Regulatory and Audit Committee
28 January 2015

Report to Regulatory and Audit Committee

AGENDA ITEM 4

Title: **Treasury Management Strategy Report 2015/16**

Date: **28 January 2015**

Date Decision can be implemented: **n/a**

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Electoral Divisions Affected: **n/a**

Portfolio Areas Affected: **All**

Relevant Overview and Scrutiny Committee:

Summary

The purpose of this report is for the Regulatory and Audit Committee to consider the Council's Annual Treasury Management Policy Statement, Treasury Management Strategy Statement, Annual Investment Strategy and the Minimum Revenue Provision Policy Statement for 2015/16, together with the Prudential Indicators for the next three years before it is submitted to Council at its meeting on 12 February 2015.

Recommendation

The Committee are asked to RECOMMEND to Council the Treasury Management Policy Statement, Treasury Management Strategy Statement, Annual Investment Strategy and the Minimum Revenue Provision Policy Statement for 2015/16, together with the Prudential Indicators for the next three years.

A. Narrative setting out the reasons for the decision

Supporting Information

1. The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management Code of Practice 2011 edition (the CIPFA Code) on 1 April 2012, the Code defines Treasury Management as:

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

2. The Code requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments which was revised in March 2010 that requires the Council to approve an investment strategy before the start of each financial year. In accordance with best practice the Council combines the Annual Investment Strategy with its Treasury Management Strategy Statement. The general policy objective is to ensure that surplus funds held on behalf of the Council are invested prudently.

3. Guidance on Minimum Revenue Provision under section 21(1A) of the Local Government Act 2003 also requires an annual statement on the Council's debt repayment policy: its Minimum Revenue Provision is submitted to the full Council for approval before the start of the financial year to which the provision will relate. Minimum Revenue Provision is defined as being the contribution from revenue to cover the unfinanced borrowing that has been undertaken to support the capital programme.

4. The Treasury Management Policy Statement, Treasury Management Strategy Statement, Annual Investment Strategy and the Minimum Revenue Provision Policy Statement for 2015/16, are attached as Appendix 1, changes from the 2014/15 Strategies are highlighted in grey. Deletions from the previous policy have a line drawn through the text. The approved investment counterparties and investments limits tables are included in the Investment Strategy, in 2014/15 they were appended to the strategy.

5. The proposed changes to the Strategy for 2015/16 are highlighted in the policy document and include the following:

- The Council may borrow £15m in advance of need during 2015/16 and a further £15m in 2016/17 for the Energy from Waste project, borrowing requirements will be reviewed.
- HM Treasury have confirmed that they are taking the necessary legislative steps to abolish the PWLB in the coming months. This development is purely being taken to address the governance of the PWLB. The CLG have stated that it will have no impact on existing loans held by local authorities or the government's policy on local authority borrowing. HMT has confirmed that the PWLB's lending functions will continue unaffected albeit under a different body so that local authorities will continue to access borrowing at rates which offer good value for money.
- Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2015/16. This diversification, particularly into secured bank investments, represents a substantial change in strategy over the coming year. This includes 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.

6. In accordance with the Local Government Act 2003 the Council is required to agree a range of indicators to demonstrate that its investment plans are affordable, prudent and sustainable. The indicators, based on 2015/16 to 2017/18 capital programme form part of this strategy, are attached as Appendix 2. The Prudential

Indicators are monitored on a quarterly basis at the Treasury Management Group meetings and progress against the Indicators is reported to the Regulatory & Audit Committee in the mid year and annual activity report.

B. Other options available, and their pros and cons

The Council has considered setting a more risk adverse strategy and a less risk adverse strategy and has considered the consequential effects on interest income.

C. Resource implications

There are no additional costs associated with the recommendation, the aim is to maximise returns within a Strategy which is affordable, prudent and sustainable.

D. Value for Money (VFM) Self Assessment

The Council seeks to maximise its investment return and minimise the cost of debt within an acceptable risk exposure.

E. Legal implications

The publication of the outturn position and treasury management policy and associated schedules conform to best practice as required by the CIPFA Code of Practice.

F. Property implications

There are none.

G. Other implications/issues

There are none.

H. Feedback from consultation and Local Member views

Not Applicable

I. Communication issues

To be published on the website.

