Public Document Pack

Blackpool Council

Date: 30th January 2015

All Members of the Council

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Dear Councillor

Executive Meeting 9th February 2015 and Council Meeting 27th February 2015

Please find attached the Appendices relating to the Treasury Management Strategy 2015/16.

This document will be considered by the Executive at its meeting on the 9th February 2015 and will be considered by the Council at its meeting on the 27th February 2015.

Please bring these documents to either of these meetings, if you are attending.

If you have any queries please contact me by the direct line or email listed above

Yours sincerely

On behalf of the Head of Democratic Governance

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BLACKPOOL COUNCIL

REPORT

of the

DIRECTOR OF RESOURCES

to the

EXECUTIVE

on

9th FEBRUARY 2015

TREASURY MANAGEMENT STRATEGY 2015/16

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1. Purpose

1.1 The Council is required by statute to publish an annual Treasury Management Strategy incorporating its Investment Strategy.

1.2 In essence the Treasury Management Strategy is an annual plan of how Blackpool Council will manage its investments and cashflows. It identifies the Council's borrowing needs and shows how it will invest temporary surplus cash balances, and how it will control its banking, money market and capital market transactions.

1.3 The Scale of Operations at Annex A shows the levels of capital expenditure, long-term borrowing and temporary investments and also the impact that spending on new capital schemes has on average council tax levels.

2. Definition

2.1 CIPFA defines Treasury Management as *"The management of the organisation's investments and cashflows, 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".*

3. Background

3.1 Blackpool's Capital Programme for 2015/16–2017/18 continues on a reduced scale following the reduction in capital grants received from central government. Nevertheless, total cash moving annually through the Council's bank account including the reinvestment of temporary cash surpluses remains over £750m in the current year.

3.2 Large capital regeneration schemes such as the development of the Central Business District and the improvements to the highways infrastructure through Project 30 are either complete or nearing completion. Other schemes are being undertaken but on a much smaller scale and only where they are fully funded.

3.3 The Treasury Management Panel, which comprises the Director of Resources, Chief Accountant and representatives from Corporate Finance, has the responsibility for managing the risks associated with treasury management activities on an operational basis. The Panel recognises the need to balance investment risk against achieving an acceptable return on temporary surplus cash balances. The balance sought is to maximise the security and liquidity of the Council's investments, with higher yields being obtained only where they are consistent with those desired levels of security and liquidity.

4. Objectives

4.1 The objectives of the Treasury Management Strategy are as follows:

- To set the framework for the Council's treasury management operations
- To manage the Council's investments and cashflows
- To control banking, money market and capital market transactions
- To plan and secure appropriate borrowing in order to finance the Capital Programme at the lowest overall cost to the Council
- To achieve the best rates of return from the investment of temporary surplus cash balances commensurate with risk, subject to the overriding principle of maintaining an acceptable level of security
- To monitor and control effectively the risks associated with these transactions
- To comply with appropriate codes and regulations including the International Financial Reporting Standards as they apply to Treasury Management.

4.2 In delivering the above objectives the Council is required to:

- Determine its own borrowing limits taking into account its financial situation, long-term plans and in particular what it thinks is affordable now and sustainable in the future
- Monitor its borrowing limits using performance measures called Prudential indicators, these are set out in detail in Annex C to this report
- Consider annual and six-monthly reports on Treasury Management which contain Prudential indicators via the Executive.

5. Economic Outlook

5.1 The outlook for the UK economy continues to improve but analysts expect only a slight increase in gross domestic product in the short-term. This slow rate of improvement means continuing risk and so it is important that the Council's treasury and investment affairs continue to be managed in a cautious and prudent manner.

5.2 The interest rate environment has remained static since the previous Treasury Management Strategy in February 2014. The Bank of England has maintained the Base Rate at 0.5% and current market expectations are that the base rate will not rise before the first quarter of 2016 with money market investment rates for temporary surplus cash balances staying at present levels. The current rate for a three-month fixed-term deposit with a high street bank is typically 0.5% and analysts anticipate that this will only change marginally during the next 12 months.

5.3 Long-term borrowing rates, influenced by gilt yields, are generally stable. The recovery in the UK economy and continued decline in the Euro Zone has reduced the interest rate that the

Government has to pay on its overseas borrowing. Therefore, long-term borrowing rates have decreased gradually during the year by 0.7% to just under 3.6% and the market expects these longer term rates to remain at this level for the next 12 months.

6. Treasury Management Strategy - Key Principles

6.1 A summary of the key principles upon which the strategy is based is set out below and is expanded in more detail in Annex B:

- Temporary investments will be restricted to UK Banks and Building Societies unless non-UK institutions satisfy the stringent requirements set out in the Investment Counterparty and Liquidity Framework (Annex B, section 5).

