BABERGH DISTRICT COUNCIL and MID SUFFOLK DISTRICT COUNCIL

From: Head of Corporate Resources	**Report Number: JAC44**
To: Joint Audit and Standards Committee	**Date of meeting: 19 January 2015**

JOINT TREASURY MANAGEMENT STRATEGY 2015/16

1. Purpose of Report

1.1 This report presents the proposed Treasury Management Strategy Statement (which includes the Annual Investment Strategy for managing surplus funds and borrowing strategy). These are in accordance with the CIPFA Treasury Management Code. The Prudential Indicators and Minimum Revenue Provision (MRP) Statement are linked to the Budget report that will be presented to Executive/Strategy Committee and Council meetings in February 2015.

1.2 The Code of Practice recommends that the strategy is subject to scrutiny before it is presented to Council, which falls within the remit of the Joint Audit & Standards Committee.

2. Recommendations to Executive and Strategy Committees and both Councils

2.1 That the key factors and information relating to and affecting treasury management activities set out in Appendices A and B be noted.

2.2 That the following be approved:

(a) The Treasury Management Policy Statement set out in Appendix C

(b) The Draft Treasury Management Strategy for 2015/16, incorporating the proposed changes referred to in paragraphs 8.17 and 8.18 of the report and including the Annual Investment Strategy as set out in Appendix D

(c) The Prudential Indicators and MRP Statement set out in Appendices G and H.

3. Financial Implications

3.1 The revenue cost of borrowing in 2015/16 and subsequent years in relation to the capital programme will be minimised by borrowing on the most beneficial basis at the most appropriate time of the year, based on advice from our treasury advisors, Arlingclose.

3.2 The General Fund revenue budget for 2015/16 will include provision for interest payments relating to external borrowing and the statutory Minimum Revenue Provision (MRP) to ensure the principal is repaid. Different arrangements apply to the Housing Revenue Account (Council Housing) – there is no MRP.

4. Risk Management

4.1 Key risks are set out below:

Risk Description	Likelihood	Impact	Mitigation Measures
Loss of investment and/or liquidity problems	Unlikely	Bad	Strict lending criteria for highly credit rated institutions.
Poor return on investments	Probable	Noticeable	Focus is on security and liquidity. Careful cash flow management and budget monitoring in accordance with the strategy, is undertaken.
Higher than expected borrowing costs – interest rate increases and/or lower capital receipts than forecast	Depends on economic and market conditions	Noticeable	Benchmark is to borrow from the Public Works Loan Board (PWLB) whose rates are very low and can be on a fixed or variable basis or from other local authorities. Continue to use internal surplus funds temporarily. Capital receipts monitored.

5. Consultations

5.1 Advice on borrowing and the investment of surplus funds from our treasury advisors, Arlingclose, who also provide regular and important updates on treasury management issues as they arise.

6. Equality Analysis

6.1 An Equality Impact Assessment (EqIA) has not been completed because this is a technical report that does not have any impact on the equality groups.

7. Shared Service / Partnership Implications

7.1 This report and the proposed Treasury Management Strategy for 2015/16 relates to both Babergh and Mid Suffolk Councils although it’s application will differ due to the different financial position of each Council.

8. Key Information

Background

8.1 Treasury Management is an important part of the overall financial management of the Councils’ affairs. It links to the Councils’ Medium Term Financial Strategy (MTFS), the Joint Strategic Plan and our investment strategy e.g. prudential borrowing, Invest to Save and ‘Profit for Purpose’.

8.2 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the CIPFA TM Code) and the Prudential Code require local authorities to determine their Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis before the start of each financial year. The TMSS also includes the Annual Investment Strategy (AIS).

8.3 The CIPFA Treasury Management and Prudential Codes have been adopted by both Councils. There is also a Treasury Management Policy Statement, which underpins the TMSS.

8.4 Babergh and Mid Suffolk invest surplus funds and both councils borrow to fund capital investment and manage cash flows. Both councils are therefore exposed to financial risks including the loss of invested funds and the revenue effect of interest rate changes.

8.5 The identification, monitoring and control of risk are central to the treasury management strategy.

8.6 In addition, treasury activities need to comply with relevant statutes, guidance and accounting standards.

Borrowing and Investments

8.7 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with usable reserves, is one of the core drivers of both Councils' Treasury Management activities.

8.8 Councils are able to borrow funds up to their CFR to finance capital expenditure. The Councils will not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. These needs are determined by the CFR. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Councils can ensure the security of such funds.

8.9 The forecast movement in the CFR in coming years is one of the Prudential Indicators. The movement in actual external debt and usable reserves combine to identify the Council's borrowing requirement and potential investment strategy in the current and future years.

8.10 As indicated in the table in Appendix D, section 1.4, Babergh currently has a maximum borrowing requirement of around £39.8m and will be required to borrow up to £26m by 2016/17 to fund the indicative capital programme. Mid Suffolk has a current maximum borrowing requirement of around £62.3m and will be required to borrow up to £73.2m by 2017/18 to fund the indicative capital programme

8.11 These amounts include a provisional sum of £25m for each council that has been included in the draft capital programme for 2015/16 for potential prudential borrowing relating to delivery plan projects. Any use of this borrowing will be subject to a business case and will achieve a return on that investment and produce additional income to help towards the council's medium term funding gap. Further details on the overall approach and strategy are set out in the draft Joint Medium Term Financial Strategy.

8.12 The current level of debt and investments for Babergh and Mid Suffolk is set out in Appendix A.

The 2015/16 Strategy

8.13 The Prudential Indicators (to be presented with the Budget and Capital programme to Executive/Strategy Committee in February 2015) illustrate the affordability and impact of capital expenditure decisions and set out both Councils overall capital and treasury framework.

