

Appendix B

South Somerset District Council Treasury Management Strategy Statement and Investment Strategy 2015/16

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1. **Background**

- 1.1 In March 2012 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.
- 1.2 In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.
- 1.3 This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance
- 1.4 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."
- 1.5 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.
- 1.6 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 activities
 - 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.
- 1.7 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.
- 1.8 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.
- 1.9 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.
- 1.10 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.

- 1.11 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.
- 1.12 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.
- 1.13 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.
- 1.14 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 Credit outlook: 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.
- 2.2 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.

~~2.3 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 3.40%.

- 2.4 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix C.

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 Actual £'000	31/03/16 Estimate £'000	31/03/17 Estimate £'000	31/03/18 Estimate £'000
CFR	9,624	9,447	9,361	9,316	9,293
Usable Capital Receipts	(36,396)	(35,659)	(30,601)	(30,276)	(30,276)
Balances & Reserves	(14,143)	(16,795)	(17,866)	(17,866)	(17,866)
Net Balance Sheet Position **	(40,915)	(43,007)	(39,106)	(38,826)	(38,849)

**excluding working capital.

Note: The reduction in usable capital receipts is due to Loans being approved to the Waste Partnership £1.9m, Kingsdon PC £28k and Hinton St George £1.9m

- 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.
- 3.5 The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall as capital receipts are used to finance capital expenditure and reserves are used to finance the revenue budget. The estimate for interest payments in 2015/16 is nil and for interest receipts is £461,320

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 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 4.3 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2015/16 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 4.4 In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) or its replacement body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except [your local] Pension Fund)
- capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues
- include any other counterparty you intend to borrow from

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

- 4.5 The Council will undertake a financial options appraisal before any borrowing is made.
- 4.6 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 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £42.9 and £64.7 million, and similar levels are expected to be maintained in the forthcoming year.
- 5.2 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.

- 5.3 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and higher yielding asset classes during 2015/16.

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

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

*includes unrated UK Local Authorities

- 5.4 **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.
- 5.5 **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 bank National Westminster Bank Plc.
- 5.6 **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.

- 5.7 **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.
- 5.8 **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.
- 5.9 **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.
- 5.10 **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. The limit on pooled funds is on the nominal value not the valuation.

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.

- 5.11 **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,
 - on the advice of Arlingclose, any existing investments that can be recalled or sold at no cost will be, following consultation with the chair of Audit Committee, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 5.12 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 on the next working day 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.

5.13 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.

5.14 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.

5.15 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.

5.16 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)	£30m
Total investments without credit ratings or rated below A- (does not include other UK Local Authorities)	£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.

5.17 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	£30m per broker
Foreign countries	£12m per country
Registered Providers	£8m in total
Unsecured investments with Building Societies	£8m in total
Loans to unrated corporates	£4m in total
Money Market Funds	£20m in total

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 **Liquidity Management:** The Authority uses cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

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 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.
- 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 Government Revenue Support Grant, 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 depreciation 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 2015/16:

- 8.12 It is proposed that for 2015/16 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 2014 and Arlingclose was reappointed. Among the various services received is **advice** on investment, debt and capital finance issues 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 doesn't divest the Council from its responsibility of its treasury decisions.

Financial Implications

The budget for investment income in 2015/16 is £461k, based on an average investment portfolio of £51.3 million at an interest rate of 0.9%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

EXISTING PORTFOLIO PROJECTED FORWARD

	31/03/14 Actual £'000	31/03/15 Actual £'000	31/03/16 Estimate £'000	31/03/17 Estimate £'000
External Borrowing:				
<i>Long-term liabilities</i>				
• <i>Finance Leases</i>	511	334	248	203
Total External Debt	511	334	248	203
Investments:				
• Short term Deposits	18,500	20,000	27,000	27,000
• Monies on call and Money Market Funds	7,690	3,720	8,000	8,000
• Long term Deposits	2,000	0	4,000	4,000
• Bonds	10,750	20,651	5,000	5,000
• Property Fund & Other pooled funds	4,000	4,000	4,000	4,000
Total Investments	42,940	48,371	48,000	48,000
(Net Borrowing Position)/ Net Investment position	42,429	48,037	47,752	47,797

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 2014/15 and the estimates of capital expenditure to be incurred for 2015/16 and future years are:

	2014/15 Approved £'000	2015/16 Approved £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Approved capital schemes	4,561	5,637	304	0
Reserve schemes	1,847	3,463	600	0
Total Expenditure	6,408	9,100	904	0

