Full Council

Thursday, 11 February, 2016, at 1.30 pm in the Council Chamber, County Hall, Preston.

Agenda

Index

Jo Turton
Chief Executive

County Hall, Preston
04 February 2016

Lancashire County Council

Meeting of the County Council
Meeting to be held on 11 February 2016

Report submitted by the Cabinet

Part A

Electoral Division affected:
All

Revenue Budget 2016/17 and Financial Strategy 2017/18 to 2019/20
Capital Investment Programme 2016/17 and beyond
Council Tax and Precept 2016/17
(Appendix A refers)

Contact for further information:
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Executive Summary

To consider the recommendations of the Cabinet on 21 January 2016 regarding:

1. The Revenue Budget 2016/17 and Financial Strategy 2017/18 to 2019/20: section 1 of this report and Appendix A;

2. The Capital Investment Programme 2016/17 and beyond: section 2 of this report and Appendix A; and

3. The Council Tax and Precept 2016/17: section 3 of this report.

Please note: The reports on the County Council's Budget for 2016/17 considered by Cabinet at their meetings on 12 August 2015, 26 November 2015 and 21 January 2016 form part of the background to the report attached at Appendix A. The detailed information from those reports is not repeated in this report. Those reports are available via the Cabinet Agendas on the County Council's website:

http://council.lancashire.gov.uk/ieListMeetings.aspx?CommitteeId=122

Recommendation

The Full Council is asked to consider the proposals of the Cabinet from its meeting on 21 January 2016 and then approve:

- The Revenue Budget for 2016/17 and Financial Strategy 2017/18 to 2019/20;
- The Capital Investment Strategy 2016/17 and future years; and
- The Council Tax Requirement and Precept for 2016/17

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Ext
Grant Settlement and Budget working papers	January 2016	Damon Lawrenson/Interim Director of Financial Resources /Ext 34715

<u>Report of the Cabinet</u>

The Cabinet **recommends** the adoption of the proposals set out below for the:

1. The Revenue Budget 2016/17 and Financial Strategy 2017/18 to 2019/20: section 1 of this report and Appendix A;

2. The Capital Investment Programme 2016/17 and beyond: section 2 of this report and Appendix A; and

3. The Council Tax and Precept 2016/17: section 3 of this report.

1. Revenue Budget 2016/17

The Cabinet **recommends** the adoption of the revenue budget proposals as set out in Appendix A and in the tables below, which sets out the proposed budget allocations to services and other budget areas. It should be noted that the budget proposals tabled in January 2016 are further supported by £46.5m of one-off reserves. In addition, £17.6m of reserves are proposed to meet the funding gap, resulting in a total of £64.1m reserves being utilised for the 2016/17 budget.

Revenue Budget 2016/17	Net Budget £m
Adult Social Care	332.663
Chief Executive	1.035
Children's Services	99.594
Community Services	129.024
Corporate Commissioning	13.715
Customer Access	3.607
Development and Corporate Services	39.496
Governance, Finance and Public Services	13.992
Lancashire Pension Fund	-2.097
Corporate & Other	41.149
Public Health	24.013
Sub-Total	**696.191**
Financing Charges	33.324
Use of one off resources	-17.603
Revenue budget 2016/17	**711.912**

2. Capital Investment Strategy 2016/17 and beyond

The Cabinet **recommends** the adoption of the proposals for the Capital Investment Strategy 2016/17 and future years as set out at Appendix A.

3. Council Tax and Precept 2016/17

The Cabinet **recommends** the Full Council to authorise, in pursuance of the provisions of the Local Government Finance Act 1992, and in order to meet the general expenses of the County Council for the financial year 2016/167

a) Budget, Council Tax Requirement and Precept for 2016/17:

   That the band D Council Tax for 2016/17 is increased by:

- Adult Social Care Precept 2% being an increase of £22.60
- General Council Tax 1.99% being an increase of £22.48

This gives an overall position of:

	£m
Budget Requirement	**711.912**
Less RSG	118.841
Less Retained Business Rates	177.985
Less New Homes Bonus grant	5.084
Equals council tax cash	**410.002**
Divided by tax base	348,980.09
Gives Band D council tax for 2016/17	£1,174.86
2015/16 council tax	£1,129.78
Percentage increase	**3.99%**

a) Council Tax (on the basis of a budget requirement of £711.912m and the Council Tax base for each property valuation band:

Council Tax Band	**£**
Band A	783.24
Band B	913.78
Band C	1,044.32
Band D (basic)	**1,174.86**
Band E	1,435.94
Band F	1,697.02
Band G	1,958.10
Band H	2,349.72

c) The share for each District Council of the net total raised from the Council Tax of £410,002,748:

District	**£**
Burnley	25,930,335
Chorley	41,333,596
Fylde	33,773,700
Hyndburn	22,426,903
Lancaster	46,641,942
Pendle	27,223,034
Preston	41,359,771
Ribble Valley	25,875,117
Rossendale	23,118,895
South Ribble	40,903,456
West Lancashire	39,969,865
Wyre	41,446,135
Total raised from the Council Tax	**410,002,749**

Jennifer Mein
Leader of the Council
County Hall, Preston

The County Council's Revenue Budget and Council Tax for 2016/17 and Capital Investment Programme for 2016/17 and future years

1. Introduction

The Council has faced an unprecedented period of financial challenge since austerity began in 2010. The funding provided by central government to the County Council has fallen by 50% from 2011/12 to 2015/16. The Provisional Settlement announced by the Secretary of State shows that the funding from 2015/16 (with the SFA for 2015/16 adjusted to reflect change in grants included within the SFA) to 2019/20 is showing a further reduction of £117.7m (34.7%).

In addition to the wider public finance environment, the County Council continues to face significant challenges from rising costs; from National Living Wage and contractual inflation as well as increasing demand for its services.

The current Medium Term Financial Strategy estimates that in 2020/21 the County Council will have a net budget available of £682m. This compares to £727m in 2015/16. From 2016/17 to 2020/21 the County Council needs to make a further £200.507m in addition to the £64.864m savings agreed Cabinet in November 2015.

This report sets out the Cabinet's proposals to Full Council to meet the financial challenges the County Council faces, through a redesign of the services it provides. The proposals recognise the financial climate in which the budget is being set and the scale of the financial challenge over the next four years.

This report presents for consideration by the Full Council the recommendations of the Cabinet for:

- The revenue budget for 2016/17;
- A revised capital investment programme for 2016/17 and future years
- The Council Tax for 2016/17.