8.14 Effective management and decisions on funding ensure both Councils comply with the provisions of Section 32 of the Local Government Finance Act 1992 to set a balanced budget. More importantly, using our borrowing powers to undertake investment in strategic plan priority outcomes and generate a rate of return to produce additional income is a key part of our MTFS in order to deal with the projected funding gap of £7m across both councils over the next 4 years.

8.15 Key documents relating to treasury management operations in terms of the annual investment and borrowing strategy proposed for 2015/16 are set out in the supporting appendices. Factors affecting the strategy are detailed in the Economic Outlook (Appendix B), the Policy Statement (Appendix C) and the proposed strategy for the year (Appendix D).

8.16 The proposed investment strategy for 2015/16 continues to focus primarily on the effective management and control of risk, giving priority to security and liquidity when investing funds. Investment returns remain an important but secondary consideration.

8.17 The minimum proposed investment criteria for UK counterparties in the 2015/16 Strategy remains at A-. Members agreed not to reduce this to BBB+ when the treasury strategy was reviewed towards the end of 2014. (Note: This would be the lowest credit rating determined by credit rating agencies Moodys, Fitch and Standard & Poors).

8.18 In line with advice received from Arlingclose (the Councils' treasury advisors) the maximum investment limit per institution has been reduced from £2m to £1m for all unsecured specified investments, with the exception of pooled funds where the limit remains at £2m. Investments with the UK Government (including the Government's Debt Management Agency Deposit Facility (DMADF) and Treasury Bills (T-Bills)), have no limit on the amount invested.

8.19 A list of the banks and building societies that both Councils can lend to (based on information on credit risk and credit ratings as at November 2014) is provided in Appendix F. This will be continuously monitored as the position changes throughout the year as credit ratings are reviewed and additional market information is evaluated.

8.20 The Councils may also invest cash with other organisations, for example by making loans to small businesses - such as 'Funding Circle' which Members approved last year. Such an investment would, however, only be made following a favourable external credit assessment and on the specific advice of the Council's treasury advisors.

8.21 Given the reduced maximum sums that can be invested with any single institution and pending the receipt of any downgrading of the credit ratings of banks, building societies etc. to BBB+ or below, the Councils will:

- Make more use of call accounts

- Use the strongest/lowest risk non-credit rated building societies

- Use covered bonds (secured against assets) for longer term investments

- Consider longer term investments in property or other funds.

8.22 The period for which a ‘specified’ investment is made will continue to be a key aspect of the investment strategy. The criterion for this is set out in Appendix D. The maximum period of any investment will be on the advice of Arlingclose. Investments in excess of 364 days are classified as ‘non-specified’ investments and will only be undertaken with the prior approval of the S151 Officer.

8.23 In terms of borrowing, consideration will be given to all forms of borrowing/financing in relation to any future capital investment plans. This is most likely to be via the Public Works Loan Board (PWLB) but consideration will also be given to borrowing from other sources such as other local authorities, commercial banks, the European Investment Bank (EIB), money markets, capital markets (stock issues, commercial paper and bills) and leasing.

8.24 In conjunction with advice from Arlingclose, both Councils will keep these sources of finance under review.

8.25 After using surplus internal funds temporarily, the PWLB remains the most likely source of new external long term borrowing whilst short or longer term borrowing would be from money market institutions and other local authorities. The Councils will receive the “certainty rate” discount of 0.2% on PWLB loans taken out between 1 November 2014 and 31 October 2015. It is unclear at the time of writing this report as to whether this will continue after 31 October 2015.

8.26 Officers will take advice on the optimum time to undertake additional borrowing and will adopt a flexible approach in consultation with their treasury advisors, after consideration of the following:

- Affordability
- Maturity profile of existing debt
- Interest rate and refinancing risks
- Borrowing source.

8.27 As clearly highlighted by the Prudential Indicators, the level and ratio of General Fund borrowing costs will increase over the next few years to finance the potential capital programme (excluding the £25m delivery plan investment projects in the 2015/16 General Fund capital programme). Affordability in terms of future revenue budgets will need to be reviewed as part of the ongoing Priority Based Resourcing (PBR) work and in relation to individual business cases for specific projects that are developed. The PBR work will need to be applied to the capital programme during 2015/16.

9. Appendices

Title		Location
(a)	Existing Investment and Debt Portfolio Position	Attached
(b)	Economic Outlook and Interest Rate Forecast	Attached
(c)	Treasury Management Policy Statement	Attached
(d)	Treasury Management Strategy 2015/16	Attached
(e)	Treasury Management Indicators	Attached
(f)	Institutions meeting high credit ratings criteria (as at end of November 2014)	Attached
(g)	Prudential Indicators	Attached
(h)	MRP Statement	Attached

10. Background Documents

CIPFA Treasury Management in the Public Services – 2011

The Prudential Code for Capital Finance in Local Authorities - 2011

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EXISTING INVESTMENT & DEBT PORTFOLIO POSITION

Babergh District Council	30/11/2014 Actual Portfolio £m
External Borrowing:	
Fixed Rate – PWLB	88
Fixed Rate – Market	0
Variable Rate – PWLB	0
Variable Rate – Market	0
Total External Borrowing	88
Other Long Term Liabilities:	
- PFI	0
- Finance Leases	0
Total Gross External Debt	88
Investments: *Managed in-house*	
- Short-term monies (Deposits/ monies on call /MMFs)	15.6
- Long-term investments	0
Total Investments	15.6

Notes

1. The £88m relates entirely to the HRA - future borrowing is allocated specifically to the HRA or the General Fund based on the respective capital programmes.