- Short-dated Gilts (UK government securities with a life of less than one year) will continue to form part of our approved list of investments.

- Fixed-term cash deposits are currently restricted to terms of not more than three months (subject to review by the Treasury Management Panel) except the approved Lend a Hand Mortgage Guarantee Scheme.

- Temporary cash surpluses will continue to be applied to reduce the Council's need to borrow.

- New long term borrowing to support capital expenditure will only be taken in favourable conditions.

- The Treasury Management Panel will remain alert to market intelligence through the financial press, contacts in the financial markets and contacts in other local authorities.

- Treasury management advisers will only be engaged on an ad-hoc basis, retaining responsibility in-house for all treasury management activities.

- Long-term debt will be repaid in advance of redemption date where there is demonstrable financial advantage to the Council.

- The Policy for allocating borrowing costs to the Housing Revenue Account for 2015/16 and future years will be the same as in previous years and will be based on the Housing Revenue Account share of the Capital Financing Requirement (HRACFR). The charge will be made up of the interest payable on long-term loans in the Housing Revenue Account pool and an additional charge or credit where the HRA pool of loans is either below or above the HRACFR.

- Prudentially funded capital schemes will be charged a Minimum Revenue Provision (MRP) and interest at the pooled borrowing rate for the General Fund except in exceptional circumstances when the Director of Resources deems it appropriate to use an alternative rate. In cases where the interest rate is lower than the pooled rate there must be clear evidence that the use of the lower rate is affordable. The policy on charging Minimum Revenue Provision is set out in Annex D. This policy is reviewed annually.

6.2 During the last 12 months the Council has taken no additional long-term borrowing. Capital spending has been financed by using internal balances and by using short-term loans which are currently available at very low interest rates.

6.3 Where the Council makes business loans, it takes into account its own cost of borrowing, the likelihood of future interest rate movements, the risks of the venture and any state aid implications in ensuring that it at least covers its own costs.

7. Recommendations

The Executive is asked to recommend to Council that it:

i) Adopts the Elements of the Treasury Management Strategy 2015/16 and approves the Prudential Indicators and Limits for 2015/16 - 2017/18 which are set out in Annex B to this report;

ii) Approves the Prudential Indicators and Limits for 2015/16 - 2017/18 which are set out in Annex C to this report; and

iii) Approves the Minimum Revenue Provision Policy Statement for 2015/16 within Annex D to this report.

STEVE THOMPSON

DIRECTOR OF RESOURCES

TREASURY MANAGEMENT STRATEGY 2015/16

ANNEX A – Scale of Operations

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Capital Expenditure - The projected capital expenditure - presented here in order to show the complete treasury position - and for which approval is separately requested in the Capital Programme 15/16 – 17/18 Report is expected to be:

Capital expenditure £M	2014/15 Revised	2015/16 Programme	2016/17 Programme	2017/18 Programme
Non-HRA	36	15	24	20
HRA	13	7	9	9
Total	49	22	33	29

Debt Requirement - Part of the capital expenditure programme will be financed directly through government grants, capital receipts etc. This leaves a residue which will increase the Council's external borrowing requirement (its Capital Financing Requirement [CFR]). The General Fund CFR is reduced each year by a statutory revenue charge for the repayment of debt. The HRA is under no requirement to make such a charge.

Capital Financing Requirement £M	2014/15 Revised	2015/16 Programme	2016/17 Programme	2017/18 Programme
Non-HRA	281	274	274	266
HRA	11	11	11	11
Total	292	285	285	277

The HRA limit on indebtedness imposed by the Department of Communities and Local Government is set out in the determination and remains at £35.74m.

Against this borrowing need (the CFR), the Council's expected external debt position for each year (the **Operational Boundary**) and the maximum amount it can borrow (the **Authorised Limit**) are:

£M	2014/15 Revised	2015/16 Projection	2016/17 Projection	2017/18 Projection
Authorised Limit	284	305	305	290
Operational Boundary	264	295	295	280

The impact of the new schemes being approved as part of this budgetary cycle on council tax and housing rents - as separately reported these are expected to be:

Incremental impact of capital investment decisions (£) on:	2014/15 Revised	2015/16 Programme	2016/17 Programme	2017/18 Programme
Average council tax	£3.96	£4.18	£4.40	£4.40
Housing rents	£nil	£0.18	£0.31	£0.63

Investments - The value of resources applied to finance the capital spend above is one of the elements which influence the Council's overall resources. The expected position of the Council's year-end resources (capital reserves, capital receipts, etc.), is shown below. This is supplemented with the expected cashflow position to provide an overall estimate of the year-end investment position. The Prudential Indicator identifying the ability to invest longer term is also shown.