In addition the report sets out the advice of the Interim Director of Financial Resources as the Council's statutory Chief Finance Officer on the robustness of the budget and the adequacy of reserves as required by Section 25 of the Local Government Act 2003.

2. The Budget Process

The County Council's approach is driven by a formal requirement to deliver a balanced budget in 2016/17. This needs to be undertaken whilst recognising the position for future years. The Cabinet has considered the budget for 2016/17 and future years at a number of its meetings. The reports considered can be found at:

http://council.lancashire.gov.uk/ieListMeetings.aspx?CommitteeId=122

3. The Context for Setting the 2016/17 Budget

The Cabinet's recommendations for the 2016/17 revenue budget and capital investment programme are framed within the context of the on-going environment of austerity across the public sector.

The challenge facing the County Council is unprecedented. The current 2016/17 budget includes £20.252m of savings identified in February 2015 and a further £64.864m identified by Cabinet in November 2015 which need to be met. Despite these reductions, the last reported MTFS showed that there is still a funding gap of £23.257m in 2016/17. Over the period 2016/17 to 2020/21 it is estimated that the County Council needs to make further savings of £200.507m. Delivering this level of saving whilst seeking to deliver effective services for our communities cannot be achieved without a radically different approach which focuses on service delivery within a reducing budget envelope.

The pressures identified for this period reflect the continuing increase in demand for council services, in particular those services delivering social care to both older people and children as well as increases in contractual prices, pay and the impact of the National Living Wage.

The County Council's reduction in government funding has yet to be confirmed for 2016/17 with the final local government finance settlement expected to be announced during February 2016. However, the provisional settlement has indicated significant reductions in 2016/17 and it is not anticipated that there will be a major change in the final announcement. The provisional settlement gives indicative figures for future years and it is clear that austerity will continue. The forecast of resources for 2017/18 to 2020/21 reflects the reductions indicated in the provisional settlement. However, the level of future resources is subject to change and therefore the level of funding remains at risk.

Reports will be provided to Cabinet in 2016/17 to update the financial position for the County Council based on the latest information.

4. The Revenue Budget 2016/17 to 2020/21

4.1 The financial challenge

The County Council's Medium Term Financial Strategy (MTFS) was approved by Full Council in February 2015 covering the 2015/16 budget and the forecast position for 2016/17 to 2017/18. This identified a funding gap of £18.3m in 2016/17 and £8.1m in 2017/18 (£26.4m in total). The County Council also agreed that the MTFS should be reviewed following the General Election in May 2015. It was also agreed that the period of the MTFS should be extended to cover the full life of the parliamentary term (to 2020/21).

During 2015/16 Cabinet has received a number of MTFS reports that have identified further changes to the expected level of spending and in the anticipated level of resources available for that period. The latest MTFS report to Cabinet in January 2016 showed a revised spending gap of £200.5m (by 2020/21) after £64.864m of savings had already been agreed in November 2015.

4.2 Meeting the challenge

In February 2015 the County Council considered a set of proposed service offers which set out what the County Council will deliver in terms of services and the offer to our communities. The service offer represented Cabinet's agreement as to how resources should be invested to maximise the use of reduced funding to deliver priorities. Savings made from these proposals formed part of the 2016/17 and 2017/18 budget. As reported to Cabinet during 2015/16, the MTFS was adjusted to take into account those savings that are not deemed to be achievable.

In November 2015, Cabinet approved new budget reductions of £64.177m in 2016/17 and £0.687m in 2017/18. The 2016/17 budget is prepared based upon these revenue decisions, with the outcome of any consultations being reported to Full Council. The MTFS incorporates these budget reductions.

The total value of the savings proposed are shown below:

Table 1

	2016/17 £m	2017/18 £m	Total £m
Prior year Savings agreed within MTFS	-20.252	-44.434	**-64.686**
Savings agreed November 2015	-64.177	-0.687	**-64.864**

Reports to Cabinet have clearly identified that the revenue budget for 2016/17 and 2017/18 will be heavily supported by reserves. The value of the County Council's reserves is currently significant but they are non-recurrent. Except for the County Fund, all available reserves are now fully committed over the next 2 years and will not therefore be available in later years to support managing future year budget pressures.

5. The level of Resources Available to support the 2016/17 Revenue Budget

The revenue resources which support the County Council’s 2016/17 budget are:

- Revenue Support Grant ;
- Business Rates ;
- Council Tax ;
- New Homes Bonus ;
- New Better Care Fund, and
- Capital receipts.

In addition to these the County Council receives a number of ring-fenced grants.

The level of resources reflected in the MTFS for 2016/17 and future years is as follows:

Table 2

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Revenue Support Grant	118.841	81.508	56.979	32.894	26.928
Business Rates	177.985	179.418	185.508	190.480	195.569
Council Tax	404.349	406.529	407.543	408.562	409.584
New Homes Bonus	5.083	5.530	3.475	3.334	3.334
Better Care Fund	0	3.210	22.656	40.014	40.014
Capital receipts	5.000	12.500	5.000	0.000	0.000
Total	**711.258**	**688.695**	**681.161**	**675.284**	**675.429**

These figures are subject to change once the final settlement is given and will be adjusted for the impact of the final Council Tax base figures as discussed below.

5.1 The resources received through the Local Government Finance Settlement

The Provisional Settlement was announced on 17th December 2015 and identified a level of resource that was less than anticipated. The provisional settlement figures are reflected in the table above and within the MTFS. The Settlement provided allocation on RSG, Business Rates baseline information and New Homes Bonus.

5.2 Council Tax and Adult Social Care Precept Resources

As part of the provisional settlement the Secretary of State confirmed that the Council Tax referendum threshold would remain at 2%. In addition to this, there is a new 2% social care precept that can be raised by authorities with adult social care responsibilities. The Secretary of State will take account of these authorities' actions when setting referendum principles in future years.

There is a requirement for Section 151 officers in those authorities levying the social care precept to provide information demonstrating that an amount equivalent to the additional Council Tax has been allocated to adult social care. This must be done within 7 days of their authority setting its budget and Council Tax for 2016/17. In subsequent years of the Parliament, Section 151 officers will be required to confirm that this additional Council Tax continues to be allocated to adult social care.

Any proposals for a Council Tax increase above these thresholds will be subject to a referendum.