Mid Suffolk District Council	30/11/2014 Actual Portfolio £m
External Borrowing:	
Fixed Rate – PWLB	76.5
Fixed Rate – Market	8.0
Variable Rate – PWLB	0
Variable Rate – Market	0
Total External Borrowing	84.5
Other Long Term Liabilities:	
- PFI	0
- Finance Leases	0
Total Gross External Debt	84.5
Investments: *Managed in-house*	
- Short-term monies (Deposits/ monies on call /MMFs)	1.1
- Long-term investments	0
Total Investments	1.1

<u>Notes</u>

1. The £84.5m relates entirely to the HRA - future borrowing is allocated specifically to the HRA or the General Fund based on the respective capital programmes.

APPENDIX B

ECONOMIC OUTLOOK AND INTEREST RATE FORECAST

1 Economic background

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

1.2 The Monetary Policy Committee's (MPC) focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings from August 2014 onwards, some Committee members have become more concerned that the economic outlook is less optimistic than at the time of the August Inflation Report.

2 Credit outlook

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

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

3 Interest rate forecast

3.1 The Councils' treasury management advisor, Arlingclose, forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 3.40%.

ECONOMIC AND INTEREST RATE FORECAST EX ARLINGCLOSE (DEC 2014)

	Mar-	Jun-	Sep-	Dec-	Mar-	Jun-	Sep-	Dec-	Mar-	Jun-	Sep-	Dec-	Mar-
Official Bank Rate													
Upside Risk				0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75
Downside Risk			-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00
3-month LIBID Rate													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.60	0.75	0.90	1.05	1.20	1.35	1.50	1.60	1.70	1.80	1.90	2.00	2.10
Downside Risk	-0.15	-0.20	-0.30	-0.40	-0.55	-0.65	-0.75	-0.85	-0.95	-0.95	-0.95	-0.95	-1.00
1-yr LIBID Rate													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.20	1.35	1.50	1.65	1.80	1.95	2.10	2.20	2.30	2.40	2.50
Downside Risk	-0.15	-0.20	-0.30	-0.50	-0.55	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80	-0.80	-0.80
5-yr Gilt Yield													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	1.45	1.60	1.75	1.90	2.00	2.15	2.25	2.35	2.45	2.50	2.55	2.60	2.60
Downside Risk	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.70	-0.70	-0.70
10-yr Gilt Yield													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.70	2.75	2.80	2.85	2.90	2.95
Downside Risk	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	0.60	-0.60	-0.60	-0.60
20-yr Gilt Yield													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	2.55	2.65	2.75	2.85	2.95	3.00	3.05	3.10	3.15	3.20	3.25	3.30	3.30
Downside Risk	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.50	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60
50-yr Gilt Yield													
Upside Risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	2.65	2.70	2.80	2.90	3.00	3.05	3.10	3.15	3.20	3.25	3.30	3.55	3.60
Downside Risk	-0.35	-0.35	-0.35	-0.4	-0.45	-0.5	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60

APPENDIX C

TREASURY MANAGEMENT POLICY STATEMENT

1 Introduction and Background

1.1 The two Councils adopt the key recommendations of the CIPFA Code of Practice on Treasury Management in the Public Services (the Code) as described in Section 5 of the Code.

1.2 Accordingly, the Councils will create and maintain the following as the cornerstones for effective treasury management:

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

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

1.3 The full Councils for Babergh and Mid Suffolk will receive recommendations from Strategy/Executive Committee on their treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

1.4 The Councils delegate responsibility for the implementation of its treasury management policies and practices to the Strategy/Executive Committee, monitoring to the Joint Audit and Standards Committee and the execution and administration of treasury management decisions to the Section 151 Officer and/or Corporate Manager - Financial Services, who will act in accordance with the organisations' policy statements, the TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Joint Audit and Standards Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2 Policies and Objectives of Treasury Management Activities

2.1 The Councils define their treasury management activities in line with the CIPFA definition as: "the management of the organisation's investments and cash flows, it's banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance associated with those risks."

2.2 The Councils regard 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 the risk implications for the Councils.

2.3 The Councils recognise that effective treasury management will provide support towards the achievement of their business and service objectives. They are therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques within the context of effective risk management.

2.4 Both Councils borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Councils transparency and control over their debt.

2.5 Both Councils' primary objectives in relation to investments remain the security of capital. The liquidity or accessibility of the Councils' investments followed by the yield earned on investments remain important but are secondary considerations.

<u>TREASURY MANAGEMENT STRATEGY 2015/16</u>

1 Background

1.1 Treasury Management is strictly regulated by statutory requirements. The Local Government Act 2003 and supporting regulations requires each Council to have regard to the Prudential Code and set Prudential Indicators for the next three years to ensure that both Councils' capital investment plans are affordable, prudent and sustainable. The Act also requires each Council to set out annually their treasury strategy for borrowing and investment.

1.2 Effective management and decisions on funding ensure the Councils comply with the provisions of Section 32 of the Local Government Finance Act 1992 to set a balanced budget.

1.3 The Councils will reappraise their strategies from time to time in response to evolving economic, political and financial events.

