Agenda Item No. 10

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANANGEMENT OVERVIEW AND SCRUTINY COMMITTEE

WEDNESDAY 4 FEBRUARY 2015

CABINET

WEDNESDAY, 18 FEBRUARY 2015

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY

2015/2016 – 2017/2018

REPORT OF THE GO SHARED SERVICE HEAD OF FINANCE

(Contact: Paul Stuart, Tel: (01993) 861171)

(The Treasury Management Strategy Statement will be approved by Council and the Prudential Indicators and Limits will also be approved by Council as part of the formal budget and tax setting process).

1. PURPOSE

To consider the Council's Treasury Management Strategy for 2015/16 and approve Prudential Indicators, MRP Statement and the Use of Specified and Non Specified Investments.

2. RECOMMENDATIONS

(a) That the Council be recommended to approve:

(i) The Treasury Management Strategy 2015/2016 to 2017/2018 at Appendix A.

(ii) The Minimum Revenue Provision (MRP) Statement - there is no requirement to charge MRP in 2015/16 (as defined within Appendix A Paragraph 6).

(b) That the Council be recommended to adopt the Prudential Indicators and Limits for 2015/2016 to 2017/2018 as summarised in Appendix E.

3. BACKGROUND

3.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services 2011 Edition (the "CIPFA TM Code") and the Prudential Code requires local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. This statement also incorporates the Annual Investment Strategy as required by the Department for Communities and Local Government (CLG) Investment Guidance. Together, these cover the financing and investment strategy for the forthcoming financial year.

3.2. The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy 2015/16 (Investments)
- Annual Investment Strategy for 2015/16
- Prudential Indicators for 2015/16, 2016/17 and 2017/18 (the Authorised Limit is a statutory limit)
- MRP Statement

3.3. In accordance with the requirements of the Prudential Code, the Council has adopted the CIPFA Treasury Management Code at its Cabinet meeting on 17 February 2010. All treasury activity will comply with relevant statute, guidance and accounting standards.

3.4. The authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

4. ALTERNATIVES/OPTIONS

The Committee may suggest amendments to the proposed Treasury Management Strategy for 2015/2016 to 2017/2018.

5. FINANCIAL IMPLICATIONS

There are no direct financial implications

6. REASONS

To incorporate the requirements of the Local Government Act 2003 and the guidance on Local Government Investments whilst complying with the principles of the CIPFA Code of Practice for Treasury Management.

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Date: 19th January 2015

<u>Background Papers:</u>
None

Appendix A

Treasury Management Strategy Statement and Investment Strategy 2015/16 to 2017/18

1. Capital Financing Requirement

1.1 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves are the core drivers of Treasury Management Activity.

1.2 The Council's current level of investments is set out below:

EXISTING INVESTMENT PORTFOLIO

Investments	**31/12/2014 Actual Portfolio £m**
Managed in-house	
- Short Term Monies (Deposits)	9.600
- Monies on Call / MMF	5.230
- Corporate Bonds	5.142
- Long Term Investments -RSL	5.000
Managed externally	
- Insight Liquidity Plus Fund	2.012
- Payden & Rygel Sterling Fund	2.019
- UBS Multi Asset Income Fund	1.045
- Aberdeen Absolute Return Bond Fund	3.860
- Schroders Income Maximiser Fund	1.061
- Threadneedle Global Equity Fund	1.030
- M&G Global Dividend Fund	1.030
Total Investments*	**37.029**
Icelandic Investment Deposits	1.125

* Please note this total excludes Icelandic Investments. The outstanding balance is shown separately in the line below.

1.3 The controls for borrowing allow an authority to borrow funds in excess of the current level of its CFR up to the three year projected date – 2017/18. The condition of such borrowing is that the Council could only borrow in advance of need if it felt 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. However, the Council is currently debt free, funding its capital programme from existing resources such as capital receipts, earmarked reserves, capital contributions and revenue contributions. The strategy is to minimise impact on the Council's revenue account. Consequently, at present while capital funding can be contained within existing resources this will be the continuing capital funding strategy.

1.4 The forecasted movement in the CFR in the coming years is one of the Prudential Indicators (PIs). The movement in actual external debt (this Council is debt free) and usable reserves combine to identify the authority's borrowing requirement and potential investment strategy in the current and future years.