£M	2014/15 Revised	2015/16 Projection	2016/17 Projection	2017/18 Projection
Total resources	-	-	-	-
Working capital	-	-	-	-
Temporary borrowing	(60)	(104)	(98)	(71)
Sums invested > 364 days	-	-	-	-

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ANNEX B – Elements of the Treasury Management Strategy 2015/16 - 2017/18

1. Introduction

1.1 The elements of this Treasury Management Strategy are designed to provide a proper framework within which the Council's cashflow 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, can be operated.

1.2 The Treasury Management Panel is an important part of the overall financial management of the Council's affairs. The Prudential Indicators in Annex C consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework. The Treasury Management Panel considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 2002. There are specific treasury Prudential Indicators included in this strategy which require approval.

1.3 The Council's treasury activities are strictly regulated by statutory requirements, in particular the Local Government Act 2003. This annex contains two of the four key elements referred to in the attached report. They are the Borrowing Strategy and the Investment Strategy, both are in accordance with the Department of Communities and Local Government (DCLG) investment guidance. These two key elements are in accordance with a professional code of practice (the CIPFA Code of Practice and Cross-Sectoral Guidance Notes on Treasury Management – 2011 Edition). This Council has adopted the 2011 edition of the Treasury Management Code.

1.4 The Council's policy requires an annual Strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks and the management of the risks associated with the treasury service. Further treasury reports are produced at the half-year stage and after the year-end to report on actual activity for the year.

1.5 This Strategy covers the following:

- The Council's debt and investment projections (section 2).
- The expected movement in interest rates (section 3).
- The Council's borrowing and investment strategies (sections 4 and 6).
- The Council's investment counterparty and liquidity framework (section 5).
- The Council's power to invest (section 7).
- Specific limits on treasury activities and attitude to risk (section 8).
- The Council's Lender Option Buyer Option (LOBO) strategy (section 9).

2. Debt and Investment Projections 2015/16 – 2017/18

2.1 The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR in the table below) and any maturing debt which will need to be re-financed. The table overleaf shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances:

£'000s	2014/15 Revised	2015/16 Projection	2016/17 Projection	2017/18 Projection
External Debt				
Long-term debt at 1 April	99,132	94,889	88,574	91,929
Repaid debt	(4,243)	(6,315)	(6,645)	(197)
Replacement of maturing debt	-	-	-	-
Additional long-term debt	-	-	10,000	15,000
Long-term debt at 31 March	**94,889**	**88,574**	**91,929**	**106,732**
Short-term debt at 31 March	60,000	103,728	98,439	70,819
LCC/ex-LCC at 31 March	20,399	19,582	18,799	18,047
PFI Liabilities	72,085	72,085	72,085	72,085
Total external debt at 31 March	**247,373**	**283,969**	**281,252**	**267,683**
Annual change in debt	**14,386**	**36,596**	**(2,717)**	**(13,569)**
Investments				
Total investments at 31 March	-	-	-	-
Investment change	**(6,250)**	**-**	**-**	**-**
Change in debt less investment	20,636	36,596	(2,717)	(13,569)
Annual change in CFR (annex C 3.3)	**1,744**	**(7,121)**	**250**	**(8,600)**

2.2 The additional long-term debt includes any borrowing in advance and catch-up borrowing. The related impact of the above movements on the revenue budget are:

£'000s	2014/15 Revised	2015/16 Projection	2016/17 Projection	2017/18 Projection
Revenue Budget				
Interest on long-term loans	5,297	6,955	7,052	7,694
Interest on short- term loans	555	424	1,968	1,416
Total Interest Cost	**5,852**	**7,379**	**9,020**	**9,110**
General Fund long-term borrowing cost	5,232	6,857	8,498	8,588
HRA long-term borrowing cost	620	522	522	522
(Investment income)	(11)	(218)	(227)	(242)

3. Expected Movement in Interest Rates

Indicative %	Base Rate	5-year Gilt	20-yr Gilt	50-yr Gilt
2014/15 (actual)	0.5	1.7	3.0	3.1
2015/16	0.5	1.7	3.0	3.1
2016/17	0.9	1.9	3.3	3.5
2017/18	1.5	2.1	3.5	3.6

3.1 The Bank of England Base Rate has remained at 0.5% since the last Treasury Management Strategy report. Analysts expect the base rate will remain at 0.5% until the first quarter 2016. It may then increase slowly.