5.2.1 Options for Council Tax in 2016/17

On 21st January 2016 Cabinet recommended to Full Council that the Band D Council Tax for 2016/17 has a 3.99% increase including 2% to be used for the social care precept. The Council Tax figures within the MTFS include the impact of a 3.99% increase in Council Tax in 2016/17 only.

Since producing the MTFS the District Councils have confirmed both the Council Tax-base and the surplus on the Collection Fund. The confirmed tax base shows a higher increase than anticipated. The impact of the change in the tax-base gives an on-going increase in the Council Tax income received of £7.453m. This is £5.653m higher than previously forecast.

A £7.037m surplus on the Council Tax Collection Fund in 2015/16 has been identified giving a one-off resource available in 2016/17.

The table below shows the impact of Council Tax increases in increments of 1.0% ranging from a freeze to an increase of 3.99%, which includes the 2% Adult Social Care precept:

Table 3

Impact of an Increase in Council Tax	2016/17 £m
Freeze	7.167
1.00% increase	11.110
2.0% increase	15.054
3.0% increase	18.994
3.99% increase	22.899

5.3 Business Rates resources

From 2013/14 an element of the County Council's funding is received from the locally retained element of Business Rates collected by the District Councils. Following the receipt of the forecast for this income for 2016/17 from the District Councils, it is estimated that the County Council will receive funding of £177.983m from Business Rates (including top up grant) and Small Business Rates Relief in 2016/17.

Information received from the Districts has confirmed a deficit in 2015/16 on the Business Rates collection of £2.334m. This will reduce the one-off resources as shown in Table 6.

5.4 Capital receipts

In previous years the use of capital receipts (income derived from the sale of long term assets) has been restricted to funding capital expenditure or the repayment of debt. However, from 1st April 2016 the Government has proposed that capital receipts can be used to fund revenue expenditure which meets certain criteria. To meet the qualifying criteria the revenue expenditure needs to be a project which is designed to generate ongoing revenue savings or to transform a service which results in revenue savings or improvements in the quality of provision.

Local authorities will only be able to use capital receipts from the sale of property, plant and equipment received in the years in which this flexibility is offered. They may not use their existing stock of capital receipts to finance the revenue costs of service reform.

The current estimates of the capital receipts to be generated are as follows:

Table 4

	2016/17 £m	2017/18 £m	2018/19 £m	Total £m
Capital receipts generated	5.0	12.5	5.0	22.5

There is suitable expenditure within the revenue budget to enable the estimated £22.5m to be applied. These receipts would normally be applied to the Capital Programme. If they are used for revenue, the Capital Programme will either have to be reduced or be funded from an increased level of borrowing.

These receipts are one-off resources and there is a possibility that the level of receipts to be generated from the sale of assets will not be maintained for a sustained period of time. The actual receipts received in any one year will fluctuate in line with local property markets and the type of asset available for sale. Therefore, there is a risk that the receipts actually received will be less than estimated.

5.5 Specific Grants and contributions to be received by the County Council in 2016/17

The following table summarises the more significant specific grants to be received by the Council in 2016/17:

Table 5

Grant	Estimated Allocation 2016/17 £m	Description
Better Care Fund	20.7	The Better Care Fund is a pooled budget to help improve the integration of health and care services. It is designed to enable local places to integrate health and care services that are currently commissioned by the NHS and local authorities. This funding has associated spend tied into various agreements that are required with the NHS.
Public Health	72.0	Ring fenced funding only able to be spent in accordance with the conditions of the grant.

5.6 One-off revenue resources

As referred to in section 5.2.1 and 5.3 the following one-off revenue resources are available in 2016/17 in the table overleaf:

Table 6

Additional one off revenue resources in 2016/17	£m
Council Tax Collection Fund surplus	7.037
Business Rates Collection Fund deficit	-2.334
Total one-off revenue resources	**4.703**

In order to balance the 2016/17 revenue budget it is currently estimated that a contribution from reserves will be required. It is proposed that these one-off resources are contributed to reserves.

5.7 Reserves

Cabinet agreed a report which transferred £117.2m from existing reserves to a Transitional Reserve to support the revenue budget in 2016/17 and part way through 2017/18. This amount assumes that the change in Minimum Revenue Provision (MRP) policy is agreed at this Full Council meeting.

A significant number of the saving proposals agreed in November will take some lead-in time to deliver. The cost incurred during this lead in time will be met from reserves.

The table below sets out the summary of the proposed use of reserves to meet the budget proposals and the funding gap identified within the updated MTFS:

Table 7

	2016/17 £m	2017/18 £m
Transitional Reserve available	117.2	47.4
Reserves required to support budget proposals	46.5	24.2
Reserves required to meet funding gap	23.3	51.5
Balance of Transitional Reserve	**47.4**	**-28.3**

This table shows that there are £28.3m of reserves less than required. The Transitional Reserve is not adequate to support the full year in 2017/18 and reinforces the need to immediately commence the budget setting process for that year. This position has been updated to reflect the latest information in table 9.

6. The Overall Revenue Budget Position for 2016/17

6.1 Summary of Cabinet's Revenue Budget Proposals

The overall impact of the Cabinet's recommendations to Full Council for the 2016/17 revenue budget and the potential changes are set out in the table overleaf.

The table reflects the following:

- Impact of further cost pressures,
- Changes in the level of resources that are currently known,
- The Cabinet's recommendation of a council tax increase of 3.99% in 2016/17,
- The anticipated use of one-off resources in 2016/17,
- The provision of final figures by the City and Borough Councils in respect of Council Tax base and Business Rates income, and
- The impact of the service offer proposals that have been recommended to Full Council following consultation with the County Council's key stakeholders.

In the table, the additional Council Tax-base income is applied to reducing the funding gap from £200.507m to £194.854m, and the additional one-off resources are applied to reserves.

