Appendix 1

South Somerset District Council
Treasury Management Strategy Statement and Investment Strategy 2014/15

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Appendices

1. Background

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

1.2 CIPFA has defined Treasury Management as:

"the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.4 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activies

- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.5 Full Council will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

1.6 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Audit Committee and for the execution and administration of treasury management decisions to the Assistant Director (Finance and Corporate Services) who will act in accordance with the organisation's policy statement and TMPs and CIPFA's standard of Professional Practice on Treasury Management.

1.7 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

1.8 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

1.9 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

1.10 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

1.11 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

1.12 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council's treasury activities are:

- Liquidity Risk (Adequate cash resources)
- Market or Interest Rate Risk (Fluctuations in the value of investments)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements)

2. Credit Outlook and interest rate forecast

2.1 The credit risk of banking failures has reduced but is not completely absent. Regulatory changes are happening in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple A' credit rating wrapper. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

2.2 The Arlingclose interest rate forecast is for the Bank Rate to remain flat until late 2016, the risk to the upside (i.e. rates being higher) are weighted more heavily towards the end of the forecast horizon, as the table on page 18 shows. Gilt yields are expected to rise over the forecast period with medium- and long-dated gilts expected to rise by between 0.7% and 1.1%.

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

3. Balance Sheet and Treasury Position

3.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31/03/14 Actual £'000	31/03/15 Estimate £'000	31/03/16 Estimate £'000	31/03/17 Estimate £'000
CFR	9,624	9,260	9,191	9,167
Usable Capital Receipts	(36,396)	(29,835)	(29,119)	(28,387)
Balances & Reserves	(14,143)	(14,337)	(13,518)	(13,312)
Net Balance Sheet Position **	**(40,915)**	**(34,912)**	**(33,446)**	**(32,532)**

***excluding working capital.*

3.2 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out at Appendix A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

3.3 As the CFR represents the underlying need to borrow and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements.

3.4 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The Council does not have external borrowing nor is the Council expecting to borrow in 2014/15 and therefore complies with this recommendation during the year.

3.5 The estimate for interest payments in 2014/15 is nil and for interest receipts is £333,840

4. Borrowing Requirement and Strategy

4.1 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 Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

4.2 The Council's strategy is to maintain maximum control over any potential long term borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimize borrowing costs over the medium to longer term (should SSDC decide to borrow). A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators. In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages

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

- Internal
- Public Works Loan Board
- UK local authorities

- Any institution approved for investments (see below)
- Any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds (except the Somerset Pension Fund)
- Capital market bond investors
- Special purpose companies created to enable joint local authority bond issues
- Structured finance
- Leasing

4.4 The Council will undertake a financial options appraisal before any borrowing is made.

4.5 For any borrowing that may be undertaken in advance of need the Council will adopt the same rigorous policies and approach to the protection of capital as it does for the investment of its surplus balances.

5. Investment Strategy

5.1 Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

5.2 The Authority may invest its surplus funds with any of the counterparties in the following table, subject to the cash and time limits shown.

Counterparty		**Cash limit**	**Time limit †**
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£4m each	10 years*
	AA+		5 years*
	AA		4 years*
	AA-		3 years*
	A+		2 years
	A		1 year
	A-		
The Authority's current account bank (Natwest) if it fails to meet the above criteria		£0.5m	next day
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£4m each	10 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		£4m each	10 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings		£3m each	5 years
UK Building Societies without credit ratings		£1m each	1 year
Money market funds and other pooled funds		£3m nominal each	n/a

Any other organisation, subject to an external credit assessment and specific advice from the Authority's treasury management adviser	£2m each	3 months
	£1m each	1 year
	£100k each	5 years

† the time limit is doubled for investments that are secured on the borrower's assets
* but no longer than 2 years in fixed-term deposits and other illiquid instruments
** but no longer than 5 years in fixed-term deposits and other illiquid instruments

5.3 There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

5.4 In addition, the Authority may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Authority's treasury management adviser.