1.4 The tables below show how the movement in actual external debt and usable reserves combine to identify the Councils' borrowing requirement and potential investment strategy in the current and future years. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

Babergh District Council	**Forecast 2014/15 £m**	**Estimate 2015/16 £m**	**Estimate 2016/17 £m**	**Estimate 2017/18 £m**
General Fund	10.5	40.5	41.1	39.8
Housing Revenue Account	87.4	86.4	85.5	84.5
TOTAL CFR	**97.9**	**126.9**	**126.6**	**124.3**
Less: Existing Profile of Borrowing*	(87.8)	(87.3)	(86.8)	(86.3)
Cumulative Maximum External Borrowing Requirement	**10.1**	**39.6**	**39.8**	**38.0**
Less: Balances & Reserves				
General Fund	(4.0)	(3.9)	(3.9)	(3.9)
Housing Revenue Account	(3.1)	(4.4)	(3.4)	(4.6)
Less: Working Capital - assets	(6.5)	(6.5)	(6.5)	(6.5)
Cumulative Net Borrowing Requirement/(Investments)	**(3.5)**	**24.8**	**26.0**	**23.0**

Mid Suffolk District Council	Forecast 2014/15 £m	Estimate 2015/16 £m	Estimate 2016/17 £m	Estimate 2017/18 £m
General Fund **Housing Revenue Account**	21.0 86.8	48.5 86.8	49.2 88.0	47.5 88.0
TOTAL CFR	**107.8**	**135.3**	**137.2**	**135.5**
Less: Existing Profile of Borrowing*	(76.0)	(75.7)	(74.9)	(74.1)
Cumulative Maximum External Borrowing Requirement	**31.8**	**59.6**	**62.3**	**61.4**
Less: Balances & Reserves General Fund Housing Revenue Account	 (4.4) (3.1)	 (4.4) (3.1)	 (4.5) (1.3)	 (4.5) (1.4)
Add: Working Capital - liabilities	16.7	16.7	16.7	16.7
Cumulative Net Borrowing Requirement/(Investments)	**41.0**	**68.8**	**73.2**	**72.2**

*Shows only loans to which the Councils are committed and excludes optional refinancing.

2 Borrowing Strategy

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

2.2 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the borrowing strategy of the Councils continue to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. This position will be monitored and evaluated on an ongoing basis to ensure the Councils achieve value for money.

2.3 By doing this, the Councils are able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Councils with this 'cost of carry' (the excess of interest payable on monies borrowed over interest received when the monies are invested) and breakeven analysis. Its output may determine whether the Councils borrow additional sums at long-term fixed rates in 2015/16 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

3 Sources of Borrowing and Portfolio Implications

3.1 In conjunction with advice from treasury management advisors, the Councils will keep under review the following borrowing sources:

- Public Works Loan Board (PWLB)
- Any institutions approved for investments (see section 4.4 below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Suffolk County Council Pension Fund)
- Capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues

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

- Operating and finance leases
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

3.3 The Councils have previously raised the majority of their long term borrowing from the PWLB but they continue to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

3.4 **LGA Bond Agency**: A new 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 Council and used to bolster the Agency’s capital strength instead.

Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

3.5 **LOBOs:** Mid Suffolk holds £4m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. There are no plans to use LOBO loans for future borrowing.

3.6 **Short-term and Variable Rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators as shown in Appendix E paragraph 2.1.

4 Debt Rescheduling

4.1 The Councils' debt portfolios can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.

4.2 The current low interest rate environment and changes in the rules regarding the premature repayment of PWLB loans adversely affect the scope to undertake meaningful debt restructuring although occasional opportunities arise. The rationale for undertaking any debt rescheduling would be one or more of the following:

- Reduce investment balances and credit risk exposure
- Align long term cash flow projections and debt levels
- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio.

4.3 Borrowing and any rescheduling activity will be reported to the Joint Audit and Standards Committee as part of the mid-year and annual treasury management reports.

5 Policy on Use of Financial Derivatives

5.1 Some local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

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

5.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria (See Appendix D, Section 4.4). The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

5.4 The Councils will only use derivatives after seeking advice from their treasury advisors, a legal opinion and ensuring officers have the appropriate training for their use.

6 Policy on Apportioning Interest to the HRA

6.1 On 1st April 2012, the Councils notionally split each of their existing loans into General Fund and HRA pools. In the future, new long term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs / income arising from long term loans (e.g. premiums and discounts on early redemption) will be charged / credited to the respective revenue account.

6.2 Differences between the value of the HRA loans pools and the HRAs' underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured annually and interest transferred between the General Fund and HRA at the net average rate earned by the Council on their portfolios of treasury investments and short-term borrowing.

7 Annual Investment Strategy

7.1 In accordance with Investment Guidance issued by CLG and best practice, the Councils' primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Councils' investments followed by the yields earned on investments are important but secondary considerations.

7.2 The Councils and their advisor remain alert for signs of credit risk and/or market distress that might adversely affect both Councils.

7.3 **Strategy:** Given the increasing risk and continued low returns from short-term unsecured bank investments, both Councils aim to diversify into more secure and/or higher yielding asset classes during 2015/16. The majority of the Councils' surplus cash is currently invested in short-term unsecured bank deposits and money market funds. This diversification will therefore represent a substantial change in strategy over the coming year.

7.4 **Approved Counterparties:** The Councils may invest their surplus funds with any of the counterparty types in the list below, subject to the cash limits (per counterparty) and the time limits shown.

Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£1m 5 years	£1m 20 years	£2m 50 years	£1m 20 years	£1m 20 years
AA+	£1m 5 years	£1m 10 years	£2m 25 years	£1m 10 years	£1m 10 years
AA	£1 m 4 years	£1m 5 years	£2m 15 years	£1m 5 years	£1m 10 years
AA-	£1m 3 years	£1m 4 years	£2m 10 years	£1m 4 years	£1m 10 years
A+	£1m 2 years	£1m 3 years	£1m 5 years	£1m 3 years	£1m 5 years
A	£1 m 13 months	£1m 2 years	£1m 5 years	£1 m 2 years	£1m 5 years
A-	£1m 6 months	£1 m 13 months	£1m 5 years	£1m 13 months	£1m 5 years
None	£1m 6 months	n/a	£1m 25 years	£50,000 5 years	£1m 5 years
Pooled funds	£2m per fund				

This table must be read in conjunction with the notes below:

Banks/Building Societies 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.

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.

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.

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 becoming insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

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.

Pooled Funds: Shares in diversified investment vehicles consisting of 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow Councils 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 both Councils' investment objectives will be monitored regularly.

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

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

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

See the table in Appendix F for an explanation of the credit ratings issued by the main credit ratings agencies.

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Councils will restrict their investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Councils' cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

7.5 **Specified and Non-Specified Investments:** Investments are categorised as "Specified" or Non-Specified" within the investment guidance issued by the CLG:

- **Specified investments** are sterling denominated investments with a maximum maturity of 364 days. They meet the definition of "high credit quality" as determined by the Councils (currently A- or A3 for UK banks, building societies, money market funds and other pooled funds; and AA- for foreign banks (AAA sovereign rating only)) and are not deemed capital expenditure investments under Statute. Specified investments may also be with the UK Government, a UK local authority, parish council or community council.
- **Non-Specified investments** are, effectively, everything else. The Councils may make investments in unrated building societies but do not intend to make any investments denominated in foreign currencies, any which are defined as capital expenditure by legislation, such as company shares, nor with bodies and schemes not meeting the definition of high credit quality. Non-specified investments will therefore be limited to long-term investments (those due to mature 12 months or longer from the date of arrangement) which are considered less liquid as the cash is not quickly realisable and to investments in unrated building societies.

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£2m
Total investments without credit ratings	£2m
Total investments rated below A- (Lloyds Bank only see paragraph 8.2)	£1m
Total non-specified investments	£5m

7.6 Investments of 12 months or over (longer than 364 days) are subject to the prior approval of the S151 officer.

7.7 Any institution can be suspended or removed from the list should any of the factors identified above give rise to concern. The institutions that currently meet the criteria for term deposits, Certificates of Deposit (CDs) and call accounts are shown in Appendix F.

7.8 It remains the Council's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. Therefore an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

8 Councils' Banker

8.1 Both Councils bank with Lloyds Bank plc which currently has a credit rating of A.

8.2 Should the credit rating fall below A-, the Councils may continue to deposit surplus cash with Lloyds Bank plc providing that investments can be withdrawn on the next working day.

9 Investment Limits

9.1 The Councils' revenue reserves available to cover investment losses are forecast to be £7 million for Babergh and £7.5 million for Mid Suffolk on 31st March 2015. In order to minimise the available reserves that would be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £1 million and £2 million for pooled funds. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£1m each
Unsecured investments with Building Societies	£2m in total
Loans to unrated corporates	£500k in total
UK Central Government	unlimited
Any group of organisations under the same ownership	£1m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£2m per country
Registered Providers	£5m in total
Money Market Funds	50% of total investments

10 Liquidity Management

10.1 The Councils use cash flow forecasts to determine the maximum period for which funds may prudently be committed. The forecasts are compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Councils being forced to borrow on unfavourable terms to meet their financial commitments. Limits on long-term investments are set by reference to the Councils' medium term financial plans and cash flow forecasts.

11 Investment Training

11.1 The needs of the Councils' treasury management staff for training in investment management are assessed regularly and as part of the staff appraisal process and, additionally, when the responsibilities of individual members of staff change.

11.2 Staff attend training courses, seminars and conferences provided by Arlingclose, CIPFA and other relevant bodies.

12 Investment Advisors

12.1 The Councils' treasury management advisors are Arlingclose. The joint contract with Babergh and Mid Suffolk commenced on 1 June 2010 for 2 years with an option to extend which has been taken up. The service from June 2015 will be market tested.

12.2 The advisors provide the following services:

- Investment advice
- Technical support
- Counterparty creditworthiness (credit ratings)
- Debt management advice
- Economic updates
- Interest rate forecasts

12.3 The treasury advisor service is subject to regular review to ensure compliance with the requirements of the Treasury Management Strategy and TMPs' Use of External Service Providers.

12.4 The Councils maintain the quality of the service with their advisors by holding quarterly meetings. Whilst the advisors provide support to the treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Council.

12.5 The Councils have regard to the requirements of the Bribery Act 2011 in their dealings with external advisors.

13 Investment of Money Borrowed in Advance of Need

13.1 The Councils 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 Councils are aware that they 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 Councils' overall management of its treasury risks.

13.2 The total amount borrowed in 2015/16 will not exceed the authorised borrowing limit (£130 million for Babergh and £141 million for Mid Suffolk). See Appendix G paragraph 8.4.

14 Other Options Considered

14.1 The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications are listed below.

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

APPENDIX E

TREASURY MANAGEMENT INDICATORS

The Councils measure and manage their exposures to treasury management risks using the following indicators.