3.2 Long-term interest rates, influenced by gilt yields, have increased gradually during the year due to the increase in the UK Governments cost of borrowing following its downgrade by Fitch from AAA to AA+. The market anticipates that long-term borrowing rates, typically priced at 100 basis points above the corresponding gilt rate and which are currently 4.1% will increase marginally during the next 12 to 18 months.

4. Borrowing Strategy 2015/16 - 2017/18

4.1 Analysts believe that short-term interest rates will remain low reflecting the base rate and are only likely to increase slightly during the first quarter of 2016. It is anticipated that they will then increase gradually over the next 18 months.

4.2 The interest rate environment has remained static since the previous Treasury Management Strategy was prepared in February 2014. The Treasury Management Panel, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time. Because of the risks involved in making temporary investments it is unlikely that there will be any borrowing in advance of the future year's requirements.

4.3 Long-term borrowing rates, influenced by gilt yields, are generally stable. The recovery in the UK economy and continued decline in the Euro Zone has reduced the interest rate that the Government has to pay on its overseas borrowing. Therefore, long-term borrowing rates which are typically priced at UK gilt + 100 basis points have reduced during the last 12 months by 0.7% to just under 3.6%. However, because of the availability of cheap short-term temporary loans the Council has continued to finance its recent borrowing requirement in this way. The interest cost of existing Public Works Loan Board long-term loans remains the same.

4.4 In order to secure the lowest cost of borrowing Blackpool Council has agreed to disclose estimates of its capital transactions including new borrowing and planned capital expenditure for the next three years to Her Majesty's Treasury. The disclosure of this information in summary format entitles the Council to receive a 20 basis point discount on all new loans borrowed from the Public Works Loan Board during the next 12 months. The information provided to Her Majesty's Treasury is updated annually.

5. Investment Counterparty and Liquidity Framework

5.1 The primary principles governing the Council's investment criteria are security and liquidity. The yield or return on investments is of secondary importance.

5.2 To achieve sufficient liquidity in its investments, guidelines will be used to determine the maximum periods for which funds may prudently be committed. These also apply to the Council's Prudential Indicators covering the maximum principal sums invested.

5.3 In relation to security, a policy will be applied to the categories of investment, the choice of investment counterparties with adequate security, and the monitoring of their security. This is set out in the Specified and Non-Specified investment sections below.

5.4 The Treasury Management Panel will maintain a counterparty list in accordance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine Specified and Non-Specified investments, as it selects which counterparties the Council will choose rather than defining what its investments are. The criteria are based on information from Fitch, Moody's and Standard & Poors, the three principal credit ratings agencies.

(i) **Banks** - the Council will use banks which have at least the following Fitch or equivalent ratings from Moody's and Standard & Poors:

- Short Term - F1 from Fitch or equivalent from Moody's or Standard & Poors.

- Long Term - Single A from Fitch or equivalent from Moody's or Standard and Poors.
- Individual / Financial Strength – C from Fitch or Moody's or the equivalent from Standard and Poors
- Support - 3 from Fitch or the equivalent from Moody's or Standard and Poors

(ii) **Bank Subsidiary and Treasury Operations** - the Council will use these where the parent bank has the necessary ratings outlined above. The investment limit to be applied will be calculated across the whole group.

(iii) **Building Societies** - the Council will use any United Kingdom Society with assets in excess of £1.5 billion.

(iv) **Local Authorities** - The Council will use upper-tier authorities only.

(v) **Investment in the UK Government** (including short-term gilts and sterling treasury bills) are permitted because of their overall security.

(vi) **Investment in Money Market Funds** are not permitted.

(vii) **Non-UK Exposure Limits** - The Treasury Management Panel may impose overall sector or country limits to restrict the level of exposure within non-UK financial institutions. The Panel has no short-term plans to start investing in non-UK financial institutions, but it can foresee the possibility in future years covered by the Strategy when it will may invest up to 25% of temporary cash investments in non-UK financial institutions which satisfy the criteria in (i) above and whose sovereign government rating is triple A according to Fitch or the equivalent from Moody's or Standard and Poors.

5.5 It is not considered necessary to apply different maximum time limits for investing with different counterparties according to their precise credit rating. Institutions are either on the list of potential counterparties for any timescale (subject to the overriding restriction of 364 days or less) or they are not on the list at all. The Treasury Management Panel has placed a temporary 3-month time limit on deposits placed with all Banks and Building Societies on its counterparty list.

5.6 The proposed criteria for Specified and Non-Specified investments are shown in section 7 for approval.

5.7 In the normal course of the Council's cashflow operations it is expected that only Specified Investments will be utilised for the control of liquidity.