Table 8

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Spending Gap as reported to Full Council February 2015	**18.300**	**8.130**				**26.430**
Add change to forecast of spending:						
Service Demand and volume Pressures	28.119	4.506	16.180	17.357	18.896	**85.058**
Inflation and Cost Changes	-4.432	2.526	26.879	27.380	29.028	**81.381**
Loss of specific grant	4.000					**4.000**
Savings identified	-23.392	11.367				**-12.025**
Total Change to Forecast of Spending	**4.295**	**18.399**	**43.059**	**44.737**	**47.924**	**158.414**
Change to forecast of resources:						
Central government funding	21.577	8.849	0.020	0.877	-0.145	**31.178**
Business rate pooling	-0.400	0.400				**0**
Capital receipts	-5.000	-7.500	7.500	5.000		**0**
Council Tax increase 2016/17	-15.515					**-15.515**
Total Change to Forecast of Resources	**0.622**	**1.749**	**7.520**	**5.877**	**-0.145**	**15.663**
Revised Spending Gap as reported to 21 Jan 2016 Cabinet	**23.257**	**28.278**	**50.579**	**50.614**	**47.779**	**200.507**
Increase Council Tax income due to tax-base	-5.653					**-5.653**
Application of reserves	-17.603	17.603				**0**
Funding Gap	**0**	**45.881**	**50.579**	**50.614**	**47.779**	**194.854**

The updated position for reserves used to help meet the funding gap is as follows:

Table 9

	2016/17 £m	2017/18 £m
Transitional Reserve available	121.9	57.8
Reserves required to support budget proposals	46.5	24.2
Reserves required to meet funding gap	17.6	45.9
Balance of Transitional Reserve	**57.8**	**-12.3**

This table shows that there is currently a £12.3m reserve shortfall.

6.2 Revenue Budgets for Services in 2016/17

The budget outlined above results in net expenditure on services of £696m. The budget by service is summarised below:

Table 10

Revenue budget 2016/17	Net Budget £m
Service	
Adult Social Care	332.663
Chief Executive	1.035
Children's Services	99.594
Community Services	129.024
Corporate Commissioning	13.715
Customer Access	3.607
Development and Corporate Services	39.496
Governance, Finance and Public Services	13.992
Lancashire Pension Fund	-2.097
Corporate & Other	41.149
Public Health	24.013
Sub-Total	**696.191**

Financing Charges	33.324
Use of one off resources	-17.603
Revenue budget 2016/17	**711.912**
Funded by	
Business rates	177.985
Council Tax	410.002
Revenue Support Grant (RSG)	118.841
New Homes Bonus	5.084
Total Resources	**711.912**

7. The Capital Investment Programme

This section of the report sets out the following:

- an outline of the 2016/17 and following two years draft capital programme including known projects and the effect on the capital programme of a number of Budget Options identified as part of the Cabinet discussions on the 26th November 2015;

- summary of the proposed funding of the 2016/17 capital programme and the revenue implications of the increased use of prudential borrowing;

Minor updates have been made to the report approved by Cabinet on 21st January 2016 which has not materially impacted to borrowing requirement.

7.1 Provisional Capital Programme for 2016/17 – 2018/19

Table 11 below details the proposed provisional capital programme for the period 2016/17 to 2018/19. City Deal is included only where LCC make a direct contribution to it or where the County Council is supporting the cash flow requirements of the project in the early years.

City Deal and other Lancashire Economic Partnership activity is reported separately via the existing LEP reporting and performance framework. LCC is the accountable body for the LEP.

Table 11

Table 3 Provisional Capital Programme	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**	**Total £m**
Programme approved February 2015				
a) 2015/16 and Prior Year Starts projects forecast requirement				
East Lancs Strategic Cycle Network	0.800	0.500		**1.300**
North Valley Road traffic model and business case	0.500	0.500		**1.000**
Ormskirk Town Centre/ A570 Congestion Relief	0.375	0.500		**0.875**
Street Lighting Challenge Fund project	5.000	4.800		**9.800**
Non highways structures	0.110	0.050		**0.160**
Burnley Town Centre	0.700	0.550		**1.250**
Fire Suppression systems at Waste plants	1.500	2.000		**3.500**
Waste transfer station (East)	0.500	7.307		**7.807**
Adult (of which 5.967m in 2016/17 relates to Extra Care Strategy, only £5.573m of which has not yet been programmed)	6.787	0.213		**7.000**
Corporate	0.129	1.333		**1.462**
Vehicles	2.850	2.850		**5.700**
Schools	4.346	3.580		**7.926**
CYP non schools	3.225	0.002		**3.227**
b) Removal of unprogrammed budgets				
Waste transfer station (East)		(7.307)		**(7.307)**
c) 2016/17 and 2017/18 Starts approved in Feb 2015 programme to spend Single Capital Pot grants confirmed by DfT as available in that year				
Highways Maintenance	20.454	19.964		**40.418**
Transport	3.570	3.320		**6.890**
LCC contribution to City Deal from Local Transport Plan	2.500	2.500		**5.000**

New for inclusion in February 2016 programme				
a) The following amounts have already received Cabinet approval and are now being listed for inclusion in the draft Capital Programme				
Schools Playing Fields programme	0.783	0.253		**1.036**
Local Priorities Response Fund	2.500			**2.500**
Schools Single Capital Pot grant from DfE for Basic Need per Schools Capital Strategy Cabinet Report-allocations for 16/17 £8.891m plus 17/18 £29.006m (7/18 phased over 2 years)	8.891	9.006	20.000	**37.897**
Property Portfolio Rationalisation-Neighbourhood Centres suitability investment	10.000	5.000	5.000	**20.000**
Property Portfolio Rationalisation-Neighbourhood Centres dilapidations on terminated or surrendered leases	0.750	0.750		**1.500**
Additional Heysham funding required not previously in Capital Programme	3.772			**3.772**
Green Energy Fund to enable research and development to support and develop green energy businesses, develop energy solutions for the County Council and the communities of Lancashire including the use of the County Council`s buildings to generate energy, as approved at Full Council 12th February 2015.	2.500	2.500		**5.000**
b) The following amounts have NOT previously received Cabinet approval. Each year DfT and DfE provide Single Capital Pot grants for Highways, Transport and Schools capital programmes. The figures below represent the value of those programmes that are equivalent to the amount indicated as being available by DfT and DfE, but not yet confirmed. Historically these amounts have been "passported" to be spent as indicated by DfT and DfE, but this principle could now be reconsidered. The only restrictions attached to these grants are that they are to be spent on capital.				
Highways Maintenance equivalent to indicative allocation			18.567	**18.567**
Transport equivalent to indicative (£6.054m less City Deal contribution £2.5m)			3.554	**3.554**

Contribution to City Deal			2.500	**2.500**
Single Capital Pot Schools indicative Condition allocations	11.319	11.319		**22.638**
c) Economic Development schemes				
SFBB Phase 2	5.400			**5.400**
Phase 2 Skelmersdale Rail Link study	0.500	3.200		**3.700**
d) The following were Budget Options approved at Cabinet on 26th November 2015.				
County Hall refurbishment (£1.4m training/ conference centre plus £2.2m for office refurbishment)	3.600			3.600
Parish Buses	0.500	0.500		1.000
Street Lighting Energy Contract Invest to save to convert 50% of remaining non LED lanterns not currently being replaced via DfT Challenge Fund programme	2.000	3.000		5.000
Total Programme	**99.761**	**74.690**	**49.621**	**224.072**

The table above does not include the impact arising from variances in expenditure and funding during 2015/16. Analysis of this impact will be undertaken as part of the year end accounting process.