Table 1: Balance Sheet Summary Analysis

	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
General Fund CFR	911	555	182	(28)
Less: Borrowing and Other Long Term Liabilities	(957)	(601)	(228)	(18)
Usable Reserves	(18,002)	(15,561)	(15,999)	(16,319)
Cumulative Net Borrowing Requirement / (Investments)	(16,134)	(15,607)	(16,045)	(16,365)

Table 1 shows that the capital expenditure plans of the authority can be funded entirely from sources other than external borrowing.

2. External Context and Interest Rate Forecast

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

2.2 The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January 2015 meeting showed unanimity in maintaining the Bank Rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

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

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

2.5 **Interest rate forecast**: The Authority's treasury management advisor Arlingclose forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 2.7%.

2.6 A more detailed economic and interest rate forecast provided by the Arlingclose is attached at ***Appendix C***.

3. <u>Borrowing Strategy</u>

3.1 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. 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.

3.2 As indicated in Table 1, the Authority is currently debt free and its capital expenditure plans do not currently imply any external borrowing requirement in 2015/16. However, it should be noted in line with the current Medium Term Financial Strategy (MTFS) the Council may need to consider borrowing to finance its capital programme in the longer term as capital receipts diminish.

3.3 In addition, the Authority may borrow short-term loans (normally up to one month) to cover unexpected cash flow shortages.

4. Annual Investment Strategy

4.1 In accordance with Investment Guidance issued by the CLG and best practice this Authority'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 is secondary, followed by the yield earned on investments which is a tertiary consideration.

4.2 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to carry on with its diversification of investments during 2015/16. This is especially the case for the estimated £22m that is available for longer-term investment. The day to day cash surpluses are currently invested in short-term unsecured bank deposits and money market funds. This diversification will therefore represent a substantial change in strategy over the coming year.

4.3 Investments are categorised as 'Specified' or 'Non Specified' within the investment guidance issued by the CLG.

4.4 **Specified Investments**: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

4.5 The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

4.6 **Non-specified Investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality.

4.7 **Use of Custodian Account:** Due to bank regulation changes as mentioned in paragraph 2 – 'Credit Outlook', the council has recently opened a custodian account with King and Shaxson

Ltd, which will enable the council to invest with high credit rated institutions, with a pool of other investors, such as Certificate of Deposits (CD's), Bonds and Government T-Bills.

4.8 **Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£7m 5 years	£7m 20 years	£7m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£6m 10 years	£5m 25 years	£3m 10 years	£5m 10 years
AA	£5m 4 years	£6m 5 years	£6m 15 years	£2m 5 years	£5m 10 years
AA-	£5m 3 years	£6m 4 years	£5m 10 years	£2m 4 years	£5m 10 years
A+	£5m 2 years	£6m 3 years	£4m 5 years	£2m 3 years	£3m 5 years
A	£5m 13 months	£5m 2 years	£5m 5 years	£2m 2 years	£3m 5 years
A-	£5m 6 months	£5m 13 months	£4m 5 years	£2m	£3m 5 years
BBB+	£1m 100 days	£1m 6 months	£2m 2 years	£1m 6 months	£1m 2 years
BBB or BBB-	£1m next day only	£1m 100 days	n/a	n/a	n/a
None	£1m 100 days	£1m 100 days	n/a	n/a	n/a
Pooled funds	£6m max per fund				

This table must be read in conjunction with the notes below and in Appendix D.

4.9 **Credit Rating:** Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

4.10 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account

4.11 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

4.12 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

4.13 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

4.14 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain a high likelihood of receiving government support if needed.

4.15 **Pooled Funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

4.16 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

4.17 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,

- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

4.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.19 **Other Information on the Security of Investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

4.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

4.21 Registered Providers (RPs) have been included within the approved counterparty investments for 2015/16 following on from their use in the 2013/14 and 2014/15 financial years. Investments with RPs will be analysed on an individual basis and discussed with Arlingclose prior to investing. If the RP have a credit rating from one of the agencies we would look at there viability rating and could lend to them on either a secured or unsecured basis on the assets it holds. If the RP does not hold a credit rating but is HCA (Homes & Communities Agency) rated then any investment made would be assessed in conjunction with Arlingclose.