5.5 Registered Providers: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

5.6 Building Societies: The Authority takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Authority's deposits would be paid out in preference to retail depositors. The Authority will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

5.7 Money Market Funds: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Authority. 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 funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

5.8 Other Pooled Funds: The Authority will have cash balances available for investment over the medium term. It will therefore continue to use pooled bond, equity and property funds that offer enhanced returns over the longer term, but are potentially more volatile in the shorter 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.

5.9 Other Organisations: The Authority may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Authority's treasury management adviser.

5.10 Risk Assessment and Credit Ratings: The Authority uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. 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.

5.11 Where a credit rating agency announces that a A- 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 overnight investments 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.

5.12 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.

5.13 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 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.

5.14 Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:

- the UK Government,
- a UK local authority, parish council or community council, or
- a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations 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.

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

Non-Specified Investment Limits

	Cash limit
Total long-term investments (over 364 days)	£23m
Total investments without credit ratings or rated below A-	£5m *
Total investments in foreign countries rated below AA+	£4m
Total non-specified investments	£32m

*This limit will be reviewed in the event a change in EU legislation results in MMFs no longer being credit rated.

5.16 Investment Limits: The Authority's revenue reserves available to cover investment losses are forecast to be £4 million on 31st March 2014. South Somerset District Council has allocated a weighting of 25% to this risk, meaning that no more than 25% of available reserves (£1 million) will be put at risk in the case of a single default. The maximum that will be lent to any one organisation (other than the UK Government) will be £4 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts *(e.g. King & Shaxson)*, foreign countries and industry sectors as below:

Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£4m per manager
Negotiable instruments held in a broker's nominee account	£25m per broker
Foreign countries	£12m per country
Registered Providers	£8m in total
Building Societies	£8m in total
Loans to small businesses	£4m in total
Money Market Funds	£20m in total

5.17 Approved Instruments: The Authority may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Authority may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £2 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

5.18 Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

5.19 Authority's Banker – The Council banks with National Westminster Bank which is currently rated above the minimum A- rating in the table under paragraph 5.2. Should the credit ratings fall below A-, Natwest will continue to be used for short term liquidity requirements (overnight) and business continuity arrangements.

6 Policy on use of financial Derivatives

6.1 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).

6.2 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 will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

6.3 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.

6.4 The local authority will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

7. Balanced Budget Requirement

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

8. 2014/15 MRP Statement

Background:

8.1 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.

8.2 The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits, or, in the case of borrowing supported by Revenue Support Grant, the aim is that MRP is charged over a period reasonably commensurate with the period implicit in the determination of that grant.

8.3 The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. Four options for prudent MRP provision are set out in the CLG Guidance. Details of each are set out below:

Option 1 – Regulatory Method:

8.4 This method replicates the position that would have existed under the previous Regulatory environment. MRP is charged at 4% of the Authority's underlying need to borrow for capital purposes, however this option allows a historical adjustment to take place that is beneficial to some authorities. This method can only be used for supported expenditure.

Option 2 – CFR Method:

8.5 This method simplifies the calculation of MRP by basing the charge solely on the authority's CFR but excludes the technical adjustments included in Option 1. The annual MRP charge is set at 4% of the CFR at the end of the preceding financial year. This method can only be used for supported expenditure.

Option 3 – Asset Life Method:

8.6 Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated by either of the following methods:

(a) Equal Installments: where the principal repayment made is the same in each year,

or

(b) Annuity: where the principal repayments increase over the life of the asset. The annuity method has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

8.7 MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken in relation to assets which take more than one year to be completed before they become operational.

8.8 The estimated life of the asset will be determined in the year that MRP commences and cannot be revised. However, additional repayments can be made in any year which will reduce the level of payments in subsequent years.

8.9 If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure, where this would exceed 50 years.

8.10 In instances where central government permits revenue expenditure to be capitalised, the Statutory Guidance sets out the number of years over which the charge to revenue must be made.