J. Progress Monitoring

A mid year review and annual review of treasury management activity will be reported. Treasury Management is formally considered at monthly Treasury Management Group meetings between the Cabinet Member for Finance & Resources, the Deputy Cabinet Member for Finance & Resources, the Director of Assurance and other key officers.

K. Review

The policy forming part of this decision will be reviewed annually.

Background Papers

There are none.

Appendix 1

BUCKINGHAMSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT, TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT FOR 2015/16

Treasury Management Policy Statement

1 Buckinghamshire County Council defines it treasury management activities as:

- The management of the organisation's investments and 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.

- The County 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.

- 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 comprehensive performance measurement techniques, within the context of effective risk management.

- The investment policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are the security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and Department for Communities and Local Government (CLG) guidance require the Council 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 generation of investment income to support the provision of local authority services is an important, but secondary, objective.

- The Council's borrowing objectives are to minimise the revenue costs of debt whilst maintaining a balanced loan portfolio. The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit.

Treasury Management Strategy Statement

Introduction

2 The Treasury Management Strategy details the expected activities of the treasury function in the forthcoming year 2015/16. The publication of the strategy is a statutory requirement.

3 The Treasury Management Strategy Statement and Annual Investment Strategy are underpinned by the CIPFA Code of Practice and Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

Current Portfolio Position

4 The Council's treasury portfolio position as at 31 December 2014 comprised:

Borrowing			
Fixed Rate Funding	**£184.2m**	**Average Rate:**	**6.1%**
Investing			
In House Investments:			
Call accounts	**£10.0m**	**Average Rate:**	**0.7%**
Money market funds	**£23.7m**	**Average Rate:**	**0.8%**
Term deposits<1 year	**£120.0m**	**Average Rate:**	**0.8%**
Certificates of deposit<1 year	**£50.0m**	**Average Rate:**	**0.8%**
Term deposits>1 year	**£19.5m**	**Average Rate:**	**1.3%**
Property fund	**£5.0m**	**Average Rate:**	**4.7%**
Gross Investments	**£228.2m**	**Average Rate:**	**0.9%**
Net Investments	**£44.0m**		

Prospects for Interest Rates

5 The Council has appointed Arlingclose as a treasury adviser to the Council. Part of Arlingclose's service is to assist the Council to formulate a view on interest rates. 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. The Bank of England Base Rate, the official base rate paid on commercial bank reserves, has been 0.5% since March 2009.

Borrowing Strategy

6 The Council's borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio.
- To manage the Council's debt maturity profile, leaving no one future year with a disproportionate level of repayments.
- To maintain a view on current and possible future interest rate movements and borrow accordingly.
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and the Prudential Indicators.

The Council may borrow in advance of spending need, where this is expected to provide the best long term value for money. Where gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy. The Council is committed to building an Energy from Waste plant. This may require additional borrowing during 2016/17, although in practice much of this may be financed through a combination of earmarked reserves and current cash investments. The Council may borrow £15m in advance of need during 2015/16 and a further £15m in 2016/17. The Council will be repaying £10m of PWLB borrowing on 14 February 2015, a further £11.732m PWLB borrowing will be repaid during 2015/16.

7 The Council will be borrowing £36m on behalf of the Thames Valley Local Enterprise Partnership (LEP) for Aylesbury Eastern Link Road. HM Treasury has agreed that the LEP can access the PWLB Project Rate at a discount of 40 basis points below the standard PWLB rate, the County Council will arrange the loan and pay the interest to the PWLB on behalf of the LEP, the LEP will reimburse the costs incurred to the County Council so that the loan is cost neutral to the County Council.

8 HM Treasury have confirmed that they are taking the necessary legislative steps to abolish the PWLB in the coming months. This development is purely being taken to address the governance of the PWLB. The CLG have stated that it will have no impact on existing loans held by local authorities or the government's policy on local authority borrowing. HMT has confirmed that the PWLB's lending functions will continue unaffected albeit under a different body so that local authorities will continue to access borrowing at rates which offer good value for money.

9 The Council may borrow short term loans, normally for up to one month, to cover unexpected cash flow shortages.

10 Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency's capital strength instead. This Council has not committed resources to investing in the company, which offers potential borrowing alternative for the Council. Any decision to borrow from the Agency will be the subject of a separate report to the Council.