4.22 **Authority's Banker** – The Authority now banks with Lloyds Bank PLC (with effect from 1st April 2015) after carrying out a recent bank tender. At the current time it does meet the proposed minimum credit criteria of A- (or equivalent) long term, with two of the three well known credit rating agencies. Even if the credit rating falls below the Authority's minimum criteria Lloyds Bank PLC will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

5. Balanced Budget Requirement

5.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

6. 2015/16 MRP Statement

6.1. The Council is required to set an annual policy on the way it calculates the prudent provision for the repayment of borrowing (MRP). This year's policy is as follows:

6.2 CLG's Guidance on Minimum Revenue Provision (issued in 2010) places 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.

6.3 The four MRP options available are:

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

6.4 Although four options are detailed, the guidance also allows authorities to develop their own method of calculating MRP, providing the method is prudent.

6.5 MRP in 2015/16: 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 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. The MRP Statement will be submitted to Council before the start of the 2015/16 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

6.6 For 2015/16 the Council will apply Option 3, the 'Asset Life' Method, which makes revenue provision over the estimated life (in equal instalments) of the asset for which the borrowing is undertaken. MRP in respect of leases 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.

6.7 Although the Council does not plan to finance capital expenditure through borrowing within the term shown within the current Medium Term Financial Strategy (MTFS), it has a duty to approve a statement of policy to account for the MRP. The requirement is that the MRP Statement is submitted to Council before the start of 2015/16 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to the Council at that time.

7. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

The Strategic Director will report to the Finance and Management Overview and Scrutiny Committee on treasury management activity and performance, including the monitoring of Prudential Indicators as follows:

(a) Activity and performance against the strategy approved for the year will be reported regularly to the Finance and Management Overview and Scrutiny Committee and as a minimum a mid-year and year end review.
(b) The Finance and Management Overview and Scrutiny Committee will receive an outturn report on treasury activity no later than 30th September after the financial year end.
(c) The Finance and Management Overview and Scrutiny Committee will be responsible for the scrutiny of treasury management activity and practices.

8. Other items

8.1 Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

8.2 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

8.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Training

8.4 The needs of the Authority's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

8.5 Staff can regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

Investment Consultants / Treasury Advisors

8.6 The Authority uses Arlingclose as Treasury Management Advisors and receives the following services:

- Credit advice
- Investment advice
- Technical advice
- Economic & interest rate forecasts
- Workshop and training events
- Ad hoc advice and events.

8.7 The Authority maintains the quality of the service with its advisors by holding regular meetings. Arlingclose have been awarded the contract until November 2015.

9. Financial Implications

9.1 The budget for investment income in 2015/16 is estimated to be £650,000, based on an average investment portfolio of £34 million at an interest rate of 1.9%.

Other Options Considered

9.2 The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Director, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain

Appendix B

Prudential Indicators 2014/15 and 2015/16 – 2017/18

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.

1.2 The revised estimates are the updates to the approved estimates. It is the revised and estimate indicators that are recommended for adoption.

2. Gross Debt and the Capital Financing Requirement:

2.1 This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that the debt 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 capital financing requirement for the current and next two financial years.

2.2 If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

2.3 The Strategic Director reports that the authority had no difficulty meeting this requirement in 2014/15, nor is 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.

Capital Expenditure	**2014/15 Approved £'000**	**2014//15 Revised £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Capital Programme	2,883	4,314	4,142	1,146	1,007

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2014/15 Approved £'000	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital receipts	1,890	2,456	1,441	95	-
Government Grants / Contributions	593	1,458	301	251	251
Revenue contributions	400	400	2,400	800	756
Total Financing	2,883	4,314	4,142	1,146	1,007

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 Approved %	2014/15 Revised %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
Ratio	-7%	-7%	-8%	-10%	-12%

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 Approved £'000	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Total CFR	**910**	**911**	**555**	**182**	**-28**

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 31/03/2014	£'000
Borrowing	0
Other Long-term Liabilities	1,297
Total	**1,297**

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. 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	2014/15 Approved £	2014/15 Revised £	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £
Increase in Band D Council Tax	£0.75	£1.28	£0.66	£0.05	£0

7.2 The Council's capital plans, as estimated in forthcoming financial years, have a neutral impact on council tax. This reflects the fact that capital expenditure is predominantly financed from internal resources (grants, contributions, and capital receipts).

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. excluding investments) for the Council. It is measured on a daily basis against all external debt 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	2014/15 Approved £'000	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	8,000	8,000	8,000	8,000	8,000
Other Long-term Liabilities	957	957	601	228	18
Total	**8,957**	**8,957**	**8,601**	**8,228**	**8,018**

8.5 The Operational Boundary has been set on the estimate of the most likely i.e. prudent but not worse case scenario with sufficient headroom over and above this to allow for unusual cash movements.