Option 4 - Depreciation Method:

8.11 The deprecation method is similar to that under Option 3 but MRP is equal to the depreciation provision required in accordance with proper accounting practices to be charged to the Income and Expenditure account

MRP Policy for 2014/15:

8.12 It is proposed that for 2014/15 the Council adopts Option 3 – Asset Life Method. Option 3 enables the calculation of MRP to be aligned with the life of the asset. If it is ever proposed to vary the terms of this MRP Statement during the year, a revised statement will be made to Council at that time.

8.13 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.

9. Monitoring and Reporting on Treasury Management

The scrutiny of the treasury management function is carried out by the Audit Committee who then make recommendations to Full Council. The Assistant Director (Finance and Corporate Services) will report to Council/Audit Committee on treasury management activity / performance as follows:

(a) Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

(b) Audit Committee will review the Treasury Management Strategy Statement, Investment Strategy, MRP Statement, and Prudential Indicators twice per year and recommend them to Council for Approval

(c) Audit Committee will monitor Treasury Management activity quarterly and annually and will approve the Treasury Management Practices on an annual basis

(d) Full Council will receive the Treasury Management Strategy Statement, Investment Strategy, MRP Statement, and Prudential Indicators prior to the start of the financial year and a mid year review against the strategy approved for the year.

(e) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

10. Other Items

Training

CIPFA's revised Code requires the Assistant Director (Finance and Corporate Services) ensures 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.

Officers tasked with treasury management responsibilities are engaged in regular financial and treasury training through attendance at selective seminars/workshops and treasury courses.

Treasury Management Advisors

The Council appointed Arlingclose as its Treasury Advisers in 2005. The provision of treasury advisory services was formally re-tendered in autumn 2009 and Arlingclose was reappointed. Among the various services received is **advice** on capital financing, borrowing and investments appropriate to the Council's individual circumstances and objectives.

The Council monitors the service through measuring:

- The timeliness of advice
- The returns from investments
- The accuracy of technical advice
- Regular market testing
- Regular internal meetings to discuss performance
- Direct access to a nominated advisor
- The quality and content of training courses

However, this does not divest the Council from its responsibility of its treasury decisions.

APPENDIX A

EXISTING PORTFOLIO PROJECTED FORWARD

	31/03/13 Actual £'000	31/03/14 Actual £'000	31/03/15 Estimate £'000	31/03/16 Estimate £'000
External Borrowing:				
Long-term liabilities				
• *Finance Leases*	382	511	146	78
Total External Debt	382	511	146	78
Investments:				
• Short term Deposits	25,500	18,500	26,600	26,750
• Monies on call and Money Market Funds	4,810	7,690	5,028	5,035
• Long term Deposits	0	2,000	0	0
• Bonds	9,000	10,750	5,000	5,000
• Property Fund & Other pooled funds	0	4,000	2,000	2,000
Total Investments	**39,310**	**42,940**	**38,628**	**38,785**
(Net Borrowing Position)/ Net Investment position	**38,928**	**42,429**	**38,482**	**38,707**

APPENDIX B

PRUDENTIAL INDICATORS 2014/15 TO 2016/17

Background:

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, 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. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Prudential Indicator 1 - Capital Expenditure:

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. The approved expenditure for 2013/14 and the estimates of capital expenditure to be incurred for 2014/15 and future years are:

	2013/14 Approved £'000	**2014/15 Approved £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Approved capital schemes	2,140	3,642	761	41
Reserve schemes	1,062	1,847	0	0
New Schemes for 2014/15 start		919	670	650
Total Expenditure	**3,202**	**6,408**	**1,431**	**691**

The figures in the later years are showing income streams. This is due to income already budgeted from previously approved schemes. This will change as anticipated capital projects are approved. Additional capital expenditure will also occur if new capital receipts are received and used to finance projects currently on the reserve list, as per the capital strategy.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure. This shows how much of the revenue budget is committed to the servicing of finance.

