Basingstoke and Deane Borough Council

TREASURY MANAGEMENT STRATEGY STATEMENT

AND

THE INVESTMENT STRATEGY

FOR 2015/16

Contents:

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1. **Background Information**

1.1 This strategy statement has been produced in accordance with:


ii) The latest Code of Practice on Treasury Management published by the Chartered Institute of Public Finance and Accountancy (CIPFA).


iv) The council’s constitution which requires the annual production of a Treasury Management Strategy Statement for the forthcoming year.

v) The Government Department guidance on local government investments which requires the production of an Annual Investment Strategy.

1.2 The Council’s Treasury Management Strategy is undertaken within the following context:

i) The Local Government Act 2003 introduced a prudential capital system from April 2004 which gave councils greater freedom to borrow to finance capital expenditure within prudential limits. From April 2004 the types of investments allowed are subject to Government Department guidance.

ii) The level of the council’s investments is one of the highest of all district authorities and is likely to remain so for the foreseeable future. The council can therefore take longer term investment decisions.

iii) The income generated from investments is significant to the council and supports the cost of services. The Medium Term Financial Forecast assumes that between £3.5 million and £3.8 million per annum of interest and investment income is available to support the revenue budget over the medium term period.

2. **Risk Management Assessment**

2.1 Treasury management involves the management of risk as no treasury management activity is without risk.

2.2 Due to the size, complexity and importance of the income generated from treasury management activities it is important that all associated risks are assessed and managed.

2.3 The main risks associated with treasury management are as follows:

i) **Credit and counterparty risk** (risk to capital) – the risk that a third party will fail to meet its contractual investment obligation resulting in a loss of the council’s capital investment or the risk that there will be a permanent reduction in the capital value of the investment.
ii) **Liquidity risk** – the risk that the council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or losses upon disposal of tradable securities.

iii) **Market or interest rate risk** – the risk that fluctuating interest rates will have an adverse impact on the council’s investment income or the value of its investments.

iv) **Other risks** – this includes risks associated with cash management, legal requirements and fraud.

2.4 These risks are managed as follows:

i) **Credit and Counterparty Risk (risk to capital)**

Wherever possible the council will attempt to externalise the management of credit risk through the use of pooled funds and fund managers who have the required knowledge, experience and resources needed to assess and monitor credit risk effectively.

For any remaining internally managed credit risk the council’s exposure to this risk is controlled by limiting the maximum sum invested with any single counterparty and by restricting investments to only those counterparties considered to be of high credit quality, as agreed in the council’s Treasury Management Practices.

The Council’s treasury advisors (Arlingclose Ltd) provide advice on the security of the council’s investments which includes credit ratings and other factors such as sovereign guarantees, country of origin, credit default swaps, share prices and market sentiment.

The assessment of security includes credit ratings produced by the international credit rating agencies which are used throughout the banking and investment industry. Credit ratings are continuously monitored and any changes are reflected in the council’s investment criteria.

The market prices of the council’s tradable investments are also monitored as these give an indication of market sentiment which can include credit concerns.

If the credit rating of a counterparty or a security held by the council is downgraded with the result that it no longer meets the council’s minimum acceptable credit quality or other factors give cause for serious concern then the counterparty will be withdrawn from the council’s investment criteria list and potential opportunities to dispose of the security will be investigated.

The council requires the necessary flexibility in its investment strategy to enable it to move a proportion of the portfolio into safer investment instruments during times of general concern about credit risk.
ii) **Liquidity Risk**

This risk is managed by maintaining a minimum proportion of investments in the short term for cash flow purposes and by setting a maximum amount that can be invested long term (more than 364 days).

When the council is using long term investments it sets limits on the maximum amount that can be invested in each future year to ensure that the maturity structure for its investments results in a significant amount of investments maturing each year which can be used (rather than being re-invested) if required for short term cash requirements.

The council also has the option to borrow short term funds in order to meet its commitments if necessary.

iii) **Market or Interest Rate Risk**

The Treasury Management Strategy attempts to control interest rate risk by spreading investments across different financial instruments and for different time periods.