It should be noted that the above is based upon the principle agreed with the Budget Scrutiny Working Group that prudential borrowing should take place wherever possible, rather than utilisation of capital reserves. Capitalisation of activity is subject to regulatory control and a review is undertaken prior to capitalisation to ensure compliance. In particular, within the CIPFA code, site selection is not regarded as eligible capital expenditure.

7.2 Funding Implications

The capital programme is currently funded by a variety of funding streams including specific government capital grants, capital receipts, LCC revenue funds and prudential borrowing. A number of actions are being recommended within this report including ceasing to fund the capital programme from the use of revenue and revenue reserves and utilise more prudential borrowing. The total borrowing is £61.281m.

7.2.1 Capital Receipts

In line with new Government legislation taking effect from 1st April 2016, capital receipts are included in the MTFS Strategy to support revenue. Capital receipts are excluded from Table 13 below with the exception of those specifically earmarked for a scheme included in the capital programme. There are two anticipated sources of capital receipts:

- The Property Portfolio Rationalisation Strategy regarding Neighbourhood Centres includes expected capital receipts from the sale of surplus properties of approximately £11m; and
- Expected capital receipts from property other than Neighbourhood Centres of approximately £11.5m.

The estimated figures for capital receipts detailed above could change as a result of:

- Open market conditions at the point of sale of individual properties;
- The outcome of the exercise currently ongoing by officers in Asset Management to apply the principles of the Property rationalisation strategy approved by Cabinet on 26th November 2015; and
- Proposals to transfer surplus properties to third party organisations at a nominal sum as an alternative to sale on the open market.

7.2.2 Proposed funding

Table 12 overleaf summarises the funding sources for the capital programme up to 2018/19:

Table 12

Capital Programme Funding	2016/17 £m	2017/18 £m	2018/19 £m	Total £m
Capital Programme per table 3	**99.761**	**74.690**	**49.621**	**224.072**
less				
Capital receipts earmarked for School Playing Fields programme	(1.036)			**(1.036)**
Single Capital Pot Grants confirmed by DfE and currently on DfE website:				
SCP Schools Basic Need	(8.891)	(14.484)	(14.522)	**(37.897)**
SCP Highway maintenance	(20.514)	(18.567)		**(39.081)**

SCP Transport (Local Transport Plan)	(6.054)	(6.054)		**(12.108)**
Single Capital Pot Grants indicative:				
Schools Condition	(11.319)	(11.319)		**(22.638)**
Highway maintenance			(18.567)	**(18.567)**
Transport (Local Transport Plan)			(6.054)	**(6.054)**
Other Grants and Contributions:				
Allocated in Feb 15 programme	(0.362)	0.000	0.000	**(0.362)**
DfT challenge fund Street Lighting	(5.000)	(4.800)	0.000	**(9.800)**
Burnley BC contribution to Burnley Town Centre	(0.700)	(0.550)		**(1.250)**
BDUK match funding re SFBB Phase 2	(2.700)			**(2.700)**
Contribution from existing capital programme Economic Development block re Skelmersdale Rail Link	(0.500	(3.200)		**(3.700)**
Contribution from existing capital programme Highways block re Local Priorities Response Fund	(2.500)			**(2.500)**
Set aside from Reserves:				
Set aside from Waste PFI Reserve for Fire Suppression Systems at Thornton & Farington (total £4m less £0.5m for 15/16)	(1.500)	(2.000)		**(3.500)**
Set aside for Green Energy Fund	(2.500)	(2.500)		**(5.000)**
Net Prudential Borrowing Requirement excluding City Deal	**36.185**	**11.216**	**10.478**	**57.879**
City Deal - cash flow support	28.024	18.373	7.333	**53.730**
Total borrowing requirement	**64.209**	**29.589**	**17.811**	**111.609**

Table 13 identifies the revenue implications of the changes in the borrowing requirements (excluding City Deal cash flow support):

Table 13

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
Net Prudential Borrowing Requirement excluding City Deal per Table 13	36.185	11.216	10.478	57.879
Interest Cost	0.666	1.536	1.897	2.054
Minimum Revenue Provision (Principal)	0	0.559	0.748	0.944
Total cost to revenue (interest and principal)	**0.666**	**2.905**	**2.645**	**2.998**

The interest calculations are based upon an interest rate of 3%. This is based on the current average rate used by the Public Works Loan Board (PWLB), with 6 months interest being calculated in the first year of borrowing and a full 12 months in the following year. The minimum revenue provision is one fortieth of the prior year's debt. The revenue implications of this borrowing have been included within the MTFS.

8. Council Tax for 2016/17

The recommendation of the Cabinet to Full Council on the council tax requirement is that the Band D Council Tax for 2016/17 be increased 3.99% increase which includes the 2% social care precept. The impact of these increases are:

Table 14

	Band D Council Tax	Council Tax income
Adult Social Care Precept at 2%	£22.60	£7.887m
General Council Tax increase at 1.99%	£22.48	£7.845m

The overall position is summarized as follows:

Table 15

	£m
Budget Requirement	**711.912**
Less Revenue Support Grant	118.841
Less Retained Business Rates	177.985
Less New Homes Bonus grant	5.084
Equals council tax cash	**410.002**
Divided by tax base	348,980.09
Gives Band D council tax for 2016/17	£1,174.86
2015/16 council tax	£1,129.78
Percentage increase	**3.99%**

9. Consultation Feedback

In framing its budget proposals on 26th November 2015, the Cabinet resolved that the budget proposals be approved, officers be authorised to proceed with their implementation subject to consultation where appropriate and that the 2016/17 budget be prepared based upon these revenue decisions be agreed. The outcome of any consultations will be reported to Full Council.