Estimates of the ratio of financing costs to net revenue stream for the 2014/15 and future years, and the approved figures for 2013/14 are:

Portfolio	**2013/14 Approved £'000**	**2014/15 Approved £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Financing Costs*	(220)	(226)	(276)	(322)
Net Revenue Stream	17,955	17,541	18,107	18,237
%*	**(1.2)**	**(1.3)**	**(1.5)**	**(1.8)**

*Figures in brackets denote income through receipts or reserves.

The financing costs include interest payable, notional amounts set aside to repay debt, less, interest on investment income. The figures are in brackets due to investment income outweighing financing costs significantly for SSDC. This shows the extent that the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement:

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Estimates of the year-end capital financing requirement for the authority are:

	2013/14 Approved £'000	**2014/15 Approved £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Opening CFR	9,499	9,374	9,260	9,191
Capital Expenditure	3,598	5,410	893	122
Capital Receipts*	(2,140)	(4,461)	(831)	(91)
Grants/Contributions*	(1,458)	(949)	(62)	(31)
MRP	(125)	(114)	(69)	(24)
Additional Leases taken on during the year	0	0	0	0
Closing CFR	**9,374**	**9,260**	**9,191**	**9,167**

*Figures in brackets denote financing through receipts or reserves.

Prudential Indicator 4 – Gross Debt and the Capital Financing Requirement:

The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the gross external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period. This is a key indicator of prudence.

	2013/14 Revised £'000	**2014/15 Revised £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	0	0	0	0
Finance leases	261	349	78	54
Total Debt	**261**	**349**	**78**	**54**

Total debt is expected to remain below the CFR during the forecast period

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. Overall the authority is aiming to keep within the following exposure to fixed rates as and when market conditions improve.

	2013/14 % Limit	2014/15 % Limit	2015/16 % Limit	2016/17 % Limit
Fixed	80	80	80	80
Variable	100	100	100	100

The Council must also set limits to reflect any borrowing we may undertake.

	2013/14 % Limit	2014/15 % Limit	2015/16 % Limit	2016/17 % Limit
Fixed	100	100	100	100
Variable	100	100	100	100

The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

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	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Between 1-2 years	25,000	25,000	25,000	25,000
Between 2-3 years	20,000	20,000	20,000	20,000
Between 3-4 years	10,000	10,000	10,000	10,000
Between 4-5 years	10,000	10,000	10,000	10,000
Over 5 years	5,000	5,000	5,000	5,000

The estimates are considerably higher than the actual balances held in previous years to ensure the Council has sufficient flexibility to deal with any unexpected events. **The overall limit for maturities of greater than 364 days will not exceed 70% of the portfolio.**

Prudential Indicator 7 – Credit Risk:

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

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.

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 and its sovereign
- 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

The only indicators with prescriptive values remain to be credit ratings. The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average long-term credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

The Council targets a portfolio average long-term credit rating of 'A' or higher. (This target rating is one notch above the Council's minimum rating criteria of A-.)

Other indicators of creditworthiness are considered in relative rather than absolute terms.

Prudential Indicator 8 - Actual External Debt:

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	511
Total	**511**

Prudential Indicator 9 - Authorised Limit for External Debt:

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.

This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council has acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A £9.1m borrowing requirement has been identified to finance the capital programme and further borrowing may be undertaken to increase our borrowing to this level if and when it is the most cost effective way of funding SSDC's requirements. A ceiling of £12 million for each of the next three years is recommended, to allow flexibility to support new capital projects over and above the identified borrowing requirement.

	2013/14 Approved £'000	**2014/15 Approved £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	11,000	11,000	11,000	11,000
Other Long-term Liabilities	1,000	1,000	1,000	1,000
Total	**12,000**	**12,000**	**12,000**	**12,000**

Prudential Indicator 10 – Operational Boundary for External Debt:

The Operational Boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million is recommended for each of the next three years. The table

overleaf shows that SSDC's current borrowing is well within this limit. This indicator more than covers the capital financing requirement.