5.8 The use of longer-term instruments (greater than one year from inception to repayment) would fall in the Non-Specified Investment category. These instruments will not be used for the control of liquidity. This will also be limited by the investment Prudential Indicator below.

6. <u>Investment Strategy 2015/16 – 2017/18</u>

6.1 In managing the Council's treasury on a day-to-day basis, the Treasury Management Panel takes heed of a quotation contained in a House of Commons Treasury & Civil Services Committee report of 1991 following the BCCI closure which stated: "*in balancing risk and return, local authorities should be more concerned to avoid risks than to maximise returns.*"

6.2 Expectations on shorter-term interest rates, on which investment decisions are based, are that rates will remain low during 2015 increasing by 0.4% by the middle of 2016. Rates may then rise incrementally during the following 18 months. The Council's investment decisions are based on comparisons between the current low level of interest rates and the market's expectation of gradual increases during the following 18 months. As a result it is likely that investment decisions will continue to be made for shorter periods until investment rates start to rise during 2016. However, the overriding principle is to maintain sufficient security and liquidity within the cash balances and a shorter profile of temporary investments will help achieve this. The Treasury Management Panel, under delegated powers, will undertake the most appropriate form of investments based on current market conditions as surplus funds become available. The three-month time limit for temporary investments will continue during 2015 but may be relaxed in future years covered by this Strategy. The current restrictions are explained in more detail in paragraph 6.3

6.3 The Treasury Management Panel currently operates a restriction of 3 months or less on all fixed term deposits placed with those counterparties included in paragraph 5.4 (i), (ii), (iii), (iv) and (v). It also considered it necessary to restrict temporary fixed-term investments to UK Banks and Building Societies and those subsidiaries of non-UK financial institutions which are incorporated in the UK. However, as market conditions improve the Panel is likely to lift these restrictions and extend the term of temporary investment back to a maximum of 364 days. Moreover, the Treasury Management Panel may invest up to 25% of temporary cash investments in non-UK financial institutions which satisfy the requirements set out in paragraph 5.4 (vii).

7. Power To Invest

7.1 Blackpool Council has the power to invest:

(i) for any purpose relevant to its functions under any enactment, and

(ii) for the purposes of the prudent management of its financial affairs.

This includes investments which are not directly linked to statutory functions but are simply made in the course of treasury management. This allows for the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future.

7.2 **Speculative borrowing purely in order to invest is unlawful.**

7.3 **The speculative purchase and subsequent disposal of property is generally also unlawful.** However, there may be occasions when such purchase and resale are necessary as part of a strategic development. This is permitted only where this is part of an approved project plan which is covered by proper statutory powers in pursuance of the Council's approved objectives. Examples of this are in the pursuit of delivery of projects related to Blackpool's regeneration strategy - such as the planned phases of the Central Business District.

7.4 Priority is to be given to the security of investments and then to liquidity. The highest rate of return (yield) can only be sought once officers are satisfied that the principal sums invested are secure.

7.5 No other types of (Non-Specified) investments are identified as being permissible, other than those explicitly allowed as share or loan capital under paragraph 7.6.

7.6 Investments in share or loan capital are restricted to shareholdings in Blackpool Transport Services Ltd., Blackpool Operating Company Ltd., Blackpool Entertainments Company Ltd., the housing development company and a minority interest in 50,000 'B' shares in the Airport company. The guidance defines acquisition of share or loan capital in a corporate body as capital or revenue expenditure (rather than as an investment). This means that such expenditure needs to be funded out of capital or revenue resources respectively.

8. Treasury Management Prudential Indicators, Limits on Activity and Attitude to Risk

8.1 Blackpool Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities is measured. It uses the Treasury Management Prudential Indicators as part of the risk control process to limit activity and monitor performance.

8.2 There are five treasury Prudential Indicators. The purpose of these Prudential Indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:

8.3 **Gross debt and the Capital Financing Requirement (CFR)** - In order that over the medium-term, debt will only be taken for a capital purpose, the Council should ensure that external debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. If in any of these years there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR which is used for comparison with gross external debt. This is a key indicator of prudence.

8.4 **Upper limits on variable interest rate exposure** - This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments. In cases where the terms of the borrowing or investment raise questions as to whether it should be treated as fixed or variable, it is to be treated as variable for the purposes of these Prudential Indicators. Advice previously received from Butlers suggests that this indicator is best calculated using the principal capital value rather than percentages where there are significant levels of investments.

8.5 **Upper limits on fixed interest rate exposure** - This indicator is similar to the previous indicator but covers a maximum limit on fixed interest rates.