Investment Strategy

11 This Council maintains investments that are placed with reference to cash flow requirements. Investment of the Council's funds is in accordance with the Annual Investment Strategy.

Debt Rescheduling

12 The potential for debt rescheduling is monitored in light of interest rate movements. Any rescheduling will be in accordance with the borrowing strategy. The reasons for rescheduling include:

- The generation of cash savings at minimum risk.
- Fulfilment of the borrowing strategy.
- Enhancement of the maturity profile of the borrowing portfolio.

13 All rescheduling will be reported retrospectively as part of the Treasury Management Update Reports to the Regulatory and Audit Committee and County Council.

CIPFA Treasury Management Code of Practice

14 CIPFA recommends that all public service organisations adopt the following four clauses.

15 This Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives, approach to risk management of its treasury management activities, borrowing policies and investment policies.
- Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

16 This Council will receive reports on its treasury management policies and activities, including an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in its TMPs.

17 This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Regulatory and Audit Committee, and for the execution and administration of treasury management decisions to the Director of Assurance, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

18 This Council nominates the Regulatory and Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Annual Investment Strategy

Introduction

19 This Council has regard to the CLG's revised Guidance on Local Government Investments issued in 2010 and the 2011 revised CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes.

20 The Annual Investment Strategy states which investments, specified and non-specified, the Council may use for the prudent management of its treasury balances during the financial year. ~~These are listed in Schedule A.~~

21 This strategy sets out this Council's policies for managing its investments and for giving priority to the security of capital and liquidity of those investments.

Investment Objectives

22 The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are the **security** of capital and **liquidity** of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and CLG guidance require the Council 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 generation of investment income to support the provision of local authority services is an important, but secondary, objective. The effective management and control of risk are prime objectives of the Council's treasury management activities. Investment of the Council's funds will be in accordance with the Treasury Management Strategy and Policy. All investments will be in sterling to mitigate the impact of currency risk.

23 The Council's investments, agreed lending list and strategy are reviewed on a monthly basis by the Treasury Management Group.

24 The Council's treasury management ensures it has sufficient cash to meet its needs, balancing achieving value for money with the security of its investments (achieving a balance between security, liquidity and yield). Performance is monitored against its treasury management strategy and outcomes matched against benchmarks. The Council meets any tax and prompt payment legislation (Late Payment of Commercial Debts (Interest) Act 1998).

25 The CLG maintains that the borrowing of monies purely to invest or lend on and make a return is unlawful and this Council will not engage in such activity.

26 Through various mechanisms identified in this strategy, the Council ensures that investment risks are effectively mitigated. The Council will ensure that an appropriate balance is found between maximising investment income to the Council within a prudent, transparent and logical investment strategy. The security of the principal sum shall be the Council's prime risk factor.

Approved Counterparties

27 A country is assigned a sovereign rating which signifies a country's ability to provide a secure investment environment which reflects factors such as economic status, political stability and foreign currency reserves. The strongest sovereign rating that can be achieved is "AAA", "AA+" is the next strongest. The Council invests in the UK or specified AAA and AA+ sovereign rated countries, the total maximum that can be invested in an individual AAA sovereign rated country is £30m and the total maximum that can be invested in an individual AA+ sovereign rated country is £15m. Countries that are currently AAA sovereign rated are Australia, Canada, Denmark, ~~Finland~~, Germany, Luxembourg, Norway, Singapore, Sweden and Switzerland. Austria, Finland, ~~France,~~ Netherlands, United Kingdom and the USA are currently AA+ sovereign rated. Santander UK plc and Clydesdale Bank plc are deemed to be

UK institutions, although their parent banks are based in Spain and Australia respectively. Both banks have extensive UK operations. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