8.6 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.

Operational Boundary for External Debt	2014/15 Approved £'000	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	4,000	4,000	4,000	4,000	4,000
Other Long-term Liabilities	957	957	601	228	18
Total	**4,957**	**4,957**	**4,601**	**4,228**	**4,018**

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Cabinet meeting on 17 February 2010.

The Authority has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

10.2 The Council is debt free and will maintain that position in the medium term. The Council is not planning to borrow long term, but may need the flexibility to borrow on a temporary short term basis to accommodate cash flow fluctuation, within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

10.3 The Council's existing level of fixed or variable rate exposure is nil.

	2014/15 Approved %	2014/15 Revised %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	100	100	100	100	100

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 As the Council is debt free and intends to remain so for the immediate future, this indicator does not apply.

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.

Upper Limit for total principal sums invested over 364 days	**2014/15 Approved £m**	**2014/15 Revised £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**
	15	**15**	**15**	**15**	**15**

Appendix C

Arlingclose Economic & Interest Rate Forecast January 2015

Underlying assumptions:

- The UK economic recovery slowed towards the end of 2014, with economic and political uncertainty weighing on business investment. However, the Q3 growth rate of 0.7% remains slightly above the long run average, suggesting the recovery remains robust.
- Household consumption is key to the recovery in 2015. While we expect consumption growth to slow, given softening housing market activity and slower employment growth, the fall in inflation and resulting rise in both real (and nominal) wage growth and disposable income should support spending.
- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term. The fall in oil prices has yet to feed fully into the prices of motor fuel and retail energy and CPI is expected to fall further. Supermarket price wars are also expected to bear down on food price inflation.
- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.
- Nominal earnings growth is strengthening, but remains relatively weak in historical terms, despite large falls in unemployment. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.
- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.
- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.
- The ECB has introduced outright QE as expected. While this may alleviate some of the anxiety about the economic potential of the Eurozone, political risk remains significant (e.g. Greek election). Therefore fears for the Eurozone are likely to maintain a safe haven bid for UK government debt.

Forecast:

- We continue to forecast the first rise in official interest rates in Q3 2015, but the risks to this forecast are very much weighted to the downside. The February Inflation Report will be key to our review of the possible path for Bank Rate.

- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.
- Market sentiment (derived from forward curves) has shifted significantly lower in the past three months; market expectations are now for a later increase in interest rates and a more muted increase in gilt yields.
- The short run path for gilt yields has flattened due to the sharp decline in inflation expectations. We project gilt yields on an upward path in the medium term.
- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**	**1.75**	**1.75**	**1.75**
Downside risk			0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	**0.55**	**0.60**	**0.80**	**0.90**	**1.05**	**1.15**	**1.30**	**1.40**	**1.55**	**1.65**	**1.80**	**1.95**	**2.00**
Downside risk	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	0.95	0.95	0.95	0.95	1.00
1-yr LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.95**	**1.00**	**1.20**	**1.30**	**1.45**	**1.55**	**1.70**	**1.80**	**1.95**	**2.05**	**2.20**	**2.35**	**2.40**
Downside risk	0.15	0.20	0.30	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.80	0.80	0.80
5-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50
Arlingclose Central Case	**1.10**	**1.20**	**1.30**	**1.40**	**1.50**	**1.65**	**1.80**	**1.95**	**2.10**	**2.20**	**2.35**	**2.40**	**2.50**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.70	0.75
10-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.55	0.55
Arlingclose Central Case	**1.60**	**1.70**	**1.80**	**1.90**	**2.00**	**2.15**	**2.30**	**2.45**	**2.60**	**2.70**	**2.85**	**2.90**	**3.00**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.75	0.80
20-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.10**	**2.20**	**2.30**	**2.35**	**2.45**	**2.50**	**2.65**	**2.75**	**2.90**	**3.00**	**3.15**	**3.20**	**3.30**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90
50-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.15**	**2.25**	**2.35**	**2.40**	**2.50**	**2.55**	**2.70**	**2.80**	**2.95**	**3.05**	**3.20**	**3.25**	**3.35**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90

Appendix D

Recommended Sovereign and Counterparty List

- **Group Limits -** For institutions within a banking group, the authority executes a limit of 1.5 times the individual limit of a single bank within that group.