8.6 **Maturity structures of borrowing** - These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits. They show the amount of projected borrowing that is fixed rate maturing in each period as a percentage of the total projected borrowing that is fixed rate.

8.7 **Total principal funds invested for greater than 364 days** - These limits are set to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

8.8 The Council is asked to approve the following Prudential Indicators. Note that for each year, the upper limits on fixed interest rates equate to the expected Capital Financing Requirement for that year:

	2015/16	2016/17	2017/18
Gross debt (£M)			
	Upper	**Upper**	**Upper**
Gross Debt	284	281	268
Capital Financing Requirement	285	285	276
Interest rate exposures (£M)			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	285	285	276
Limits on variable interest rates based on net debt	114	114	111
Maturity structure of fixed interest rate borrowing 2015/16 (%)			
		Lower	**Upper**
Under 12 months		-	18%
12 months and within 2 years		-	18%
2 years and within 5 years		-	30%
5 years and within 10 years		2%	60%
10 years and within 30 years		2%	70%
30 years and above		15%	90%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£ nil	£ nil	£ nil

9. Lender Option Borrower Option debt (LOBOs)

9.1 LOBOs typically carry a cheaper initial rate of interest than new debt available from other sources. They are structured with an initial period in which a fixed rate of interest is paid, followed by a much longer ‘variable’ period. During this period at the agreed ‘call’ dates (typically between every six months to every five years) the Lender has the option to increase the interest rate. If the Lender exercises their Option to increase the rate, the Borrower has the Option to repay the debt.

9.2 When general interest rates are rising, the interest the Council pays on its LOBOs will tend to ratchet up at call dates, lagging just below other available market rates. The higher rate chosen by the lender is always likely to be enticingly below other immediately available market rates so that at the decision points when the borrower has the option to repay, it will be seduced into a longer relationship with the LOBO at higher rates. However, when general interest rates are falling, the interest the borrower pays on its LOBOs will remain fixed at the higher rates.

9.3 The Treasury Management Panel notes that whenever a lender calls an increase in the rate of a LOBO there will be a great temptation to accept the higher rate and remain tied into the LOBO (as the alternative borrowing is likely to be slightly more expensive in the short term). The Council will continue to take advantage of the beneficial rates available through LOBOs as part of a balanced portfolio of fixed and variable debt, especially through the early fixed period of the instrument.

9.4 The Council’s policy is that on every occasion when a lender opts to increase the interest rate on one of its LOBOs there is a presumption that the Council will repay the LOBO.

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1) Background and Summary

1.1 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code for Capital Finance in Local Authorities (2011 Edition) and agree Prudential Indicators. This report revises the Indicators for 2014/15, 2015/16, 2016/17 and introduces new Indicators for 2017/18. Each indicator either summarises the expected activity or introduces limits upon the activity and reflects the outcome of the Council's underlying capital appraisal systems.

1.2 Within this overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity. As a consequence the Treasury Management Strategy for 2015/16 is included at Annex B to complement the Indicators and this report includes the Prudential Indicators relating to the treasury activity.

2) Capital expenditure plans

2.1 The Council's capital expenditure plans are reported and recommended for approval in the Capital Programme 2015/16 Report and are summarised below. This forms the first of the Prudential Indicators. This expenditure can be paid for immediately (by resources such as capital receipts, capital grants, etc.), but if resources are insufficient any residual expenditure will need to be borrowed.

2.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and will need to be paid for from the Council's own resources. The Government retains an option to control either the total of all local authorities' plans or those of a specific council, although no such control has yet been invoked.

2.3 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.

2.4 The Council is referred to the summary capital expenditure projections below, as reported in the Capital Programme Report 2015/16. This forms the first Prudential Indicator:

£'000s	**2014/15 Revised**	**2015/16 Programme**	**2016/17 Programme**	**2017/18 Programme**
Capital Expenditure:				
Non-HRA	35,600	14,745	24,770	20,088
HRA	13,450	6,826	8,636	9,250
Financed by:				
Capital receipts	(114)	(114)	(114)	(76)
Capital grants	(28,586)	(19,957)	(24,292)	(29,262)
Capital reserves	(2,273)	-	-	-
Revenue	(8,009)	-	-	-
Net financing need for the year: *(para 3.3)*	**10,068**	**1,500**	**9,000**	**-**

3) The Council's borrowing need (the Capital Financing Requirement)

3.1 The second Prudential Indicator is the Council's Capital Financing Requirement (CFR). The Capital Financing Requirement is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow. The capital expenditure above which has not immediately been paid for will increase the CFR.