28 The Authority may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the 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	£15m 5 years	£25m 20 years	£25m 50 years	£15m 20 years	£5m 5 years
AA+	£15m 5 years	£25m 10 years	£25m 25 years	£15m 10 years	£5m 5 years
AA	£15m 4 years	£25m 5 years	£25m 15 years	£15m 5 years	£5m 5 years
AA-	£15m 3 years	£25m 4 years	£25m 10 years	£15m 4 years	£5m 5 years
A+	£15m 2 years	£25m 3 years	£15m 5 years	£15m 3 years	£5m 5 years
A	£10m 13 months	£25m 2 years	£15m 5 years	£10m 2 years	£5m 5 years
A-	£10m 6 months	£25m 13 months	£15m 5 years	£10m 13 months	£5m 5 years
BBB+	£3m 100 days	£3m 6 months	£3m 2 years	£3m 6 months	£5m 2 years
BBB or BBB-	£3m next day only	£3m 100 days	n/a	n/a	n/a
None	£3m 6 months	n/a	£25m 25 years		£5m 5 years
Pooled funds	£25m per fund				

This table must be read in conjunction with the notes below

29 **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.

30 **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 Lloyds plc.

31 **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.

32 **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.

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

34 **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.

35 **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.

36 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.

Group Limits

37 The maximum amount invested with a connected group of counterparties is £20m (although the maximum investment with a single counterparty within any group is dependent on the bank's credit rating). Investments in part nationalised and nationalised banks are not subject to a government group limit.

Credit Watch / Outlook

38 From time to time an institution will be placed on negative watch or negative outlook, indicating that a downgrade is either likely or possible in the future. Watches are considered short term actions, whereas outlooks are considered

over a longer time horizon. If an institution is on negative watch so that it is likely to fall below the above 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.

Credit Default Swaps (CDS)

39 Credit rating agencies lag market events and therefore do not provide investors with an up to date picture of the credit quality of a particular institution. A CDS is a financial instrument which insures against the risk of a counterparty defaulting on its credit. When the cost of this insurance is highest, then it is more likely that the market considers a credit event will occur. Each month Arlingclose provides CDS spreads information enabling the Treasury Team to monitor short, medium and long term trends of CDS spreads. If there is a spike in the values of CDS's due to adverse market conditions, then Arlingclose alert the Treasury Team immediately.

Specified Investments

40 Specified investments offer relatively high security and high liquidity. These investments can be used with minimal procedural formalities. The CLG Guidance defines specified investments as those denominated in sterling, with a maturity of no more than a year and invested with one of the UK Government, a UK local authority, parish council or community council or a body or investment scheme with a long term rating of A- or above.

Non-Specified Investments

41 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor with any low credit quality bodies. The overall limit that can be invested in non-specified investments is £150m.

42 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, unrated funds and unrated organisations. EU proposals are being introduced to remove the credit rating AAA wrapping that money market funds are currently assigned, some of the Council's liquidity funds could be unrated. For non-specified investments proper procedures must be in place for undertaking risk assessments prior to investments being placed. Investment instruments identified for use in the financial year are listed in Schedule A under the specified and non-specified investments categories.

43 The majority of the Council's investments will be made for relatively short periods and in highly credit rated investments, giving priority to security and liquidity ahead of yield. However, where the Council has a core cash balance that is not required for any current or planned cash outflow, these funds will be considered suitable for a wider range of investments, with a more moderate focus on security and liquidity and a greater focus on achieving a level of investment income that can support Council services. These may include long-term investments with registered providers of social housing or corporate bond funds where an enhanced return is paid to cover the additional risks presented, only a small proportion of cash would be invested at any one time in these investments. Standard risk mitigation techniques, such as wide diversification and external credit assessments, will be employed, and no such investment will

be made without a specific recommendation from the Council's treasury management adviser in consultation with the Cabinet Member for Finance and Resources, the Deputy Cabinet Member for Finance and Resources and the internal Treasury Management Group.

44 Limits on non-specified investments are shown in the table below.

	Cash limit
Total long-term investments	£75m
Total investments without credit ratings or rated below A- (includes other local authorities)	£100m
Total non-specified investments	£150m

45 The table below sets out investment limits

	Cash limit
Any single organisation, except the UK Central Government	£25m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£100m per broker
AAA sovereign rated foreign countries	£30m per country
AA+ sovereign rated foreign countries	£15m per country
Registered Providers	£25m in total
Unsecured investments with Building Societies	£25m in total
Money Market Funds	£150m in total

Security of Capital: The use of Credit Ratings

46 This Council relies on credit ratings published by the ratings agencies Fitch, Moodys and Standard and Poors to establish the credit quality of counterparties and investment schemes. The lowest available credit rating will be used to determine credit quality. Credit rated institutions are selected using criteria based on the country, also known as sovereign rating if the institution is not UK.