The council uses a mix of instruments in order to spread the risk and reduce the overall volatility. Limits are set on the maximum amount in each type of investment.

Having a significant proportion of the council’s investments in longer term fixed rate instruments enables the council to lock into guaranteed investment returns for years to come and provide protection against a fall in short term rates.

Internally managed investments that have a fluctuating market price are purchased with the intention that they will be held to maturity (‘buy to hold’), thereby reducing the impact of market risk.

In addition the council currently has an interest rate risk reserve (currently £1.0 million but increasing to £2.0 million, as part of the council’s budget proposals) in order to reduce the impact of adverse in-year returns from interest income.

When the council uses investment instruments that could produce negative returns or where the accounting treatment for certain investment instruments does not allow the gains to be treated as income then it will adjust the level of the risk reserve to provide some degree of protection from losses and enable the smoothing out of any adverse or favourable variances against budgeted income.

iv) **Other Risks**

These risks are managed through the council’s adoption of standard Treasury Management Practices (TMPs) which are reviewed annually. These cover all aspects of treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.
 Appendix 2

All treasury management procedures and transactions are subject to annual inspections by both internal and external auditors.

The council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

The council will ensure that all staff and elected members tasked with treasury management responsibilities will receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

3. Interest Rate Forecast

3.1 In order to put an investment strategy into context it is necessary to appreciate the current forecasts for interest rates.

3.2 The UK Central Bank Official Rate (base rate) is currently at 0.50%. City forecasters and the council’s own treasury advisors (Arlingclose Ltd) are forecasting that the Bank of England will begin to raise rates during 2015/16, but that the pace of any subsequent increases will be gradual. The independent average of forecasts is that the official rate will average 1.00% in 2015, 1.70% in 2016 and 2.20% in 2017.

3.3 The council’s advisors’ forecasts for interest rates are shown below:

### Arlingclose’s Forecast for Interest Rates (December 2014)

<table>
<thead>
<tr>
<th>Official Bank Rate</th>
<th>Longer Term (5yr Gilts)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Upside Risk</td>
</tr>
<tr>
<td>Mar-15</td>
<td>0.00</td>
</tr>
<tr>
<td>Jun-15</td>
<td>0.00</td>
</tr>
<tr>
<td>Sep-15</td>
<td>0.00</td>
</tr>
<tr>
<td>Dec-15</td>
<td>0.25</td>
</tr>
<tr>
<td>Mar-16</td>
<td>0.25</td>
</tr>
<tr>
<td>Jun-16</td>
<td>0.50</td>
</tr>
<tr>
<td>Sep-16</td>
<td>0.50</td>
</tr>
<tr>
<td>Dec-16</td>
<td>0.50</td>
</tr>
<tr>
<td>Mar-17</td>
<td>0.50</td>
</tr>
<tr>
<td>Jun-17</td>
<td>0.50</td>
</tr>
<tr>
<td>Sep-17</td>
<td>0.50</td>
</tr>
<tr>
<td>Dec-17</td>
<td>0.50</td>
</tr>
</tbody>
</table>

3.4 The forecasts are based on the following assumptions:

i) The pace of interest rate rises will be gradual and the extent of rises limited: the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. 
ii) The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. While the ECB is likely to introduce outright QE, fears for the Eurozone are likely to maintain safe haven demand for UK government debt.

4. Overall Resources and the Investment Portfolio

4.1 The council’s Balance Sheet as at 31 March 2014 shows that it had overall net resources of approximately £374 million. This included £237 million of investment property and £154 million of usable resources in the form of long and short term investments.

4.2 The council’s Medium Term Financial Forecast estimates that the council will have usable resources of £151 million at the beginning of 2015/16. The latest forecast is for this to increase by £12 million in the early part of the year before returning to £148 million at the end of the year. This results in an average balance for the year of £162 million and this is expected to generate £3.5 million of interest income in 2015/16.

4.3 The council’s existing investment portfolio reflects the effect of previous treasury management strategies. Investments have been made for a combination of short and long term periods using different investment instruments.