3.2 The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge known as the Minimum Revenue Provision (MRP). The overriding principle in calculating the Minimum Revenue Provision is that it must be prudent and this is covered in more detail in Annex D.

3.3 The Council is asked to approve the Capital Financing Requirement projections below:

£'000s	2014/15 Revised	2015/16 Programme	2016/17 Programme	2017/18 Programme
Capital Financing Requirement:				
CFR – Non Housing	281,232	274,111	274,361	265,761
CFR - Housing	11,363	11,363	11,363	11,363
Total CFR	292,595	285,474	285,724	277,124
Movement in CFR	**1,744**	**(7,121)**	**250**	**(8,600)**

Movement in CFR represented by:				
Net financing need for the year: *(para 2.4)*	10,068	1,500	9,000	-
MRP/Voluntary Revenue Provision and other financing movements:	(8,324)	(8,621)	(8,750)	(8,600)
DCLG - HRA Settlement	-	-	-	-
Movement in CFR	**1,744**	**(7,121)**	**250**	**(8,600)**

3.4 In order to ensure that over the medium-term net borrowing will only be taken for a capital purpose, the local authority should ensure that net external borrowing 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. This is a key indicator of prudence.

4) The use of the Council's resources and the investment position

The application of resources (capital receipts, reserves, etc.) to either finance capital expenditure or support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales, etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cashflow balance

Year End Resources £'000s	2014/15 Revised	2015/16 Programme	2016/17 Programme	2017/18 Programme
Useable capital receipts reserve	276	276	276	276
Earmarked capital reserves	-	-	-	-
Total core funds	276	276	276	276
Working capital*	-	-	-	-
Anticipated (reduction) in cash balances	-	-	-	-

** Working capital balances shown are estimated at year-ends; these may be different mid-year.*

5) Limits to borrowing activity

5.1 Within the Prudential Indicators there are a number of key indicators to ensure the Council operates its activities within well-defined limits.

5.2 For the first of these the Council needs to ensure that its total borrowing - net of any investments - does not, except in the short term, exceed the total of the Capital Financing Requirement CFR in the preceding year plus the estimates of any additional Capital Financing Requirement for 2015/16 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

Y/end positions £'000s	2014/15 Revised	2015/16 Projection	2016/17 Projection	2017/18 Projection
L/T borrowing	94,889	88,574	91,929	106,732
Short-term debt	60,000	103,728	98,439	70,819
LCC/ex-LCC	20,399	19,582	18,799	18,047
PFI Schemes	72,085	72,085	72,085	72,085
Gross borrowing	247,373	283,969	281,252	267,683
(Investments)	-	-	-	
Net borrowing	247,373	283,969	281,252	267,683
CFR	292,595	285,474	285,724	277,124

5.3 The Director of Resources reports that the Council has complied with this Prudential Indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the proposals in next year's budget report.

5.4 A further two Prudential Indicators control or anticipate the overall level of borrowing:

5.5 **The Authorised Limit for external debt -** This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

5.6 **The Operational Boundary for external debt -** This indicator is based on the expected maximum external debt during the course of the year; it is not a limit. The Operational Boundary differs from the Authorised Limit in that it is based on expectations of the maximum external debt according to probable - not simply possible - events and is consistent with the maximum level of external debt projected by the estimates. The setting of this Operational Boundary is a matter of careful judgement. If it is set too high then it may be too near the Authorised Limit for there to be a margin sufficient to allow time to take corrective action before the Authorised Limit is breached. Alternatively, if it is set too low it will be breached so frequently that it will cease to act as a credible warning indicator. The intention therefore is that this operates as a form of early warning about certain cash-flow problems.

5.7 The Council is asked to approve the following Authorised Limit and Operational Boundaries, two indicators which are based on debt (including short-term) and are gross of investments.

Authorised Limit £'000s	**2014/15 Revised**	**2015/16 Projection**	**2016/17 Projection**	**2017/18 Projection**
Borrowing limit	211,000	232,000	232,000	217,000
Other long term liabilities limit	73,000	73,000	73,000	73,000
Total limit	284,000	305,000	305,000	290,0000
Operational Boundary £'000s	**2014/15 Revised**	**2015/16 Projection**	**2016/17 Projection**	**2017/18 Projection**
Borrowing limit	191,000	222,000	222,000	207,000
Other long term liabilities limit	73,000	73,000	73,000	73,000
Total limit	264,000	295,000	295,000	280,000

5.8 The Authorised Limit is set to allow for any potential overdraft position, since this will be counted against the overall borrowing. The Operational Boundary is set to equate to expected debt levels without headroom.