Monitoring of credit ratings:

- The Council has access to Fitch, Moodys and Standard & Poors credit ratings and is alerted to changes through e-mail updates.
- The Council invests in UK or specified AAA / AA+ sovereign rated countries, to improve the potential for diversification and also to optimise access to investments in the world's highest rated institutions the total maximum that can be invested in a AAA sovereign rated individual country is £30m and £15m individual country maximum for AA+ sovereign rated.

- If a counterparty or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately.
- If a counterparty is upgraded so that it fulfils the Council's criteria, its inclusion on the lending list will be considered and put to the Director of Assurance for approval.
- From time to time an institution will be placed on negative watch or negative outlook, indicating that a downgrade is either likely or possible in the future. Watches are considered short term actions, whereas outlooks are considered over a longer time horizon. If an institution is on negative watch so that it is likely to fall below the above 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.

Use of Specified and Non-Specified Investments

47 The use of specified and non-specified investments is limited to those set out above. The Director of Assurance will keep the use of such investments under continuous review in the light of risk, liquidity and return. No additions will be made without the approval of the Council, following appropriate consultation.

Investment balances / Liquidity of investments

48 Based on its cash flow forecasts, the Council anticipates its fund balances in 2015/16 to range between £200m and £250m. A prime consideration in the investment of fund balances is liquidity and the Council's forecast cash flow. Investments are made in accordance with this Annual Investment Strategy and the investment strategies approved by the Director of Assurance during the year.

Policy on Use of Financial Derivatives

49 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).

50 The general power of competence in section 1 of the Localism Bill 2011 removes much of the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

51 The Council 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 Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they represent will be managed in line with the overall treasury risk management strategy. This Council used swaps to hedge against currency and interest rates fluctuations for the Energy for Waste project.

Provisions for Credit-related losses

52 If any of the Council's investments appear at risk of loss due to default the Council will make revenue provision of an appropriate amount; although, the Council will make all reasonable attempts to secure any potential defaults prior to such an occurrence.

Reporting & Governance Arrangements

53 The treasury strategy, six monthly review and annual activity reports are presented to the Regulatory and Audit Committee. The Council's investments, agreed lending list and strategy are reviewed on a monthly basis by the Treasury Management Group which includes the Cabinet Member for Finance & Resources, the Deputy Cabinet Member for Finance & Resources, the Director of Assurance and other key officers; the Prudential Indicators are reviewed quarterly at this meeting. Following a recent review the internal audit team's overall conclusion on the system of internal control being maintained is "substantial". A substantial audit opinion is the best grading that internal audit can award. It means that "there is a strong system of internal control in place and risks are being effectively managed. Some minor action may be required to improve controls".

Training

54 Member and officer training is essential in terms of understanding roles and keeping up to date with changes. It is an essential component of the CIPFA Treasury Management Code of Practice; to address this training need, training will be provided to all members of the Regulatory & Audit Committee and key officers attend relevant courses / seminars on treasury management.

Treasury Management Advisers

55 The Council has appointed Arlingclose as treasury management advisers and receives specific advice on investment, debt and capital finance issues. However, responsibility for final decision making remains with the Council and its officers. The services received include advice and guidance on relevant policies, strategies and reports, advice on investment decisions, notification of credit ratings and changes, other information on credit quality, advice on debt management decisions, accounting advice, reports on treasury performance, forecasts of interest rates and training courses for officers and members.

56 The quality of this service is reviewed by participating in CIPFA's treasury management benchmarking and monitoring investment performance against a weighted average LIBID.

Investment of Money Borrowed in Advance of Need

57 The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks

will be managed as part of the Authority's overall management of its treasury risks.

58 The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Minimum Revenue Provision Policy Statement

59 Prior to 2008/09, the Council in accordance with legislation made a contribution from revenue to cover 4% of the unfinanced borrowing that has been undertaken to support the capital programme. This contribution is called the Minimum Revenue Provision (MRP).