Instrument	Country/ Domicile	Counterparty	Long-Term Credit Rating Fitch/ Moody's/S&P	Maximum Counterparty Limit- Unsecured £m	Maximum Counterparty Limit- Secured £m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Santander UK Plc (Banco Santander Group)	A/A2/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	A/A1/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Lloyds TSB (Lloyds Banking Group)	A/A1/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Barclays Bank Plc	A/A2/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Close Brothers Limited	A/A3/na	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Goldman Sachs International Bank	A/A2/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	HSBC Bank Plc	AA-/Aa3/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Leeds Building Society	A-/A3/na	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Nationwide Building Society	A/A2/A	£5m	£5m

Instrument	Country/ Domicile	Counterparty	Long-Term Credit Rating Fitch/ Moody's/S&P	Maximum Counterparty Limit- Unsecured £m	Maximum Counterparty Limit- Secured £m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	NatWest (RBS Group)	A/Baa1/A- Not able to lend to at present	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Royal Bank of Scotland (RBS Group)	A/Baa1/A- Not able to lend to at present	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	UK	Standard Chartered Bank	AA-/A1/A+	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Australia	Australia and NZ Banking Group	AA-/Aa2/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Australia	Commonwealth Bank of Australia	AA-/Aa2/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	AA-/Aa2/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Australia	Westpac Banking Corp	AA-/Aa2/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Canada	Bank of Montreal	AA-/Aa3/A+	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Canada	Bank of Nova Scotia	AA-/Aa2/A+	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Canada	Canadian Imperial Bank of Commerce	AA-/Aa3/A+	£5m	£6m

Instrument	Country/ Domicile	Counterparty	Long-Term Credit Rating Fitch/ Moody's/S&P	Maximum Counterparty Limit- Unsecured £m	Maximum Counterparty Limit- Secured £m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Canada	Royal Bank of Canada	AA/Aa3/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Canada	Toronto-Dominion Bank	AA-/Aa1/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Finland	Nordea Bank Finland	AA-/Aa3/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Finland	Pohjola Bank	A+/Aa3/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Germany	Deutsche Bank AG	A+/A3/A	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Germany	Landesbank Hessen-Thuringen (Helaba)	A+/A2/A	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Netherlands	ING Bank NV	A+/A2/A	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Netherlands	Rabobank	AA-/Aa2/A+	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Netherlands	Bank Nederlandse Gemeenten	AAA/Aaa//AA+	£7m	£7m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Singapore	DBS Bank Ltd	AA-/Aa1/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Singapore	Oversea-Chinese Banking Corporation	AA-/Aa1/AA-	£5m	£6m

Instrument	Country/ Domicile	Counterparty	Long-Term Credit Rating Fitch/ Moody's/S&P	Maximum Counterparty Limit- Unsecured £m	Maximum Counterparty Limit- Secured £m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Singapore	United Overseas Bank	AA-/Aa1/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Sweden	Svenska Handelsbanken	AA-/Aa3/AA-	£5m	£6m
Term Deposits / CDs /Corporate Bonds/Call Accounts	Switzerland	Credit Suisse	A/A1/A	£5m	£5m
Term Deposits / CDs /Corporate Bonds/Call Accounts	US	JP Morgan	A+/Aa3/A+	£5m	£6m

***Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively, if counterparty is downgraded, this list may be shortened.*

Appendix E

Summary of Prudential Indicators to be submitted to Council 25 February 2015.

	2014/15 Revised	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital expenditure	£4,317m	£4,142m	£1,146m	£1,007m
Ratio of financing costs to net revenue stream	-7%	-8%	-10%	-12%
Capital financing requirement	£0.911m	£0.555m	£0.182m	-£0.028
Actual External Debt as at 31/03/2014	Nil	Nil	Nil	Nil
Incremental impact of capital investment decisions on the Band D Council Tax	£1.28	£0.66	£0.05	£0
Authorised limit external debt	£8.957m	£8.601m	£8.228m	£8.018m
Operational boundary external debt	£4.957m	£4.601m	£4.228m	£4.018m
Adoption of the CIPFA Code of Practice in Treasury Management	Yes	Yes	Yes	Yes
Upper Limit for Fixed Interest Rate Exposure	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	100%	100%	100%	100%
Maturity structure of fixed rate borrowing	N/A	N/A	N/A	N/A
Upper Limit for total principal sums invested over 364 days	£15m	£15m	£15m	£15m