The Assistant Director (Finance and Corporate Services) 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 the next Council meeting.

	2013/14 Approved £'000	**2014/15 Approved £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	9,200	9,200	9,200	9,200
Other Long-term Liabilities	800	800	800	800
Total	**10,000**	**10,000**	**10,000**	**10,000**

Prudential Indicator 11 - Maturity Structure of Fixed Rate borrowing:

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.

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	**2013/14 % Actual**	**2014/15 % Estimate**	**Lower Limit %**	**Upper Limit %**
Under 12 months	0	0	0	100
12 months and within 24 months	0	0	0	100
24 months and within 5 years	0	0	0	100
5 years and within 10 years	0	0	0	100
10 years and within 20 years	0	0	0	100
20 years and within 30 years	0	0	0	100
30 years and within 40 years	0	0	0	100
40 years and within 50 years	0	0	0	100
50 years and above	0	0	0	100

As the council doesn't have any fixed rated external borrowing at present the above upper and lower limits have been set to allow flexibility to borrow within any of the maturity bands.

Prudential Indicator 12 - Incremental Impact of Capital Investment Decisions:

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Increase in Band D Council Tax	0.04	0.15	0.17

Prudential Indicator 13 - Adoption of the CIPFA Treasury Management Code:

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 Council meeting on 18th April 2002.

APPENDIX C

Arlingclose's Economic and Interest Rate Forecast

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Official Bank Rate												
Upside risk	0.25	0.25	0.25	0.50	0.25	0.50	0.50	0.50	0.50	0.75	0.75	1.00
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50
Downside risk					0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00
3-month LIBID rate												
Upside risk	0.30	0.35	0.40	0.55	0.60	0.70	0.75	0.80	0.90	0.95	1.00	1.00
Arlingclose Central Case	0.50	0.55	0.60	0.65	0.85	1.00	1.15	1.25	1.40	1.50	1.65	1.70
Downside risk	0.05	0.10	0.15	0.20	0.30	0.40	0.55	0.65	0.75	-0.85	-1.00	-1.00
1-yr LIBID rate												
Upside risk	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80	0.80
Arlingclose Central Case	0.90	0.95	1.00	1.05	1.20	1.35	1.45	1.55	1.65	1.70	1.80	1.90
Downside risk	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.75	-0.80
5-yr gilt yield												
Upside risk	0.40	0.50	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.05
Arlingclose Central Case	1.80	1.95	2.10	2.20	2.30	2.40	2.50	2.65	2.75	2.85	2.90	3.00
Downside risk	-0.30	-0.40	-0.50	-0.50	-0.60	-0.70	-0.75	-0.80	-0.85	-0.85	-0.85	-1.00
10-yr gilt yield												
Upside risk	0.45	0.50	0.60	0.70	0.75	0.90	1.00	1.00	1.00	1.00	1.00	1.05
Arlingclose Central Case	2.40	2.60	2.80	2.85	3.00	3.15	3.30	3.45	3.60	3.70	3.80	3.80
Downside risk	-0.40	-0.50	-0.55	-0.60	-0.70	-0.80	-0.90	-0.95	-1.00	-1.05	-1.10	-1.15
20-yr gilt yield												
Upside risk	0.50	0.60	0.75	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.00	3.20	3.40	3.55	3.65	3.70	3.75	3.80	3.85	3.90	3.95	3.95
Downside risk	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.85	-0.90
50-yr gilt yield												
Upside risk	0.50	0.60	0.75	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.05
Arlingclose Central Case	3.05	3.20	3.35	3.50	3.65	3.75	3.85	3.95	4.00	4.00	4.05	4.10
Downside risk	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.85	-0.90

Underlying assumptions:

- The UK economic recovery has continued apace and now appears more sustainable. GDP growth has averaged 0.8% per quarter since the middle of 2013.

- While still largely driven by household consumption, the large and continued rise in employment makes this position of less concern in the short term. On the back of strong consumption growth, business investment is recovering quickly, albeit from a low base, and should support continued expansion of GDP throughout this year.