60 The Secretary of State under section 21(1A) of the Local Government Act 2003 issued guidance on the calculation of MRP in February 2008, 2008/09 was the first year of operation.

61 Where capital expenditure was incurred before 1 April 2008 MRP will continue to be charged at the rate of 4% of the outstanding Capital Financing Requirement, in accordance with the guidance. For capital expenditure incurred on or after 1 April 2008 and funded through borrowing, the Council will calculate MRP using a more complex calculation called the asset life annuity method. Using this method MRP is calculated in a similar way as calculating the capital repayment element of a fixed rate repayment mortgage.

62 In accordance with provisions in the guidance, MRP will be first charged in the year following the date that an asset becomes operational.

63 Certain expenditure reflected within the debt liability at 31st March 2008 will under delegated powers be subject to MRP using the asset life annuity method, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure.

64 The asset life annuity method calculation requires estimated useful lives of assets to be input in to the calculations. These life periods will be determined under delegated powers to the Director of Assurance, with regard to the statutory guidance.

65 However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the asset life annuity method would not be appropriate.

66 As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Background Papers

CIPFA Code of Practice on Treasury Management in the Public Service revised 2011
CLG Guidance on Local Government Investments revised in 2010
Communities and Local Government Guidance on Minimum Revenue Provision issued February 2008.

Director of Assurance
20 January 2015

Appendix 2

PRUDENTIAL INDICATORS FOR MTP 2015/16 to 2017/18

1. BACKGROUND

1.1. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The key objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable. A further objective is to ensure that treasury management decisions are taken in accordance with good professional practice.

1.2. Local Authorities are required to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003. To demonstrate compliance the Code sets prudential indicators designed to support and record local decision making.

1.3. The purpose of this report is to update and revise the indicators approved by Council last year contained within the proposed MTP for 2015/16 to 2017/18. The report describes the purpose of each of the indicators and the proposed values and parameters for Buckinghamshire County Council. Monitoring of the Prudential Indicators takes place throughout the year and a mid-year and annual report are reported to Regulatory & Audit Committee and Council.

2. CAPITAL EXPENDITURE INDICATORS

2.1. CAPITAL EXPENDITURE

This indicator is required to inform the Council of capital spending plans for the next four years. It is the duty of a local authority to determine and keep under review the amount that it can afford to allocate to capital expenditure.

The estimates of gross capital expenditure to be incurred for the current and future years is summarised below:

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of capital expenditure	£000	135,934	88,491	91,607	242,635	43,086

The 2014/15 estimates reflect the forecast gross capital expenditure against the revised budgets to the end of December 2014 including proposed slippage.

The estimate of capital expenditure for 2015/16 to 2018/19 reflects the capital programme within the MTP. In 2016/17 the programme includes an allowance for the Energy from Waste plant, which will be supported in part through prudential borrowing.

2.2. CAPITAL FINANCING REQUIREMENT

The Capital Financing Requirement measures the Council's underlying need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation (see 5.3). Estimates of the end of year Capital Financing Requirement for the Council for the current and future years, net of repayments are:

Indicator	Unit	Revised Estimate 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of capital financing requirement (CFR)	£000	247,801	317,161	328,189	317,449	307,066

Authorities can finance schemes in a variety of ways these include;

- The application of useable capital receipts
- A direct charge to revenue
- Application of a capital grant
- Contributions received from another party
- Borrowing

It is only the latter method that increases the Capital Financing Requirement (CFR) of the Council. The profile above reflects prudential borrowing of £113.5m in 2014/15 and £132.5m in 2015/16, in respect of the Energy from Waste (EfW) Project.

The Council, as the accountable body on behalf of the LEP, is also supporting the forward funding of Aylesbury Eastern Link road. It is anticipated that £36m will be borrowed from the Public Works Loan Board (see indicator 3.1) by 2015/16 to support this development. This will be recognised in the capital financing requirement at the point that the assets or roads are adopted by the Council to the extent that assets are not funded through developer contributions. This is not currently shown in the figures above as the timescales for completion are not yet known and are estimated to be outside of the current 3-year period.

AFFORDABILITY INDICATORS

2.3. RATIO OF FINANCING COSTS TO NET REVENUE STREAM

Purpose of the Indicator

This indicator measures the proportion of the revenue budget that is being allocated to finance capital expenditure. For the General Fund this is the ratio of financing costs of borrowing against net expenditure financed by government grant and local taxpayers.