4.4 A breakdown of the forecast investment portfolio as at 31 March 2015 shows total investments of £151 million (with a nominal value of £147 million) as below:

<table>
<thead>
<tr>
<th>Instruments</th>
<th>£’m</th>
<th>%</th>
<th>Maximum Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Gilts</td>
<td>70.0</td>
<td>46%</td>
<td>95%</td>
</tr>
<tr>
<td>Local Authority Deposits/Bonds</td>
<td>20.0</td>
<td>11%</td>
<td>£40m</td>
</tr>
<tr>
<td>Money Market and Cash Funds</td>
<td>35.9</td>
<td>24%</td>
<td>£50m</td>
</tr>
<tr>
<td>Bank and Building Society Depos</td>
<td>1.0</td>
<td>1%</td>
<td>£50m</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>4.1</td>
<td>5%</td>
<td>£5m</td>
</tr>
<tr>
<td>Diversified Credit Funds</td>
<td>20.0</td>
<td>13%</td>
<td>£50m</td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td>151.0</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

4.5 The following table summarises the limits and ranges that the portfolio currently operates within and where the portfolio is forecast to be at the start of 2015/16:

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>2014/15 Limits</th>
<th>Forecast Position at 31/03/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Term</td>
<td>0% to 95%</td>
<td>63%</td>
</tr>
<tr>
<td>Short Term</td>
<td>5% to 100%</td>
<td>37%</td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>0% to 100%</td>
<td>63%</td>
</tr>
<tr>
<td>Variable Rate</td>
<td>0% to 100%</td>
<td>37%</td>
</tr>
<tr>
<td><strong>Specific Limits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principal Sums &gt; 1 Year</td>
<td>£122m</td>
<td>£52m</td>
</tr>
</tbody>
</table>
5. **The Annual Investment Strategy for 2015/16**

**Background**

5.1 The Investment Strategy is drawn up in order to comply with central government guidance on Local Government Investments and CIPFA’s Treasury Management Code of Practice.

5.2 The Investment Strategy sets out the ranges and limits within which the treasury management function can operate. It states which investments the council may use for the prudent management of its treasury balances during the financial year and sets limits on the different types of investment.

**Investment Objectives**

5.3 The investment policy objectives for this council are to invest prudently having regard to all of the associated risks including the security of investments and to maintain liquidity in the investment portfolio to meet the council’s spending plans.

5.4 Statute maintains that the speculative procedure of borrowing purely in order to invest or lend on and make a return is unlawful and this council will not engage in such activity.

**Fund Selection**

5.5 The selection of collective investment schemes or pooled funds will be determined following a selection process that will include evaluation of certain criteria including the size, duration, credit worthiness of the underlying investments, income distribution levels, past performance, management fees and risk and reward profiles.

5.6 The council will seek to ensure that any fund managers used have their own responsible investment policies or have signed up to widely recognised policies such as the United Nations Principles for Responsible Investment.

5.7 Any selection of funds or fund managers by the council would be made with the assistance of its treasury management advisors Arlingclose Ltd and KPMG Investment Advisory.

**Counterparty Selection**

5.8 For in-house specified investments the council has determined that the minimum allowable credit rating for investments that are not with the UK Government or a UK local authority will be a long term rating of: A- (Fitch); A3 (Moody’s); A- (Standard & Poor’s).

5.9 The council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have ‘Responsible Investment Policies or Environmental, Social and Governance (ESG) policies’ in place prior to investing.

5.10 The lowest available counterparty credit rating will be used to determine credit quality, unless an investment specific rating is available.

5.11 In the event that the credit rating of the council’s contracted provider of banking services or any of its current overnight call accounts falls below the council’s minimum credit rating criteria the bank will continue to be used for business
continuity and short term liquidity requirements (overnight and weekend) and the council will ensure that balances are kept at the minimum amount practicable.

5.12 Currently the council’s banking services are provided by HSBC Bank Plc. and the current call accounts are with Santander UK Plc., Svenska Handelsbanken, Bank of Scotland (Lloyds Group) and Royal Bank of Scotland.