For the consultation, a letter from the leader outlining the financial situation, a link to the full list of proposals and a link to an electronic questionnaire were sent on 10 December. Alternatively, respondents could email their reply. They were asked to include their thoughts on actions that could be taken to mitigate the impact of the policy decisions and budget reductions. The closing date for the consultation was 18 January 2016.

The letter was sent by email to 334 partners and stakeholders by email and was also published on the County Council's "Have Your Say" webpage, where it is available for anyone to complete.

There were a limited number of respondents who agreed with the budget proposals but the majority of respondents were opposed to the proposals.
Respondents felt that the County Council should consider:

- the future impacts of the budget proposal on other services, and other organisations and their services;
- the cumulative impact of some of the proposals on groups, communities and areas; and

- the impact of the budget proposals on those no longer receiving services, particularly those who are seen as vulnerable people.

Some respondents asked for the opportunity to explore other options prior to budgets being reduced, further detailed information on costs and mitigations, and for the council to better to communicate the reasons for the cuts.

A report on the results of the Consultation was presented to Cabinet on 21st January 2016.

10. Equality and Diversity

The consideration of savings proposals will also take full account of the County Council's duty under Section 149 of the Equality Act 2010 to have due regard to the need: to eliminate discrimination, harassment, victimisation or other unlawful conduct under the Act; to advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it; and to foster good relations between persons who share a relevant protected characteristic and persons who do not share it. Where necessary this consideration will involve consultation with those people who may be adversely affected by the proposals.

Having due regard means analysing at each step of formulating, deciding upon and implementing policy what the effect of that policy is, or may be, upon groups who share protected characteristics defined by the Act. The protected characteristics are: age, disability, gender reassignment, race, sex, religion or belief, sexual orientation or pregnancy and maternity, and, in some circumstances, marriage and civil partnership status.

Where analysis shows that there may be a possible negative impact it will then be necessary to consider whether any steps can be taken to mitigate or reduce the potential adverse effects. This may involve an amendment to the original proposals. The analysis and negative impacts must then be balanced against the reasons for the proposals, that is to say the need for budget savings.

Where it has been determined that an Equality Analysis is required in respect of a savings option these have been provided with the presentation of the various proposals to Cabinet meetings.

11. The Robustness of the Budget and the Adequacy of Reserves

Section 25 of the Local Government Act 2003 requires that in giving consideration to budget proposals members have regard to the advice of the Council's Chief Finance Officer (in the case of the County Council the Interim Director of Financial Resources) on the robustness of the estimates and the adequacy of the Council's reserves.

11.1 Robustness of the Estimates

This section is concerned with the scale of financial risks faced by the County Council as a result of the estimates and assumptions which support any budget. The basis of the estimates on which the budget has been prepared, as in previous years, relies on the forecast of activity and the impact of changes in policy previously agreed by the Full Council. These forecasts are kept under review as part of the budget monitoring process and actions identified to address financial risks arising from changes in the forecast as they occur. A number of specific risks remain within the budget as follows:

11.1.1 Government Funding

The Provisional Local Government Settlement on 17th December 2015 included the Government offer of a four year funding settlement to provide greater certainty around financial planning to any authority that wishes to take it. The County Council has declined to take up the offer of a four year settlement.

The settlement reflects a significantly worsening position with greater reliance on locally raised funding. There is still the possibility of further reductions in future years should, for example, new responsibilities be given to councils which are not fully funded. Previous reports to Cabinet have clearly identified an impending scenario whereby the County Council will have insufficient resources to meet statutory responsibilities as they are currently provided. It has been recognised previously that the County Council will need to quickly assess and make fundamental changes to the current business model to deliver further savings given the significant funding gap that remains.

There is no guarantee that the changes to the business model, which will need to be focused on reducing costs, will be sufficient to deliver balanced budgets over the period of this financial strategy. Therefore the County Council will need to continuously lobby Central Government and relevant stakeholders regarding the extreme challenges being faced as a result of the local government finance system.

There are future changes to the funding of local government being proposed by the Government. Details of the proposals are not yet known but there is a risk of potential volatility in resources which may impact on the required level of reserves.

11.1.2 Service Demand

This is a key risk facing the County Council in both preparing future budgets and managing budgets during the year. As reported in the budget monitoring reports presented to Cabinet over the year, demand for both adult and children's social care services continues to see increases despite the impact of demand management measures.

Over the period 2016/17 to 2020/21, £97.4m has been provided for demand pressures of which approximately 70% relates to adult social care and approximately 14% to children's social care. This has been based on current and historical trends and population projections (particularly linked to the ageing population).

There are further risks that could impact on demand. These include the developing relationship with the NHS (including the impact of the Better Care Fund) and the interaction between increasingly tightening health and local authority resources. While reasonable steps have been taken to estimate future demand and ongoing work is being undertaken with health colleagues, it is still possible that demand will exceed budget. Although the Council does have a good record of managing demand pressures, the flexibility in other parts of the budget which has assisted with this has been significantly eroded in recent years following the delivery of the previous savings.

The pressure resulting from the increasing numbers and complexity of Learning Disability service users, increased demand for direct payments within Physical Disability services and increased demand for residential care within Mental Health Services continue to be significant issues. This is potentially exacerbated by the Transforming Care (Winterbourne) agenda should there be significant additional costs of moving anyone who is inappropriately in hospital to community-based support.

11.1.3 Pay Costs

The MTFS makes provision for pay of a 1% increase each year. Overall salary costs will continue to be driven by the national pay agreement and this assumption will be kept under review.

The County Council is committed to paying its employees as an accredited member of the Living Wage Foundation (LWF). The LWF have announced a 5% increase in the Living Wage. This is significantly higher than the 1% assumed for all other staff. The impact of this initial increase and further 5% increases in subsequent years has been factored into the MTFS. However, this does not address maintaining current pay differentials between grades. This will have to be addressed in future years as more grades are absorbed into the Living Wage threshold. This poses an additional risk to financial resources.

11.1.4 Inflation

Actual inflation remains relatively low but analysts are anticipating slight increases over coming years. Provision made within the budget is limited to areas where the County Council has no choice but to pay increased prices, for example due to contractual terms. The inflation forecasts used in recent years are based on the future level of inflation implied by yields on interest linked gilts. Historically, this has tended to give a more accurate forecast. It is anticipated that the continued use of this methodology will reduce the risk of needing to make catch up additions to the budget for "missed" inflation and the need to absorb additional inflationary costs in year.