1 Security

1.1 The Councils have adopted a voluntary measure of their exposure to credit risk by monitoring the value-weighted average credit score of their investment portfolios. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target
Portfolio average credit score	7.0

2 Interest Rate Exposure

2.1 This indicator is set to control both Councils' exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as a proportion of net principal borrowed will be:

Babergh District Council **Interest Rate Exposures**	**2015/16** **£m**	**2016/17** **£m**	**2017/18** **£m**
Fixed			
Upper Limit on Fixed Interest Rate Exposure	127	127	125
Variable			
Upper Limit on Variable Interest Rate Exposure	20	20	20

Mid Suffolk District Council **Interest Rate Exposures**	**2015/16** **£m**	**2016/17** **£m**	**2017/18** **£m**
Fixed			
Upper Limit on Fixed Interest Rate Exposure	136	138	136
Variable			
Upper Limit on Variable Interest Rate Exposure	40	40	40

2.2 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

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

2.4 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements.

3 Maturity Structure of Borrowing

3.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

3.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment. LOBO's are classified as maturing on the next call date i.e. the earliest date that the lender can require repayment.

Babergh District Council **Maturity structure of fixed rate borrowing**	**Existing level at 31/12/14**	**Lower Limit for 2015/16**	**Upper Limit for 2015/16**
under 12 months	0.6%	0	50%
12 months and within 24 months	0.6%	0	50%
24 months and within 5 years	1.7%	0	50%
5 years and within 10 years	0.9%	0	100%
10 years and within 20 years	42.0%	0	100%
20 years and within 30 years	53.0%	0	100%
40 years and above	1.2%	0	100%

Mid Suffolk District Council **Maturity structure of fixed rate borrowing**	**Existing level at 31/12/14**	**Lower Limit for 2014/15**	**Upper Limit for 2014/15**
under 12 months	5.6%	0	50%
12 months and within 24 months	0.5%	0	50%
24 months and within 5 years	2.4%	0	50%
5 years and within 10 years	0.7%	0	100%
10 years and within 20 years	37.3%	0	100%
20 years and within 30 years	33.8%	0	100%
30 years and above	19.7%	0	100%

4 Upper Limit for total principal sums invested over 364 days

4.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Councils having to seek early repayment of the sums invested. The limits on the total principal sum invested to final maturities beyond the period end will be:

Babergh and Mid Suffolk District Councils	**2014/15 Approved** **£m**	**2015/16** **£m**	**2016/17** **£m**	**2017/18** **£m**
Limit on principal invested beyond year end	2	2	2	2

INSTITUTIONS MEETING HIGH CREDIT RATINGS CRITERIA (AS AT END OF NOVEMBER 2014)

This is based on UK Banks and Building Societies A-, Money Market Funds, Foreign Banks AA-. Foreign banks must be in a country with a sovereign rating of AAA.

Instrument	Long Term Rating Fitch		Counterparty
UK BANKS			
Term Deposits & Certificates of Deposit	AA-	*	HSBC Bank Plc
Term Deposits & Certificates of Deposit	AA-	*	Standard Chartered Bank
Term Deposits & Certificates of Deposit	A	****	Barclays Bank
Term Deposits & Certificates of Deposit	A	*	Bank of Scotland (Lloyds Banking Group)
Term Deposits & Certificates of Deposit	A	*	Lloyds TSB (Lloyds Banking Group)
Term Deposits & Certificates of Deposit	A-	****	Close Brothers Ltd
Term Deposits & Certificates of Deposit	A	*	Santander UK Plc
BUILDING SOCIETIES			
Term Deposits & Certificates of Deposit	A	*	Nationwide
Term Deposits & Certificates of Deposit	A-	****	Leeds Building Society
FOREIGN BANKS			
Australia			
Term Deposits & Certificates of Deposit	AA-	*	Australia & NZ Banking Group
Term Deposits & Certificates of Deposit	AA-	*	Commonwealth Bank of Australia
Term Deposits & Certificates of Deposit	AA-	*	National Australia Bank
Term Deposits & Certificates of Deposit	AA-	*	Westpac Banking Group
Canada			
Term Deposits & Certificates of Deposit	AA	*	Royal Bank of Canada
Term Deposits & Certificates of Deposit	AA-	*	Toronto-Dominion Bank
Netherlands			
Term Deposits & Certificates of Deposit	AAA	*	Bank Nederlandse Gemeenten NV (BNG)

Instrument	Long Term Rating Fitch		Counterparty
Term Deposits & Certificates of Deposit	AA-	*	Rabobank
Singapore			
Term Deposits & Certificates of Deposit	AA-	*	Oversea-Chinese Banking Corporation
Term Deposits & Certificates of Deposit	AA-	*	United Overseas Bank
Sweden			
Term Deposits & Certificates of Deposit	AA-	*	Svenska Handelsbanken
MONEY MARKET FUNDS (MMF)		**	
Call Account	AAA	***	Ignis Sterling Liquidity Fund
Call Account	AAA	***	Goldman Sterling Liquid Reserves Fund
Call Account	AAA	***	Insight Sterling Liquidity Fund
Call Account	AAA	***	Prime Rate Sterling Liquidity Fund
Call Account	AAA	***	BlackRock Institutional Sterling Liquidity Fund

* Maximum limit to maturity of 6 months
** Maximum exposure limit of 10% of total investments per fund
*** Overnight limit
**** Maximum limit to maturity 100 days
MMFs – Prime Rate is domiciled in the UK for tax and administration purposes, Ignis Goldman Sachs, BlackRock and Insight are domiciled in Ireland for tax and administration purposes.

