender's Option Borrower's Option) loans. 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.

8.6 Neither of the two LOBO loans are due to be "called" during 2014/15 and Arlingclose Ltd, consider that it is highly unlikely that lenders will exercise their options in the current low interest rate environment. If the LOBOs are called, this 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.

8.7 Sources of future borrowing in 2014/15, will be in conjunction with advice from our treasury advisor, Arlingclose Ltd, and will be from 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.

In addition, the Council anticipates receiving a £1m loan from the University of Derby to specifically support the delivery of the innovation campus project and £515k from D2N2 Local Enterprise Partnership for the Magistrates Court.

8.8 Any future borrowing undertaken from the above sources will be adopt a flexible approach and may be short tern or long term. 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.

8.9 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount, depending on interest rates at the time. However, 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. 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.

9. Annual Investment Strategy

9.1 As requested under the Prudential Code, the core objective of the Council's annual investment strategy is to invest prudently, with regard to security and liquidity of investments before seeking the highest rate of return, or yield.

9.2 Arlingclose Ltd, provide the Council with a list of suitably secure financial institutions after analysis and on-going monitoring of:

- published credit ratings for financial institutions
- 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.

Members should be assured that any institution can be suspended or removed from the Council's approved lending list should any of the factors identified above give rise to concern.

9.3 Investment decisions will be taken in conjunction with advice and information from Arlingclose Ltd, who regularly update treasury management staff with a "lending list" of investment financial institutions.

9.4 Any future investments made will also follow the legislative and regulatory framework for treasury management activities which requires investments to be categorised as "Specified" or "Non-Specified". 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

9.5 In order to diversify the 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 also be set to ensure prudent diversification is achieved.

9.6 The Council can invest its funds with any of the counterparties in the Table below which are classed as specified or non-specified:

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 (T-Bills)	✓	✗
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	✗
Commercial Paper	✓	✗
Corporate Bonds	✓	✓
Money Market Funds – MMF	✓	✗
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	✗

9.7 The institutions that meet the criteria for term deposits and call accounts are included in Appendix 3. It also remains the Council's current policy, to restrict investments only to UK institutions.

9.8 Money Market Funds shown in the table above are pooled investment vehicles which enable the Council to diversify investment risk, and by offering immediate access to funds, maintain a high degree of liquidity. These will continue to be used in 2014/15 and the Council will restrict its exposure to not exceeding 0.5% of the net asset value of the MMF. In accordance with good treasury management practice, the Council will also seek to diversify any exposure by utilising more than one MMF.

9.9 Overnight and weekend (short term and liquidity) investments, will continue with the Council's main bank. The current overnight and weekend investments are however restricted in accordance with advice from Arlingclose Ltd.

10. The Prudential Indicators

10.1 The Local Government Act 2003 requires the Council to adopt the CPFA Prudential Code and produce a set of Indicators when determining how much money it can afford to borrow. The Prudential Code requires that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

10.2 The Prudential Indicators 2014/15 to 2016/17 are included at Appendix 5 and demonstrate that the Council has fulfilled the objectives of the code.

OTHER OPTIONS CONSIDERED

11.1 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.

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

11.3 Therefore, to exercise its decision-making competence most effectively the Council must focus its attention on the 2013/14 to 2016/17 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	Nicola Goodacre, Group Accountant
Human Resources officer	
Estates/Property officer	
Service Director(s)	Martyn Marples, Director of Finance and Procurement
Other(s)	

For more information contact:	Andrea Croud, Principal Accountant - 01332 643361 andrea.croud@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications Appendix 2 - Projected Investment and Debt Portfolio Appendix 3 – Recommended Counterparty List Appendix 4 – Economic and Interest Rate Forecast Appendix 5 – Prudential Indicators 2014/15 to 2016/17

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As described in the report.

Legal

2.1 None.

Personnel

3.1 None.

Equalities Impact

4.1 None.

Health and Safety

5.1 None.

Environmental Sustainability

6.1 None.

Property and Asset Management

7.1 None.

Risk Management

8.1 The Council has adopted the CIPFA Prudential Code for Capital Finance which is designed to balance the financial risks of investment and borrowing activities with value for money.

Corporate objectives and priorities for change

9.1 None.

Appendix 2

Projected Investment and Debt Portfolio Position 1 April 2014

	£000
External Borrowing:	
- Fixed Rate PWLB	265,295
- Fixed Rate PWLB (HRA self-financing loan)	28,164
- Fixed Rate Market (LOBO's)	20,000
- Other Local Authorities	34,000
Other Long-term Liabilities:	
- Transferred Debt from other Local Authorities	33,630
- PFI Financing	102,433
Total Gross External Debt	**483,522**
Investments:	
- Short-term	(20,000)
- Long-term	0
Total Investments	**463,522**
Total Net External Debt	**463,522**

Recommended Counterparty List
Appendix 3

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 Council is currently going through a bank tender process and the new contract with the successful tenderer will start 1 April 2014. Once the new provider is in place it is expected that there could be a balance with the Bank of up to £15m during the course of the 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.