There is particular concern regarding care markets, both residential and homecare. Care funding of is recognised as being a nationally and regionally significant issue. Whilst a significant amount of resource has been included within the MTFS to fund price increases and the estimated impact of the Government's National Living Wage on care providers, there are significant capacity and sustainability issues within the market which the social care precept will only partly help mitigate.

11.1.5 The Level of Reserves

The Council holds reserves for a number of reasons:

• To enable the organisation to deal with unexpected events such as flooding or the destruction of a major asset through fire.
• To enable the organisation to manage variations in the demand for services which cause in year budget pressures.
• To fund specific projects or identified demands on the budget.

There is no specified level of appropriate reserves for a local authority. This is a matter of judgement taking into account:

• The level of risk evident within the budget as set out above.
• A judgement on the effectiveness of budgetary control within the organisation.
• The degree to which funds have already been set aside for specific purposes which will reduce the need for general reserves.

Previous reports to Cabinet have clearly identified that the revenue budget for 2016/17 and 2017/18 will be heavily supported by reserves. Except for the County Fund, all available reserves are now fully committed over the next two years and will not be available in later years to support managing future budget pressures. It is proposed that the County Fund remains set at £36m.

As shown in table 9 of this report, the Council has an appropriate level of reserves available to manage the financial risk in 2016/17, but there are not sufficient reserves available in 2017/18. It is therefore critical that the zero based budget work identifies and is able to deliver additional savings over the next two years in addition to those savings already agreed.

12. Conclusion

Following the budget risk assessment undertaken early in the year, ongoing detailed budget monitoring, base budget review work and detailed review of the current reserves commitments, a balanced budget for 2016/17 with the use of £64.1m of reserves can be recommended.

However, this is clearly dependent on all budget options agreed at Cabinet in November 2015 being delivered fully within the timeframes identified, along with the other savings agreed in previous budget cycles. Should any of these budget options ultimately not be taken forward they will need to be replaced with alternative savings to avoid increasing the size of the funding gap.

There is a further £17.603m of savings to be identified relating to the remaining funding gap in 2016/17, that will need to be delivered by 2017/18. This cannot be met from reserves as there are already insufficient reserves to meet the estimated funding gap in 2017/18.

The budget targets can only be met as a result of a careful and systematic review of services and a revised delivery model. The use of a zero based approach, moving towards the lowest quartile of the most appropriate comparator group, will need to make early progress during 2016/17 to meet the 2016/17 and 2017/18 funding gaps. Consideration will need to be given as to whether a sustainable financial position will be achievable over a longer period, as there is a strong likelihood that by 2017/18 the County Council will be unable to set a budget which will meet the cost of the statutory responsibilities.

Meeting of the Full Council
Meeting to be held on 11 February 2016

Report submitted by: Head of Legal and Democratic Services

Part A

Electoral Division affected:
None

Report of the Cabinet
(Annex 1 refers)

Contact for further information:
Josh Mynott, (01772) 534580, Democratic Services Manager,
Josh.mynott@lancashire.gov.uk

Executive Summary

This report presents the recommendation of Cabinet made at its meeting on 4 February 2016 to Full Council for consideration, in relation to the County Council's Treasury Management Policy and Strategy 2016/17.

As the meeting of Cabinet will be held after the publication of this report, the Deputy Leader of the Council will update Full Council on the recommendations made by Cabinet.

Recommendation

Full Council is asked to consider the recommendations of Cabinet as set out by the Deputy Leader.

Background and Advice

Attached at Annex 1 is the report "Lancashire County Council Treasury Management Strategy 2016/17" to be considered by Cabinet at its meeting on 4 February 2016.

As the meeting of Cabinet at which this item will be considered will be held after the publication of this report, the Deputy Leader will report the recommendations of Cabinet, for the consideration of Full Council.

Lancashire County Council

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Tel
Agenda and Minutes of the Cabinet	4 February 2016	Josh Mynott, Democratic Services Manager, 01772 534580

Reason for inclusion in Part II, if appropriate

N/A

Annex 1

Cabinet
Meeting to be held on 4 February 2016

Report of the Interim Director of Financial Resources

Electoral Divisions affected: All

Lancashire County Council Treasury Management Policy and Strategy 2016/17
(Appendices 'A', 'B', and 'C' refer)

Contact for further information:
Mike Jensen, 01772 534742, Chief Investment Officer,
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Executive Summary

This report outlines the proposed Treasury Management Policy and Strategy for 2016/17 as required by the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice. It includes the County Council's borrowing and investment strategies, the updated strategy on the use of financial derivatives and the new proposed minimum revenue provision policy, together with the treasury management prudential indicators which seek to ensure that the Council's borrowing levels remain both sustainable and affordable.

The MRP policy incorporates changes which propose that the MRP, with respect to repaying the pre 2007 debt is over 50 years rather than a 4% reducing balance and changing the post 2007 debt to an annuity basis are implemented. Attached as Appendix 'C' is the revised MRP policy for approval.

Approval of the Treasury Management Policy and Strategy is a matter reserved to the Full Council.

Recommendations

Cabinet is asked to:

(i) Recommend the treasury management policy as set out at Appendix 'A' to the Full Council for approval.

(ii) Recommend the treasury management strategy for 2016/17 as set out at Appendix 'B' to Full Council for approval.

(iii) In respect of the new minimum revenue provision set out at Appendix 'C', recommend that Full Council:

   a. Approves the Capital Financing Requirement method and the Asset Life method (Equal Charge approach) for expenditure funded from borrowing incurred in 2015/16 and future years.
   b. Charges to revenue a sum equal to the repayment of any credit liability.

c. Approves the proposed treatment of assets constructed under the Preston, South Ribble and Lancashire City Deal and Homes and Community Agency Local Infrastructure Fund, subject to annual review.
d. Implement the changes to the MRP policy from 2015/16.

Background and Advice

Treasury management is the management of the Council's investments and cash flows, its banking, money market and capital market transactions; it also includes the effective control and management of the risks associated with these activities, ensuring that the Council gets the best performance for the least risk.

The Treasury Management Strategy sets out the Council's policies for ensuring the security and liquidity of its investments, whilst having regard to investment returns in order to protect the value of the funds. It also outlines the Council's strategy for financing existing borrowing and future capital borrowing requirements, with the aim of securing the required funds at the lowest possible rate.