The figures in the reserve scheme for 2015/16 is showing lower than in 2016/17. This is due to income already budgeted from previously approved schemes. The expenditure for 2017/18 is currently nil. 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 2015/16 and future years, and the approved figures for 2014/15 are:

Portfolio	2014/15 Approved £'000	2015/16 Approved £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Financing Costs*	(226)	(461)	(416)	(438)
Net Revenue Stream	17,541	17,390	16,933	16,718
%*	(1.3)	(2.7)	(2.5)	(2.6)

*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:

	2014/15 Approved £'000	2015/16 Approved £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Opening CFR (Actual 14/15)	9,624	9,484	9,361	9,316
Capital Expenditure	5,410	6,795	335	0
Capital Receipts*	(4,561)	(5,637)	(304)	0
Grants/Contributions*	(849)	(1,158)	(31)	0
MRP	(140)	(123)	(45)	(23)
Closing CFR	9,484	9,361	9,316	9,293

*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.

	2014/15 Revised £'000	2015/16 Revised £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	0	0	0	0
Finance leases	334	186	203	180
Total Debt	334	186	203	180

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.

	2014/15 % Limit	2015/16 % Limit	2016/17 % Limit	2017/18 % Limit
Fixed	80	80	80	80
Variable	100	100	100	100

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

	2014/15	2015/16	2016/17	2017/18

	% Limit	% Limit	% Limit	% 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	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 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 31/03/2015	£’000
Borrowing	0
Other Long-term Liabilities	334
Total	334

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.

	2014/15 Approved £’000	2015/16 Estimate £’000	2016/17 Estimate £’000	2017/18 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.

	2014/15 Approved £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 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	2014/15 % Actual	2015/16 % 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	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £
Increase in Band D Council Tax	0.07	0.17	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.

Arlingclose's Economic and Interest Rate Forecast

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Average
Official Bank Rate														
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.33
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	1.17
Downside risk				-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-0.73
3-month LIBID rate														
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.35
Arlingclose Central Case	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.90	1.90	1.29
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20	-0.75
1-yr LIBID rate														
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.40
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15	1.74
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25	-0.80
5-yr gilt yield														
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.55
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35	1.97
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25	-0.87
10-yr gilt yield														
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.55
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80	2.45
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25	-0.87
20-yr gilt yield														
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.55
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95	2.71
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20	-0.82
50-yr gilt yield														
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.55
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00	2.75
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15	-0.77

Underlying assumptions:

- The UK economic recovery has continued. Household consumption remains a significant driver, but there are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP throughout this year.
- UK economic growth picked up as expected in Q2 following softer activity in Q1; the third estimate confirmed Q2 GDP growth was 0.7%, although the annual growth rate slowed to 2.4%, broadly in line with our expectation of 2.5% GDP growth for 2015.
- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth. Consumption will be supported by real wage and disposable income growth.
- The outlook for business investment is tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.
- Inflation is currently very low and, with the further fall in commodity prices, will remain so in the near-term. The CPI rate is likely to rise towards the end of 2015 due to baseline effects. The MPC is likely to look through temporary periods of very low inflation, as it has done when inflation has been well above the 2% target.

- The annual average earnings growth rate picked up to 2.9% in the three months to July. Real earnings and income growth are running at relatively strong levels and could feed directly into unit labour costs and households' disposable income. The development of wage growth is one of the factors being most closely monitored by the MPC.
- China's growth has slowed and its economy is performing below expectations, which in turn will dampen activity in countries with which it has close economic ties; its slowdown and emerging market weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.
- The recent China-led stock market turbulence and rout in commodities have led to sharp falls in global equity indices, but they are unlikely to blow economic recovery in the UK and US off course. The more cautious members of the Bank of England's MPC and the US Federal Reserve may however delay voting to raise interest rates. A rate rise by the Fed in 2015 remains on the cards after a strong upward revision to Q2 GDP, but the weak external environment was a factor in the decision to hold the policy rate this month.
- Longer term rates will be tempered by international uncertainties and weaker global inflation pressures.

Arlingclose Forecast:

- Arlingclose forecast the first rise in official interest rates in Q2 2016. They project a slow rise in Bank Rate. The appropriate level for Bank Rate will be lower than the previous norm and will be between 2 and 3%.
- We project medium term gilt yields on a shallow upward path in the medium term, with continuing concerns about the Eurozone, and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and the Chinese stock market-led turmoil, are likely to prompt short term volatility in gilt yields.

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