5.13 For investments with other UK local authorities the council will consider their financial strength by assessment of their financial statements and other external indicators where available.

5.14 For externally managed investments minimum credit ratings shall be determined by the fund managers as part of their own investment policy and this policy will be considered fully by the council as part of the fund selection process prior to investment in any fund.

5.15 The council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on credit quality including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

5.16 All credit ratings and other factors detailed above are monitored in-house and by Arlingclose Ltd (the council’s treasury advisors) and the council is alerted to any changes.

5.17 The council will consider the use of counterparties outside of the United Kingdom where the country of origin has a sovereign rating of not lower than AA+ or equivalent. The council may also have exposure to non-UK investments indirectly through the use of money market funds and collective investment funds.

Investment Balances / Liquidity of Investments

5.18 Based on cash flow forecasts, the council anticipates its fund balance at the end of 2015/16 will be £148 million. Of this, £10 million is required for cash flow requirements. This would leave £138 million available for short and long term investment. The minimum percentage of its overall investments that the council will hold in short term investments is 5% (estimated to equate to £7 million in 2015/16).

5.19 Giving due consideration to the council’s level of balances over the next three years, the need for liquidity and its spending commitments, the council has determined that £131 million of its overall fund balances could be prudently committed to longer term investments (i.e. those with a maturity exceeding 364 days) in 2015/16.

5.20 Where investments are made in longer term instruments, the council will maintain liquidity by spreading the investments over future years ensuring that significant amounts mature each year.

Allowable Investment Types for 2014/15

5.21 In deciding which types of investment to use the council has regard to its treasury management advisors. This year’s strategy has been drawn up following reviews by the council’s treasury advisors (Arlingclose Ltd) in 2014/15 which assessed the risks, returns and volatility of the different instruments used.
5.22 The investment types that this council will allow to be used for new investment in 2015/16 are as follows and are categorised under the headings of specified and non-specified in accordance with the statutory guidance:

**Specified Investment Instruments (maximum period 1 year)**
- Bank and building society overnight call account deposits
- Reverse repurchase agreements with banks and building societies (subject to minimum quality of collateral)
- Loans to UK local authorities
- UK treasury stock (Gilts)
- Treasury Bills
- Money market funds
- Debt Management Agency Deposit Facility

**Non-specified Investment Instruments**
- Bank and building society overnight call account deposits
- Loans to UK local authorities up to 5 years
- Bonds issued by UK local authorities up to 10 years
- UK treasury stock (Gilts) up to 10 years
- Supranational bonds up to 10 years
- Collective investment schemes (pooled funds) including: short term cash; and diversified credit funds.
- Reverse repurchase agreements with banks and building societies up to 3 years (subject to minimum quality of collateral)

5.23 All investments will be denominated in pounds sterling.

5.24 For Specified Investments the Authority defines “high credit quality” organisations and securities as:

- UK Government
- UK Local Authorities
- AAA rated Supra-national bonds
- AAA rated money market funds
- Banks and building societies 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.

5.25 The code requires the council to state its position regarding the use of derivative investments. The council does not intend to use standalone financial derivatives directly. However, the use of derivatives by fund managers or collective investment funds is permitted.

5.26 The council will allow previously purchased investments to be held during 2015/16 which are a result of investments made in previous years.

5.27 The council will allow the existing fixed deposit with Lloyds Bank to continue because it relates to the council’s participation in the Local Authority Mortgage Scheme (LAMS). There will be no new investment in the scheme because it has been replaced by the Government's Help to Buy Scheme.
Risks with Non-Specified Investments

5.28 In deciding which type of non-specified investment instruments to use the reasons and associated risks were assessed and are detailed below:

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Why use it?</th>
<th>Associated risks?</th>
</tr>
</thead>
</table>
| **Fixed deposits** with UK local authorities with maturities greater than 1 year | High credit quality.  
Certainty of rate of return over period invested which aids forward planning.  
No movement in capital value of deposit despite changes in interest rate environment. | Illiquid: cannot be traded or repaid prior to maturity.  
Return will not increase if interest rates rise after making the investment.  
Returns are lower than comparative investments with banks and building societies. |
| **Reverse Repurchase Agreement (Repo)**               | Investment is secured with collateral. Quality of collateral can be specified prior to agreement.  
Tri-party repos involve an agent who values and manages the collateral during the time of the agreement.  
Certainty of rate of return. | Collateral needs to be monitored to ensure its value remains adequate for security of the loan.  
Collateral received in the event of a default could be subject to potentially negative market conditions if not sold immediately. |
| **Gilts** (UK sovereign bonds). Custodial arrangement required prior to purchase | Liquid, unlike fixed deposits.  
Most secure asset class.  
Potential for capital gain through appreciation in value if sold before maturity. | ‘Market or interest rate risk’: Yield subject to movement during life of bond which could negatively impact on price of the bond. |
| **Local Authority Bonds** Custodial arrangement required prior to purchase | If held to maturity, known yield (rate of return) per annum, which would be higher than that on comparable gilt.  
High credit quality. | Scarcity of supply.  
‘Market or interest rate risk’: Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss.  
The price of these bonds is more volatile than gilts. |
| **Supranational Bonds** Custodial arrangement required prior to purchase | Excellent credit quality.  
Relatively liquid (not as liquid as gilts).  
If held to maturity, known yield (rate of return) per annum, which would be higher than that on comparable gilt.  
Potential for capital gain through appreciation in value if sold before maturity. | ‘Market or interest rate risk’: Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss.  
The price of these bonds is more volatile than gilts. |
| **Short Term Cash Funds** Collective Investment Schemes | High credit quality.  
Liquid, unlike fixed deposits.  
Likely to provide higher returns than Money Market Funds and short term deposits. | Potential for capital loss.  
Potentially more volatile than Money Market Funds due to longer maturities of assets held. |
| **Overnight Call Accounts with Banks** That are not “High Credit Quality” | Liquidity  
Day to day operational cash management. | Potential for capital loss mitigated by limited overnight exposure. |
| **Diversified Credit and Bond Funds** Collective Investment Schemes | Highly diversified portfolio of credit assets.  
Liquid, unlike fixed deposits.  
Likely to provide higher returns than traditional fixed income investments.  
Can remove interest rate risk to provide positive returns in both rising and falling interest rate environments. | Potential for capital loss.  
Credit risk; exposure to some sub-investment grade assets.  
Increased credit risk requires expertise and resources in the management of credit quality.  
Potential for volatility over the short term. |
5.29 For each type of investment that might be used during 2015/16 the maximum amounts allowed as a percentage of the overall portfolio are as follows:

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Expected 2015/16 % age of Portfolio</th>
<th>Counterparty Limit 2015/16</th>
<th>Maximum Limit £’s/ % age of Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Gilts</td>
<td>43%</td>
<td>None</td>
<td>95%</td>
</tr>
<tr>
<td>Treasury Bills</td>
<td>0%</td>
<td>None</td>
<td>95%</td>
</tr>
<tr>
<td>H M Treasury (DMADF)</td>
<td>0%</td>
<td>None</td>
<td>100%</td>
</tr>
<tr>
<td>Supranational Bonds</td>
<td>0%</td>
<td>£20m</td>
<td>100%</td>
</tr>
<tr>
<td>Local Authority Loans/Bonds</td>
<td>16%</td>
<td>£5m</td>
<td>£40m</td>
</tr>
<tr>
<td>Money Market Funds</td>
<td>10%</td>
<td>£5m</td>
<td>£25m</td>
</tr>
<tr>
<td>Collective Investments: Short Term Cash Funds</td>
<td>9%</td>
<td>£5m</td>
<td>£50m</td>
</tr>
<tr>
<td>Collective Investments: Diversified Credit &amp; Bond Funds</td>
<td>19%</td>
<td>£25m</td>
<td>£50m</td>
</tr>
<tr>
<td>Bank and Building Society Repurchase Agreements</td>
<td>0%</td>
<td>£10m</td>
<td>£25m</td>
</tr>
<tr>
<td>Bank Overnight Call Accounts</td>
<td>0%</td>
<td>£5m</td>
<td>£15m</td>
</tr>
<tr>
<td>Corporate Bonds (Direct)</td>
<td>2%</td>
<td>N/A</td>
<td>£5m</td>
</tr>
<tr>
<td>Bank Fixed Loans (LAMS)</td>
<td>1%</td>
<td>£5m</td>
<td>£5m</td>
</tr>
</tbody>
</table>