Counterparty	**Max period**	**Limit**
Long term A-/A3/A-	1year	£15m
Bank of England Debt Management Office	6 months	n/a
Money Market Funds	n/a	0.50% of fund size to a max of £8m
Other Local Authorities	1 year	£15m
Main bank contract (see 1.2 above)	Overnight	£15m
Treasury Bills	1 year	n/a

Appendix 4

Economic and Interest Rate Forecast

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

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17		Average
Official Bank Rate															
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	1.00		
Arlingclose 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**		**0.50**
Downside risk															
3-month LIBID rate															
Upside risk	0.20	0.25	0.30	0.35	0.40	0.50	0.55	0.60	0.65	0.70	0.75	0.90	0.95		
Arlingclose Central Case	**0.45**	**0.45**	**0.50**	**0.55**	**0.65**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**		**0.67**
Downside risk			0.05	0.10	0.20	0.30	0.30	0.30	0.30	0.30	-0.35	-0.35	-0.35		
1-yr LIBID rate															
Upside risk	0.35	0.30	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80		
Arlingclose Central Case	**0.90**	**0.95**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**1.20**	**1.25**	**1.30**	**1.40**	**1.40**		**1.12**
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50		
5-yr gilt yield															
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
Arlingclose Central Case	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**	**1.85**	**1.95**	**2.10**	**2.30**	**2.50**	**2.50**		**1.88**
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80		
10-yr gilt yield															
Upside risk	0.50	0.50	0.50	0.65	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
Arlingclose Central Case	**2.55**	**2.60**	**2.65**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**3.00**	**3.10**	**3.30**	**3.50**	**3.50**		**2.94**
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80		
20-yr gilt yield															
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
Arlingclose Central Case	**3.25**	**3.30**	**3.35**	**3.40**	**3.45**	**3.50**	**3.55**	**3.65**	**3.75**	**3.85**	**4.05**	**4.15**	**4.15**		**3.65**
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80		
50-yr gilt yield															
Upside risk	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
Arlingclose Central Case	**3.45**	**3.50**	**3.55**	**3.60**	**3.65**	**3.70**	**3.75**	**3.80**	**3.85**	**3.95**	**4.05**	**4.15**	**4.15**		**3.78**
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80		

Underlying assumptions of the above table:

- Growth continues to strengthen with the initial estimate for Q3 growth coming in at 0.8%. The service sector remains the main driver of growth, boosted by a significant contribution from construction.
- The unemployment rate remained at 7.7%. The pace of decline in this measure will be dependent on a slower expansion of the workforce than the acceleration in the economy, alongside the extent of productivity.

- The CPI for September remained at 2.7%. Regulated and administered prices are likely to keep CPI above target in the near term. In the medium term inflation is expected to come back towards the target 2%.
- The principal measure in the MPC’s Forward Guidance on interest rates is the Labour Force Survey (LFS) unemployment rate. The MPC intends not to raise the Bank Rate from its current level of 0.5% at least until this rate has fallen to a threshold of 7%. It currently forecasts this level to emerge in Q2/2016, but this will be updated in the November Inflation Report.
- House price inflation is likely to rise due to the government's Help to buy scheme, where it will guarantee up to 15% of purchasers’ 95% mortgages. This could lead to a housing bubble, which in turn could come under pressure if rates were to rise quickly.
- Federal Reserve monetary policy expectations - the slowing in the pace of asset purchases ('tapering') and the end of further asset purchases - will remain predominant drivers of the financial markets. Recent weaker data from the US suggests that the recovery is slowing, therefore tapering looks more likely in Q1 2014.
- The US political deadlock over spending cuts and the debt ceiling is likely to reoccur in Q1 2014. The partial closedown on government in is estimated to have cost the US economy over $24bn.
- The European backstop mechanisms have lowered the risks of catastrophic meltdown. The slightly more stable economic environment at the aggregate Eurozone level could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over longevity of their coalitions). The ECB has discussed a third LTRO, as credit conditions remain challenging for European banks.
- China data has seen an improvement, easing markets fears.
- On-going regulatory reform and a focus on bail-in debt restructuring are likely to prolong banking sector deleveraging and maintain the corporate credit bottleneck.
- Geopolitical tensions make for a less than conducive backdrop while global economies remain fragile, especially the emerging economies.

Forecast:

- Our projected path for short term interest rates remains flat. Markets are still pricing in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. However, upside risks now weight more heavily at the end of our forecast horizon.
- We continue to project gilt yields on an upward path through the medium term. The recent climb in yields was overdone given the soft fundamental global outlook and risks surrounding the Eurozone, China and US. Yields are slowly drifting lower now that tapering is less likely to occur in the near-term.