Arlingclose expect all government support to be removed from credit ratings during 2015. It is anticipated that this will reduce the credit rating of a number of the above institutions below the A- minimum credit rating for investment. These institutions are listed below:

- Lloyds Bank
- Nationwide Building Society
- Santander UK
- Barclays Bank

Long Term Investment Grades

Rating Agency	Rating	Definition
HIGHEST RATING		
Fitch	AAA	Highest credit quality – 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
Moody's	Aaa	Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.
Standard & Poor's	AAA	An obligator rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest issuer credit rating assigned by Standard & Poor's.
NEXT HIGHEST RATING		
Fitch	AA+ AA AA-	Very high credit quality 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
Moody's	Aa1 Aa2 Aa3	Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.
Standard & Poor's	AA+ AA AA-	An obligator rated 'AA' has very strong capacity to meet its financial commitments. It differs from the highest rated obligators only to a small degree.
THIRD HIGHEST RATING		
Fitch	A+ A A-	High credit quality – 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
Moody's	A1 A2 A3	Obligations rated A are considered upper-medium grade and are subject to low credit risk.
Standard & Poor's	A+ A A-	An obligator rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligators in higher rated categories.

APPENDIX G

PRUDENTIAL INDICATORS 2015/16 – 2017/18

1 Background

1.1 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. The objects of the Prudential Code are to ensure that the investment plans within the Councils are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice.

2 Gross Debt and the Capital Financing Requirement

2.1 This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the Councils should ensure that debt does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

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

2.3 The Section 151 Officer reports that the Councils will have no difficulty meeting this requirement in 2015/16, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Babergh District Council

Gross Debt	**2014/15 Revised £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**
Outstanding Borrowing (at nominal value)	87.797	118.435	121.364	122.464
Other Long-term Liabilities (at nominal value)	0	0	0	0
Gross Debt	**87.297**	**118.435**	**121.364**	**122.464**

Mid Suffolk District Council

Gross Debt	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Outstanding Borrowing (at nominal value)	103.454	132.130	137.138	138.671
Other Long-term Liabilities (at nominal value)	0	0	0	0
Gross Debt	**103.454**	**132.130**	**137.138**	**138.671**

3 Estimates of Capital Expenditure

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels. The table below shows planned capital expenditure up to 2017/18:

Babergh District Council Capital Expenditure	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
General Fund	7.872	5.250	30.990	3.343	1.516
HRA	5.398	7.800	7.292	9.885	7.372
Total	**13.270**	**13.050**	**38.282**	**13.228**	**8.888**

Mid Suffolk District Council Capital Expenditure	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
General Fund	6.313	7.392	29.157	4.072	1.885
HRA	6.277	7.189	7.336	10.562	7.005
Total	**12.590**	**14.581**	**36.493**	**14.634**	**8.890**

3.2 Capital expenditure is expected to be financed for the General Fund and HRA as follows:

Babergh District Council

Capital Financing	2014/15 Approved	2014/15 Revised	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
GF	**£m**	**£m**	**£m**	**£m**	**£m**
Capital receipts	0.843	0.410	0.066	0.066	0.066
Government Grants	0.227	0.472	0.285	0.350	0.350
Revenue contributions	0.000	0.000	0.000	0.000	0.000
Total Financing	**1.070**	**0.882**	**0.351**	**0.416**	**0.416**
Unsupported borrowing	6.802	4.368	*30.639	2.927	1.100

Total Financing and Funding	**7.872**	**5.250**	**30.990**	**3.343**	**1.516**

*Includes £25m re unspecified Delivery Plan projects

Capital Financing HRA	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Capital receipts	0.276	0.560	0.539	0.066	0.067
Major Repairs Allowance	2.631	2.431	2.921	2.792	2.843
Revenue contributions	2.491	4.809	3.832	7.027	4.462
Total Financing	**5.398**	**7.800**	**7.292**	**9.885**	**7.372**
Unsupported borrowing	0.000	0.000	0.000	0.000	0.000
Total Financing and Funding	**5.398**	**7.800**	**7.292**	**9.885**	**7.372**

Mid Suffolk District Council

Capital Financing GF	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Capital receipts	0.074	0.385	0.238	0.064	0.065
Government Grants	0.265	0.216	0.243	0.288	0.288
Revenue contributions	0.510	0.000	0.000	0.000	0.000
Total Financing	**0.849**	**0.601**	**0.481**	**0.352**	**0.353**
Unsupported borrowing	5.464	6.791	*28.676	3.720	1.532
Total Financing and Funding	**6.313**	**7.392**	**29.157**	**4.072**	**1.885**

*Includes £25m re unspecified Delivery Plan projects

Mid Suffolk District Council

Capital Financing HRA	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Capital receipts	0.716	1.344	0.727	1.379	1.126
Major Repairs Allowance	2.734	3.018	5.322	3.350	3.076
Revenue contributions	2.827	2.827	1.287	4.545	2.803
Total Financing	**6.277**	**7.189**	**7.336**	**9.274**	**7.005**
Unsupported borrowing	0.000	0.000	0.000	1.288	0.000
Total Financing and Funding	**6.277**	**7.189**	**7.336**	**10.562**	**7.005**

4 Ratio of Financing Costs to Net Revenue Stream

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code and excludes revenue contributions to capital.

4.2 The ratio is based on costs net of investment income. One set of General Fund figures set out below includes the impact of the potential £25m delivery plan investment projects in the 2015/16 General Fund capital programme. The other set excludes this impact. A business case(s) will be prepared at the time of wanting to borrow that demonstrates affordability.