1Counterparty limit per fund.
2Includes a £20 million limit on each allowable foreign country.

5.30 For bank and building society investments a list of counterparties will be chosen by the council’s Treasury Management Strategy Team in conjunction with the council’s treasury advisors and will be approved by the Chief Finance Officer. A group of banks under the same ownership will be treated as a single organisation for counterparty limit purposes.

5.31 The counterparty limit with local authorities shall be a maximum of £5 million of principal invested with any one authority for new investment however this does not apply to existing fixed investments. The maximum total of all local authority investments shall remain at £40 million.

6. **Borrowing Requirement and Strategy for 2015/16**

6.1 The council’s underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement. This council’s Capital Financing Requirement is zero. Councils with borrowing requirements are required to make provision within their revenue budgets for the redemption of their debts. This provision is called the Minimum Revenue Provision. As the council’s Capital Financing Requirement is estimated to be zero at 31 March 2015 there is no requirement to make a Minimum Revenue Provision.

6.2 Although the council is a major investor it is occasionally necessary to borrow on a short term basis for cash flow reasons. All borrowing during 2015/16 will be temporary (i.e. for less than 365 days). The council has no plans or intentions to carry out any long term borrowing during 2015/16.
7. **Prudential Indicators**

7.1 Part 1 of the Local Government Act 2003 established a duty for the council to determine and keep under review how much money the council can afford to borrow for capital expenditure. This, together with the relevant regulations, introduced the new prudential capital finance system which replaced the previous capital control system from April 2004.

7.2 The key feature of the system is that local authorities are free to determine their own levels of affordable borrowing (subject exceptionally to any national limits imposed) in support of their capital expenditure plans.

7.3 The prudential capital finance regulations specify that local authorities must have regard to the "Prudential Code for Capital Finance in Local Authorities" issued by CIPFA when setting and reviewing their affordable borrowing limit.

7.4 The objectives of the CIPFA Prudential Code are to ensure 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.

7.5 The recommended prudential indicators for 2014/15 to 2017/18 are categorised by type of indicator and are as follows:

**Capital Expenditure Indicators**

7.6 The total capital expenditure indicator is taken from the proposed capital programme detailed in the budget report plus any treasury management investments which are deemed to count as capital expenditure under the prudential code.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Programme</td>
<td>£12,713</td>
<td>£10,169</td>
<td>£8,386</td>
<td>£5,293</td>
</tr>
<tr>
<td>Capital Investments</td>
<td>£10,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Capital Expenditure</strong></td>
<td><strong>£22,713</strong></td>
<td><strong>£10,169</strong></td>
<td><strong>£8,386</strong></td>
<td><strong>£5,293</strong></td>
</tr>
</tbody>
</table>

**Financing:**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Receipts</td>
<td>£14,203</td>
<td>£1,653</td>
<td>£1,503</td>
<td>£2,936</td>
</tr>
<tr>
<td>Grants and Contributions</td>
<td>£3,944</td>
<td>£1,411</td>
<td>£1,334</td>
<td>£1,261</td>
</tr>
<tr>
<td>Revenue Contributions</td>
<td>£4,566</td>
<td>£7,105</td>
<td>£5,549</td>
<td>£1,096</td>
</tr>
<tr>
<td><strong>Total Capital Financing</strong></td>
<td><strong>£22,713</strong></td>
<td><strong>£10,169</strong></td>
<td><strong>£8,386</strong></td>
<td><strong>£5,293</strong></td>
</tr>
</tbody>
</table>