Estimates of the ratio of financing costs to net revenue stream for the current and future years are:

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of ratio of financing costs to net revenue stream	%	5.9%	6.0%	5.5%	6.5%	6.3%

2.4. ESTIMATES OF INCREMENTAL IMPACT OF NEW CAPITAL INVESTMENT DECISIONS ON COUNCIL TAX

This is a key affordability indicator that demonstrates the incremental effect of planned capital expenditure and hence any increased or decreased borrowing, on Council Tax.

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of the incremental impact of capital investment decisions on Council Tax	£ per Band D equivalent	-£0.09	-£1.19	-£1.67	-£6.40	-£12.48
	%	-0.01%	-0.11%	-0.15%	-0.56%	-1.08%

The delivery of a number of projects within the capital programme including the replacement of Street Lamps with more efficient equipment, introduction of a bio-mass boilers and rationalisation of premises will result in revenue savings. In addition a net saving is forecast in relation to the Energy from Waste project.

3. FINANCIAL PRUDENCE INDICATOR

3.1. GROSS DEBT AND THE CAPITAL FINANCING REQUIREMENT

This indicator records the extent that gross external borrowing is less than the capital financing requirement (2.2 above).

This is a key indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. The Council should ensure that gross debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. The values are measured at the end of the financial year.

Where gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy.

The figures for 2015/16 onwards are based on estimates:

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Gross Borrowing	£000	187,649	195,000	220,000	225,000	225,000
Capital Financing Requirement	£000	247,801	317,161	328,189	317,449	307,066

The Council is committed to building an EfW plant. This may require additional borrowing during 2016/17, although in practice much of this may be financed through a combination of earmarked reserves and current cash investments. The gross borrowing indicator assumes borrowing £15m per annum in advance during 2015/16 and a further £15m during 2016/17. The need for borrowing in advance will be reviewed.

The indicator also includes £16m in 2014/15 and £20m in 2015/16 borrowed on behalf of the Buckinghamshire Thames Valley Local Enterprise Partnership (BTVLEP) for Aylesbury Eastern Link Road. HM Treasury has agreed that the LEP can access the PWLB Project Rate at a discount of 40 basis points below the standard PWLB rate, the County Council will arrange the loan and pay the interest to the PWLB on behalf of the LEP, the LEP will reimburse the costs incurred to the County Council so that the loan is cost neutral to the County Council.

4. TREASURY AND EXTERNAL DEBT INDICATORS

4.1. AUTHORISED LIMIT FOR EXTERNAL DEBT

The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Authorised limit (for borrowing) *	£000	250,000	250,000	270,000	320,000	320,000
Authorised limit (for other long term liabilities) *	£000	50,000	150,000	200,000	15,000	15,000
Authorised limit (for total external debt) *	£000	300,000	400,000	470,000	335,000	335,000

* These limits can only be changed with the approval of the full Council

The authorised limits are consistent with approved capital investment plans and the Council's Treasury Management Policy and Practice documents, but allow sufficient headroom for unanticipated cash movements.

Accounting for the Energy from Waste Plant

Construction commenced on site on 11 September 2013. Technical accounting rules require the Council to recognise an asset under construction and a corresponding PFI-equivalent liability for the work certified to date and forecast under the project. The liability is included in the 'other long-term liabilities' line.

Actual total liabilities are shown in Indicator 5.2 Operational Boundary for External Debt.

The limit will be reviewed on an on-going basis during the year. If the authorised limit is liable to be breached at any time, the Director of Quality and Assurance will either take measures to ensure the limit is not breached, or seek approval from the Council to raise the authorised limit.

4.2. OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

This is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Operational boundary (for borrowing)	£000	187,649	210,000	230,000	270,000	270,000
Operational boundary (for other long term liabilities)	£000	42,237	130,000	140,000	6,500	6,500
Operational boundary (for total external debt)	£000	229,886	340,000	366,500	276,500	276,500

This indicator is consistent with the Council's plans for capital expenditure and financing and with its Treasury Management Policy and Practice documents. It will be reviewed on an on-going basis.