Prudential Indicators 2014/15 to 2016/17
Appendix 5

1 Introduction

1.1 The Prudential Indicators assist in the process of monitoring the degree of prudence with which the Council undertakes its Capital Expenditure and Treasury Management activities. It 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 Council had no difficulty meeting this requirement in 2013/14, 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:

	2013/14 Estimate £000
Borrowing 2013/14	347,459
Long term Liabilities	102,433
Transferred Debt	33,630
GROSS DEBT	493,522
MAX CFR	590,400
Headroom	96,850

3 Estimates of capital expenditure

3.1 The estimates of capital expenditure both for the General Fund (GF) and the Housing Revenue Account (HRA) underpin the calculation of the other prudential indicators. These estimates are based on future levels of capital expenditure. It is important that the level of proposed capital expenditure remains within the Council's long term affordability.

Capital Expenditure	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
General Fund	103.0	80.3	81.8
HRA	19.4	14.9	19.1
Total	**122.4**	**95.2**	**100.9**

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

Capital Financing	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Capital receipts	0.2	0.0	0.0
Government Grants	62.9	26.8	22.7
Major Repairs Allowance	19.4	14.9	19.1
External Contributions	4.9	4.2	0.5
Revenue contributions	0.8	0.4	0.1
Total Funded	**88.2**	**46.3**	**42.4**
Supported borrowing	1.0	0.0	0.0
Unsupported borrowing	33.2	48.9	58.5
Total To Be Financed	**34.2**	**48.9**	**58.5**
Total Funded and To Be Financed	**122.4**	**95.2**	**100.9**

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	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
Non-HRA	9.50	12.12	13.81
HRA	17.85	16.43	16.53

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 it's financing.

Capital Financing Requirement	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Non-HRA	357.1	307.3	377.3
HRA	232.7	232.7	232.7
Total CFR	**589.8**	**540.0**	**610.0**

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 (see section 8 below).

Forecast External Debt as at 31/03/2014	£m
Borrowing	347.459
Transferred Debt (managed by Derbyshire County Council)	33.630
Other Long-term Liabilities (PFI)	102.433
Total	**483.522**

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 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 £8.113m. This is needed to undertake additional borrowing to support the existing borrowing and proposed future borrowing.

7.3 The full revenue impact of the capital programme is not felt until the year following capital expenditure, because the Council's Minimum Revenue Policy – MRP - stipulates that the provision for debt repayment need not be made until the year following actual expenditure. Therefore the effect of the 2016/17 capital programme will not impact on the Council's revenue position until 2017/18.

Incremental Impact of Capital Investment Decisions	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Impact on Band D Council Tax	23.76	40.10	65.58
Increase in Average Weekly Housing Rents	0.52	0.52	0.82

7.4 The actual council tax rate will not increase by the above 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.

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 is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).
It 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 Council's authorised limits for the next 3 years are:

Authorised Limit for External Debt	2014/15 £m	2015/16 Estimate £m	2017/18 Estimate £m
Borrowing	610	716	796
Other long-term liabilities	100	96	92
Total	710	812	888

8.5 The Operational Boundary links directly to the Council's estimate 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	2014/15 £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	540	610	716
Other long-term liabilities	100	96	92
Total	640	706	808

9 Adoption of the CIPFA Treasury Management Code

9.1 This indicator acknowledges that the Council has adopted the principles of best practice. The CIPFA Code of Practice outlines a number of principles which 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".

10 Maturity structure of fixed rate borrowing

10.1 This indicator highlights where there are any large concentrations of fixed rate debt which may need to be replaced at times of uncertainty over interest rates. It 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.

10.2 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 31/03/13 %	Upper Limit for 2014/15 %
under 1	5.93	15
under 2	8.59	20
Under 3 years	14.52	25
under 10 years	20.15	50
under 20 years	30.94	70
under 30 years	40.98	80
under 40 years	69.58	90
under 50 years	100	100
50 years and above	0	0

11 Credit risk

11.1 The Council considers security, liquidity and yield, in that order, when making investment decisions. Credit risk is a key consideration in determining the level of security for investments.

11.2 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.

11.3 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.

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

12 Upper limit for total principal sums invested over 364 days

12.1 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.

13 HRA limit on indebtedness

13.1 This is 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 of an additional £28.2m in March 2012 in order to buy itself out of the subsidy scheme. HRA borrowing is now separately monitored and subject to separate limits.

HRA Limit on Indebtedness	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
HRA CFR	232.7	232.7	232.7
HRA Debt Cap (as prescribed by DCLG)	238.6	238.6	238.6
Headroom	5.9	5.9	5.9