- We expect consumption growth to slow later this year, alongside softening housing market activity and the subdued outlook for wage growth.

- Inflationary pressure is currently low and is likely to remain so in the short-term, notwithstanding commodity price shocks related to regional tensions. Despite a slight correction in the appreciation of sterling against the US dollar, imported inflation remains limited and will mitigate some of the effect of possible rises in $US-denominated commodity prices.

- Stronger economic growth has prompted MPC policymakers to deliver a less dovish message, but the MPC remains concerned about the sensitivity of the UK economy to a rise in Bank Rate. 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.

- Weak earnings growth continues to deteriorate with an annual decline of -0.2% in June despite large falls in unemployment, which poses a dilemma for the MPC. 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.

- The lack of wage and inflationary pressures will be the main reasons policymakers are likely to hold off monetary tightening until later than markets are currently forecasting. They are nevertheless communicating the possibility of a rise in Bank Rate; an attempt, we believe, to prompt highly indebted businesses and households to manage and reduce their exposures to rising interest rates.

- The continuing repair of public and private sector balance sheets leave them sensitive to higher interest rates. 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%.

- Potential upside risks include a shift in relative monetary policy expectations between the UK and the US, and rises in commodity prices on the back of geo-political tensions.

Arlingclose Forecast:

- We forecast the first rise in official interest rates in Q3 2015, which is later than general market sentiment. There is clear momentum in the economy, but inflation is benign and currently sits below target. We expect this situation to persist for some time, reducing the need for immediate monetary tightening.
- 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%.
- We continue to project gilt yields on an upward path through the medium term as the recovery takes hold, notwithstanding temporary volatility due to the UK General Election and other geo-political events.

APPENDIX D

Glossary of Terms

Balances and Reserves	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Bond	A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital growth	Increase in the value of the asset (in the context of a collective investment scheme, it will be the increase in the unit price of the fund)
Capital receipts	Money obtained on the sale of a capital asset.
Credit Rating	Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Collective Investment Schemes	Funds in which several investors collectively hold units or shares. The assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'Pooled Funds'). Unit Trusts and Open-Ended Investment Companies are types of collective investment schemes / pooled funds.
Corporate Bonds	Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Corporate Bond Funds	Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations.
CPI	Consumer Price Index. (This measure is used as the Bank of England's inflation target.)
Credit default swaps	Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
ECB	European Central Bank

Federal Reserve	The US central bank. (Often referred to as “the Fed”)
Floating Rate Notes	A bond issued by a company where the interest rate paid on the bond changes at set intervals (generally every 3 months). The rate of interest is linked to LIBOR and may therefore increase or decrease at each rate setting
Gilt	Is a fixed rate security issued as debt and repaid at a future date.
IFRS	International Financial Reporting Standards
Income Distribution	The payment made to investors from the income generated by a fund; such a payment can also be referred to as a ‘dividend’
Maturity	The date when an investment or borrowing is repaid
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision	An annual provision that the Authority is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets
Non-Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.
Pooled funds	See Collective Investment Schemes (above)
Prudential Code	Developed by CIPFA as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice
Prudential Indicators	Indicators determined by the local authority to define the its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators
PWLB	Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Revenue Expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges
SI (Statutory Instrumeny)	Is the principal form in which delegated or secondary legislation is made in Great Britain.
SORP	Statement of Recommended Practice for Accounting (Code of Practice on Local Authority Accounting in the United Kingdom).

Specified Investments	Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local authorities and bodies that have a high credit rating.
Supranational Bonds	Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry a AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.
Supported Capital Expenditure	The financing element of Capital expenditure that is grant funded by Central Government
Treasury Management Code	CIPFA's Code of Practice for Treasury Management in the Public Services
Temporary Borrowing	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest)
Unsupported Capital Expenditure	The financing of Capital expenditure is financed internally through the revenue budget
Yield	The measure of the return on an investment instrument