4.3. ACTUAL EXTERNAL DEBT

This is a factual indicator showing actual external debt for the previous financial year.

The actual external borrowing as at 31 March 2014 was £187.649m which includes £1.7m accrued interest. During the current financial year £11.7m of debt will be repaid. The forecast external borrowing as at 31 March 2015 is £175.8m.

5. TREASURY MANAGEMENT INDICATORS

The prudential code links with the existing CIPFA Code of Practice for Treasury Management in the Public Services.

The Treasury Management indicators consist of five elements that are intended to demonstrate good professional practice is being followed with regard to Treasury Management. The proposed values and parameters provide sufficient flexibility in undertaking operational Treasury Management.

5.1 SECURITY AVERAGE CREDIT RATING

The Council is asked to adopt a voluntary measure of its exposure to credit risk by monitoring the weighted average rating of its investment portfolio.

Security Average Credit Rating	Target
Portfolio Average Credit Rating	A+ or above

For the purpose of this indicator, local authorities which are unrated are assumed to hold an AAA rating.

5.2 HAS THE COUNCIL ADOPTED THE CIPFA TREASURY MANAGEMENT CODE?

The Council has adopted the Code. In line with the Code the Treasury Strategy for 2015/16 is reported to Regulatory and Audit Committee and Council.

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Adoption of the CIPFA Code of Practice for Treasury Management in the Public Services	N/A	Yes	Yes	Yes	Yes	Yes

5.3 UPPER LIMIT OF FIXED RATE BORROWING FOR THE 3 YEARS TO 2017/18

This indicator is set to control the Council's exposure to interest rate risk and the rate is set for the whole financial year. The upper limits on fixed interest rate exposures expressed as an amount will be:

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Fixed interest rate exposure - upper limit *	£000	133,928	210,000	230,000	270,000	270,000

* Any breach of these limits will be reported to the full Council

5.4 UPPER LIMIT OF VARIABLE RATE BORROWING FOR THE 3 YEARS TO 2017/18

This indicator is set to control the Council's exposure to interest rate risk. Here instruments that mature during the year are classed as variable, this includes the Council's Lender Option Borrower Option (LOBO) loans. For LOBO loans, on specified call dates, the lender has the option to increase the interest rate paid on the loan. If the lender exercises this option, then the borrower can agree to pay the revised interest rate or repay the loan immediately. The upper limits on variable interest rate exposures expressed as an amount will be:

Indicator	Unit	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Variable interest rate exposure - upper limit *	£000	53,732	110,000	80,000	80,000	95,000

* Any breach of these limits will be reported to the full Council

The fourth element requires limits to be set for fixed rate borrowing.

5.5 MATURITY STRUCTURE OF FIXED RATE BORROWING FOR 2013/14 – 2017/18

This Indicator is set to control the council's exposure to refinancing risk. The upper and lower limits on the maturity structure of the fixed borrowing will be:

Maturity Structure of Fixed Rate Borrowing	Actual 2013/14		Revised Estimate 2014/15		2015/16		2016/17		2017/18	
Period	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit
Under 12 months	29%	0%	50%	0%	45%	0%	45%	0%	55%	0%
12 months and within 24 months	40%	0%	35%	0%	45%	0%	50%	0%	45%	0%
24 months and within 5 years	52%	0%	55%	0%	55%	0%	55%	0%	55%	0%
5 years and within 10 years	58%	0%	55%	0%	55%	0%	60%	0%	60%	0%
10 years and above	60%	0%	100%	20%	100%	20%	100%	20%	100%	20%

These parameters control the extent to which the Council will have large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

5.6 TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS

The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments.

Indicator	Actual 2013/14	Revised Estimate 2014/15	2015/16	2016/17	2017/18
Total principal sums invested for periods longer than 364 days	£10m	£75m	£50m	£25m	£25m

With regard to longer term investments the recommendation is to limit sums for periods longer than 364 days to no more than £50m in 2015/16 and £25m in 2016/17 to 2017/18. Cash balances are anticipated to be lower from 2016/17 onwards due to financing the EfW project.

6 CONCLUSION

In approving, and subsequently monitoring, the above prudential indicators the Council is fulfilling its duty to ensure that spending plans are affordable, prudent and sustainable.