7.7 The capital financing requirement indicator is a measure of the council’s underlying need to borrow for a capital purpose taken from the balance sheet. The council is debt free and this indicator is therefore nil. The proposed future capital programme will be financed without borrowing and therefore this indicator does not change. This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits.
Affordability Indicators

7.8 The key indicator of affordability for the council to consider in setting the capital programme is the impact on the council tax that will result. This council has been debt free since April 1995 and the capital expenditure and financing proposals detailed in the budget report are based on the continuation of this policy. The proposed capital programme is therefore fully financed from revenue contributions, revenue and capital reserves and external contributions with no requirement for external borrowing.

<table>
<thead>
<tr>
<th>Affordability Indicators</th>
<th>Revised Estimate</th>
<th>Estimate</th>
<th>Estimate</th>
<th>Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014/15</td>
<td>2015/16</td>
<td>2016/17</td>
<td>2017/18</td>
</tr>
<tr>
<td>Additions to Capital Programme</td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td></td>
<td>-993</td>
<td>4,160</td>
<td>3,781</td>
<td>2,508</td>
</tr>
</tbody>
</table>

Incremental Impact of New Capital Investment Decisions on the Council Tax

|                          | -£0.33 | £1.48 | £1.46 | £1.00 |

Ratio of Financing Costs to Net Revenue Stream

|                          | -22%   | -20%  | -24%  | -26%  |

7.9 The **estimate of the incremental impact of the new capital investment decisions on the council tax** indicator shows the revenue impact of the new schemes added to the proposed capital programme. The impact is measured on a band D council tax payer. For this council it represents the loss of investment income by spending available resources rather than the costs of any borrowing.

7.10 The **ratio of financing costs to net revenue stream** indicator is used to show the change over time in the level of debt financing costs (net of investment income) compared to the council’s net income from council tax payers and government grant. For this council the ratio is negative as investment income significantly exceeds the financing costs associated with temporary cash flow borrowing. It does however indicate that at least 20% of the council’s net operating expenditure is supported by investment income.

External Debt Indicators

7.11 The external debt indicators relate to the amount that the council can prudently borrow.

<table>
<thead>
<tr>
<th>External Debt Indicators</th>
<th>Revised Estimate</th>
<th>Estimate</th>
<th>Estimate</th>
<th>Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014/15</td>
<td>2015/16</td>
<td>2016/17</td>
<td>2017/18</td>
</tr>
<tr>
<td>Authorised Limit for External Debt</td>
<td>£50m</td>
<td>£50m</td>
<td>£50m</td>
<td>£50m</td>
</tr>
<tr>
<td>Operational Boundary for External Debt</td>
<td>£25m</td>
<td>£25m</td>
<td>£25m</td>
<td>£25m</td>
</tr>
</tbody>
</table>
7.12 Under section 3(1) of the Local Government Act 2003 the council is required to set an **authorised limit for external debt**. This limit is a statutory limit and is gross of investments. For this council represents the maximum limit for external temporary borrowing for cash flow and treasury management purposes and for any possible finance lease “borrowing”. The limit is based on a prudent but not worse case estimate with sufficient headroom to allow for operational management.

7.13 To support day to day treasury management activity it is recommended that Council approve an authorised borrowing limit of £50 million for 2015/16. This is to enable possible short term cash flow management and not to provide funding for capital expenditure.

7.14 The **operational boundary for external debt** is based on the same estimates as the authorised limit for external debt but represents the estimate of normal activity without the additional headroom included in the authorised limit.

7.15 The code of practice specifies that for external borrowing to be prudent and sustainable it should be used over the medium term only for capital purposes. This is demonstrated by ensuring that, except in the short term, net external borrowing should not exceed the total Capital Financing Requirement in the previous year plus the estimates of any additional Capital Financing Requirements for the current and the next two financial years. No medium term external borrowing is proposed and therefore this requirement is met.

7.16 The revised code of practice requires councils to have an indicator identifying the differences between **gross debt and the Capital Financing Requirement (CFR)**. However, because this council’s gross debt and the CFR are both zero there is no difference to identify.