6) Affordability Prudential Indicators

6.1 The previous sections cover the overall capital and control of borrowing Prudential Indicators, but within this framework Prudential Indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

6.2 **Actual and estimates of the ratio of financing costs to net revenue stream -** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

%	**2014/15 Revised**	**2015/16 Programme**	**2016/17 Programme**	**2017/18 Programme**
Non-HRA	9.2%	11.0%	13.5%	14.3%
HRA	3.6%	3.0%	3.0%	3.0%

The estimates of financing costs include current commitments and the proposals in the Budget Report presented concurrently for approval.

6.3 **Estimates of the incremental impact of capital investment decisions on the Council Tax -** This indicator identifies the revenue costs associated with new schemes introduced to the three-year capital programme recommended in the budget report, compared with the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support.

Incremental impact of capital investment decisions on Average Council Tax	Proposed Budget 2015/16	Forward Projection 2016/17	Forward Projection 2017/18
Average Council Tax	£4.18	£4.40	£4.40

6.4 **Estimates of the incremental impact of capital investment decisions on housing rent levels -** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Incremental impact of capital investment decisions on housing rent levels	Proposed Budget 2015/16	Forward Projection 2016/17	Forward Projection 2017/18
Weekly housing rent levels	£0.18	£0.31	£0.63

This indicator shows the revenue impact on any newly approved schemes, although any discrete impact will be constrained by rent controls.

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TREASURY MANAGEMENT STRATEGY 2015/16

ANNEX D – Policy on Minimum Revenue Provision

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1. Minimum Revenue Provision Policy Statement

1.1 The Council is required by statute to charge a Minimum Revenue Provision (MRP) to the General Fund Revenue Account each year for the repayment of debt (capital expenditure financed by borrowing and credit arrangements). The Minimum Revenue Provision charge is the means by which capital expenditure which has been funded by borrowing is paid for by council taxpayers.

1.2 The scheme of Minimum Revenue Provision was set out in former regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. This system was radically revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 in conjunction with Communities and Local Government's Minimum Revenue Provision statutory guidance and also complies with the requirements of the Department for Communities and Local Government Investment Guidance issued in 2009 along with draft regulations in respect of Minimum Revenue Provision and International Financial Reporting Standards (IFRS).

1.3 The 2008 Regulations replaced the detailed rules with a simple duty for an authority each year to make an amount of Minimum Revenue Provision which it considers prudent. The term "prudent provision" is not defined within the regulation; however, the statutory guidance includes specific examples of options for making "prudent provision".

1.4 The broad aim of prudent provision is to ensure debt is repaid over a period that is either reasonably equal with that over which the capital expenditure provides benefit, or in the case of borrowing supported by Government Revenue Support Grant reasonably equal with the period implicit in the determination of that grant.

1.5 There are four options set out in the statutory guidance for determining the Minimum Revenue Provision:

Option 1 - Regulatory Method
Option 2 - The Capital Financing Requirement (CFR) Method
Option 3 - Asset Life Method (the Minimum Revenue Provision is determined by reference to the life of the asset)
Option 4 - Depreciation Method (Minimum Revenue Provision is equal to the provision required under depreciation accounting).

1.6 The Minimum Revenue Provision Policy for 2015/16 is as follows:

1.6.1 For all supported capital expenditure incurred prior to 1st April 2008 and for future supported capital expenditure, the Minimum Revenue Provision will be based on the Regulatory Method (option 1), as this minimises the annual charge to the General Fund. This charge will be supplemented by voluntary Minimum Revenue Provision (based on the useful asset life) in respect of those assets which have been financed by unsupported borrowing (sometimes known as Prudentially funded assets) because it is considered prudent to adopt this approach.

1.6.2 For capital expenditure incurred after 1st April 2008 and financed by unsupported borrowing, the Minimum Revenue Provision will be based on option 3, the Asset Life Method. This method was already being used by the Council for capital expenditure financed by unsupported borrowing prior to the introduction of the 2008 Regulations and it is considered both appropriate and prudent to continue with it.

1.6.3 In exceptional circumstances Minimum Revenue Provision for capital expenditure incurred after 1st April 2008 and which is funded by unsupported borrowing can be calculated using the Annuity Method (a variation allowed under option 3 of the 2008 Regulations). However, this method is only suitable for particular types of capital expenditure projects where the benefits are expected to increase in later years or where the income stream generated by the new project mirrors to the Annuity profile. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies where revenues will increase over time. This method may only be used if it receives approval by the Treasury Management Panel.

1.7 The above policy will ensure that the Council satisfies the requirement to set aside a prudent level of Minimum Revenue Provision