Babergh District Council

Ratio of Financing Costs to Net Revenue Stream	**2014/15 Approved** **%**	**2014/15 Revised** **%**	**2015/16 Estimate** **%**	**2016/17 Estimate** **%**	**2017/18 Estimate** **%**
General Fund (excluding Delivery Plan projects)	4.88%	4.97%	7.52%	11.47%	13.78%
General Fund (including Delivery Plan projects)	4.88%	4.97%	11.52%	32.74%	35.07%
HRA	18.08%	18.19%	17.57%	16.48%	15.57%

Mid Suffolk District Council

Ratio of Financing Costs to Net Revenue Stream	**2014/15 Approved** **%**	**2014/15 Revised** **%**	**2015/16 Estimate** **%**	**2016/17 Estimate** **%**	**2017/18 Estimate** **%**
General Fund (excluding Delivery Plan projects)	10.99%	10.21%	14.12%	21.21%	22.44%
General Fund (including Delivery Plan projects)	10.99%	10.21%	15.12%	38.21%	39.33%
HRA	24.29%	23.88%	22.12%	21.51%	20.72%

5 Capital Financing Requirement

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for capital purposes. The calculation of the CFR is taken from the amounts held on the Balance Sheet relating to capital expenditure and it's financing.

Babergh District Council

Capital Financing Requirement	**2014/15 Approved** **£m**	**2014/15 Revised** **£m**	**2015/16 Estimate** **£m**	**2016/17 Estimate** **£m**	**2017/18 Estimate** **£m**
General Fund	12.835	10.536	*40.484	41.133	39.767
HRA	88.348	87.387	86.441	85.497	84.555
Total CFR	**101.183**	**97.923**	**126.925**	**126.630**	**124.322**

*Includes £25m re unspecified Delivery Plan projects

Mid Suffolk District Council

Capital Financing Requirement	2014/15 Approved £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
General Fund	22.287	21.023	*48.527	49.126	47.457
HRA	86.759	86.759	86.759	88.047	88.047
Total CFR	**109.046**	**107.782**	**135.286**	**137.173**	**135.504**

*Includes £25m re unspecified Delivery Plan projects

6 Incremental Impact of Capital Investment Decisions

6.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Babergh District Council

Incremental Impact of Capital Investment Decisions	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £
Increase in Band D Council Tax	8.34	6.59	8.40
Movement in Average Weekly Housing Rents	6.62	16.05	-13.44

Mid Suffolk District Council

Incremental Impact of Capital Investment Decisions	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £
Increase in Band D Council Tax	10.31	9.97	11.50
Movement in Average Weekly Housing Rents	-8.50	21.79	-12.75

Note: The variations reflect changes in the value of the annual capital programmes.

6.2 The movements in Band D council tax reflect the increases / decreases in the provision for Capital Financing Charges as a result of movements in borrowing undertaken to finance the proposed capital programme from 2015/16 to 2017/18.

7 Authorised Limit and Operational Boundary for External Debt

7.1 The Councils have an integrated treasury management strategy and manage their treasury position in accordance with their approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Councils and not just those arising from capital spending reflected in the CFR.

7.2 The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Councils. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Councils' existing commitments, their proposals for capital expenditure and financing and their approved treasury management policy statement and practices.

7.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

7.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Babergh District Council

Authorised Limit for External Debt	2014/15	2014/15	2015/16	2016/17	2017/18
	Approved	Revised	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Borrowing	104	101	130	130	128
Other Long-term Liabilities	0	0	0	0	0
Total	**104**	**101**	**130**	**130**	**128**

Mid Suffolk District Council

Authorised Limit for External Debt	2014/15	2014/15	2015/16	2016/17	2017/18
	Approved	Revised	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Borrowing	111	112	139	141	139
Other Long-term Liabilities	0	0	0	0	0
Total	**111**	**112**	**139**	**141**	**139**

7.5 There is also an Operational Boundary for external debt, which links directly to the Councils' estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

7.6 The Section 151 Officer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the Joint Audit and Standards Committee as part of the half yearly reports.

Babergh District Council

Operational Boundary for External Debt	2014/15	2014/15	2015/16	2016/17	2017/18
	Approved	**Revised**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Borrowing	102	98	127	127	125
Other Long-term Liabilities	0	0	0	0	0
Total	**102**	**98**	**127**	**127**	**125**

Mid Suffolk District Council

Operational Boundary for External Debt	2014/15	2014/15	2015/16	2016/17	2017/18
	Approved	**Revised**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Borrowing	109	109	136	138	136
Other Long-term Liabilities	0	0	0	0	0
Total	**109**	**109**	**136**	**138**	**136**

8 Adoption of the CIPFA Treasury Management Code

8.1 This indicator demonstrates that the Councils have adopted the principles of best practice.

8.2 The Councils approved the adoption of the CIPFA Treasury Management Code in April 2002. CIPFA revised the Treasury Management Code in November 2011 following recent developments and anticipated regulatory changes to the Localism Act 2011, including the housing finance reforms and the introduction of the General Power of Competence.

8.3 The Councils will adopt the latest Code and the changes have been incorporated into the Treasury Management Strategy including its treasury policies, procedures and practices.

APPENDIX H

2015/16 MINIMUM REVENUE PROVISION (MRP) STATEMENT

Babergh District Council and Mid Suffolk District Counci

1 Guidance on the MRP (2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on MRP has been issued by the Secretary of State and local authorities are required to “have regard” to such Guidance under section 21(1A) of the Local Government Act 2003.

2 The four MRP options available are:

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

3 Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported non-HRA capital expenditure if the Council chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing. However, voluntary MRP contributions from the HRA may be made.

4 As in previous years the Councils will apply Option 2 in respect of supported non-HRA capital expenditure funded from borrowing and Option 3 in respect of unsupported non-HRA capital expenditure funded from borrowing.

5 If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to the Councils at that time.