**Treasury Management Indicators**

7.17 These indicators are based on estimates of the council's total resources and estimated cash flow requirements. The council follows best practice and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Adopting the code of practice is one of the indicators.

7.18 In addition to the limits set for each type of investment the Prudential Code requires the setting of specific indicators for treasury management. The indicators for 2014/15 to 2017/18 are as follows:

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Upper Limits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Rate Exposure - as %age</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Variable Rate Exposure - as %age</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Principal Sums invested over 364 days</td>
<td>£122m</td>
<td>£131m</td>
<td>£126m</td>
<td>£121m</td>
</tr>
<tr>
<td><strong>Maturity of Investments (maximum per year)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Years 1 to 5</td>
<td>£25m</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Years 6 to 10</td>
<td>£15m</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7.19 The upper limit on fixed rate exposure indicator represents the maximum level (as a percentage) of the council’s investments that will be invested in fixed interest instruments. The upper limit on variable rate exposure indicator represents the maximum level of the council’s investments that will be invested in variable rate instruments. This has been set to ensure that the council is not exposed to interest rate falls which could adversely impact on the revenue budget. These limits are designed to provide the necessary flexibility within which decisions will be made for new investments; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the investment strategy.

7.20 This means that fixed rate investments will be managed within a range of 0-100% of total investments and variable rate investments will be managed within a range of 0-100%. These indicators allow the council to manage the extent to which it is exposed to changes in interest rates.

7.21 The upper limit on principal sums invested for periods longer than 364 days indicator sets the maximum total value of investments made for periods of 1 year and beyond.

7.22 The upper limits for maturity of investments indicator sets the maximum amount of investments fixed in each year beyond 1 year. This helps to ensure a balanced maturity profile and reduces the risk of being forced to realise an investment before it reaches maturity for cash flow reasons.

**Monitoring and Revision of Prudential Indicators**

7.23 These prudential indicators will be monitored throughout the year by the Head of Resources (Section 151 Officer) and will be reported quarterly to the Audit and Accounts Committee and half-yearly to Cabinet and Council. Any revision of the indicators required will be submitted to the Council for approval.

**8. Investment Performance Monitoring and Reporting**

8.1 Performance of the council’s investments will continue to be monitored monthly and will be reported quarterly to the Audit and Accounts Committee. Half year and outturn reports on treasury management activities and performance will also be prepared for the Cabinet and Full Council.

8.2 Following the suspension of treasury management performance targets the council now participates in quarterly portfolio benchmarking provided by its treasury advisors Arlingclose. This benchmarking includes measures of the level of risk taken and the corresponding returns. Results of the benchmarking exercise are included in all of the reports detailed above.

**9. Training**

9.1 The Treasury Management Code of Practice requires the Head of Resources to ensure that all members tasked with treasury management responsibilities, including scrutiny of the function, have access to appropriate training relevant to their needs and understand fully their roles and responsibilities.
9.2 Treasury workshops are provided for members of the Audit and Accounts Committee and are open to all members of the council. The workshops are delivered by a combination of external training providers, council officers and the council’s treasury advisors.

9.3 Officers responsible for treasury management attend external workshops and seminars as part of their continued professional development and the officer responsible for the day to day treasury management activity holds the Association of Corporate Treasurers’ Certificate in International Treasury Management – Public Sector.

10. **Use of Investment Consultants/Treasury Advisors**

10.1 The council has contracted Arlingclose Ltd. as on-going treasury advisors (re-tendered every three years). Under the contract Arlingclose Ltd. provide the following services:

- Advice on counterparty selection and creditworthiness
- Assistance in compliance with codes of practice
- Economic and interest rate forecasts
- Strategy and review meetings
- An annual report on the council’s investment strategy and portfolio
- Advice and guidance on treasury management issues
- Benchmarking and performance monitoring
- Seminars and training events

10.2 Subsequent to KPMG Investment Advisory’s investment review and asset allocation advice in 2013/14 the council has also contracted them to provide on-going monitoring services of collective investment funds that are used by the council.