Minimum Revenue Provision

The MRP is an annual charge to the revenue account to pay for capital expenditure that was originally funded by debt. Before the 2007/08 financial year, the method of calculating MRP was specified in legislation. Since then the authority has had to make a prudent provision for MRP giving consideration to guidance issued by the Department for Communities and Local Government (DCLG). This guidance includes a number of methods which it considers to be prudent. The guidance is clear that authorities are also free to devise other methods they consider prudent. The guidance suggests that:

- MRP on assets acquired through finance leases and Private Finance Initiative (PFI) should be equal to the cash payments that reduce the outstanding liability each year;

- MRP on all capital expenditure incurred before 1st April 2008, and on expenditure funded by supported borrowing thereafter, is equal to 4% of the outstanding debt

- MRP on expenditure incurred from April 2008 onwards that is funded by unsupported "prudential" borrowing should be calculated by reference to the asset's useful life, using either a straight line or an annuity method, starting in the year after the asset becomes operational.

In determining a prudent charge the debt accrued pre and post 2007/8 should be considered separately.

Debt accrued post 1 April 2008

The MRP for capital expenditure funded by debt from 1 April 2008 has been calculated based on the life of the assets. This was one of the methodologies outlined in the DCLG Guidance and has been applied so that each year has an equal MRP charge. An alternative approach is the annuity method which is the cheapest MRP option in the early years, and once interest costs are taken into account maintains a constant impact on the revenue account over the useful life of the asset being financed.

It is estimated that the 2016/17 MRP charge based on the existing method would be £6.4m. Applying an annuity method would reduce this by approximately £1.4m in 2015/16 although the saving would reduce over time as shown in the table below:

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m	£m
Current basis	6.397	5.978	5.536	4.970	4.970	4.970
Annuity basis	4.940	4.667	4.353	3.890	4.015	4.144
Reduction in charge	1.457	1.311	1.183	1.080	0.955	0.826

Debt accrued pre 1 April 2008

The estimated MRP charge in 2016/17 for the pre 2007/8 debt represents the major share of the MRP charge. This is based on 4% of the outstanding capital expenditure to be financed. The 4% rate was initially set in legislation and it was the amount assumed in the calculations used for distributing the Revenue Support Grant between authorities. Hence this debt was considered to be supported borrowing. In assessing whether this is still the most appropriate basis for the calculation of the prudent charge the long term impact of the charge and the relationship with the grant need to be considered.

The current calculation is on a reducing balance and therefore it is effectively never totally repaid. It is estimated that between 51 and 100 years' time the MRP charge will be in the region of £54m. Although many of the assets financed by borrowing were of a long term nature (schools and roads) it is likely that a major refurbishment of the asset will be required at some point and therefore a methodology which does not have an end point could be deemed not to be prudent.

Since 2007/8 the funding of the local authorities has changed significantly. LG Futures state that "The introduction of Business Rates Retention in April 2013, coupled with the significant annual reductions to the Settlement Funding allocations, the continued top-slicing of Revenue Support Grant (RSG) and increasing allocations through New Homes Bonus, have a significant impact upon the national balance of funding made available to local government across these grant streams. The national dynamics, changing as they are, will vary at a local level to provide a varying position between each authority" They estimate by 2019/20 the RSG will fund 5% of local government expenditure compared to 25% in 2013/14. Given this level of fluctuation and the expected reductions in funding it seems valid to question whether the grant received includes a provision to repay debt at a level of 4%. In addition the Chancellor of the Exchequer has announced changes to the funding of local government which would see the abolition of Revenue Support Grant.

An alternative method of calculating the MRP would be to consider the length of time it is anticipated the assets have an economic benefit. The assets acquired or improved in the past would have a long term benefit and in accordance with the County Council's depreciation policy most of the County Council's property assets are seen as having an asset life in excess of 50 years. It would therefore seem appropriate to change the MRP for the pre 2007/8 debt to be repaid over 50 years rather than the reducing 4% balance. This would be deemed to be prudent as it has a definite end yet the period is not excessive taking into account current estimates of the authority's asset lives.

Based on current estimates of the capital financing requirement the estimated charges would be:

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m	£m
MRP on 4% reducing balance	17.774	17.063	16.380	15.725	15.096	14.492
50 years equal instalment	8.887	8.887	8.887	8.887	8.887	8.887
Reduction in MRP charge	8.887	8.176	7.493	6.838	6.209	5.605

MRP Policy

It is proposed that the changes to MRP with respect repaying the pre 2007 debt over 50 years and changing the post 2007 debt to an annuity basis are implemented. It is proposed that his implementation will come into effect from the 2015/16 financial year. This amends the decision taken in February 2015 in previously agreeing the 2015/16 MRP policy. Attached as Appendix C is the revised MRP policy for approval.

Consultations

Arlingclose Ltd who are the Council's external treasury management advisers

Implications:

This item has the following implications, as indicated:

Risk management

The objective of the treasury management strategy is to ensure the security of the County Council's invested reserves and balances, and to ensure that any borrowing made for cash flow or capital purposes is as efficient and cost effective as possible. In addition the strategy provides liquidity to ensure the County Council is able to meet operational objectives on a daily basis and that any daily surplus funds are invested safely. The strategy must protect the County Council's financial resources from credit risk, inflation and interest rate risk, and to that end, this document sets out how the County Council will engage with and operate within financial markets.

List of Background Papers

Paper	Date	Contact/Tel
CIPFA Treasury Management Code of Practice	2011	Andrew Ormerod 01772 534740
CIPFA Treasury Risk Management Toolkit	2012	Andrew Ormerod 01772 534740
CIPFA Using Financial Instruments to Manage Risk	2013	Andrew Ormerod 01772 534740
Arlingclose Ltd, Credit Risk Report	December 2015	Andrew Ormerod 01772 534740

Reason for inclusion in Part II, if appropriate

N/A

Appendix A

Treasury Management Policy Statement

The County Council's financial regulations require it to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition
The County Council defines its treasury management activities as:

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

Risk Appetite
The County Council's appetite for risk within its treasury management activities is low. A premium is placed on the security of capital and credit risk management and on the maintenance of financial stability in terms of managing inflation and interest rate risk, their effects on the County Council's reserves and balances and on the cost of borrowing.

Risk management
The County Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on how the actions taken and the financial instruments entered into result in reduced risk exposure for the County Council.

Value for money
The County Council acknowledges that effective treasury management provides support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy
The County Council greatly values revenue budget stability and therefore, all other things being equal, will meet its long-term funding needs at long-term fixed rates of interest. However, short-term and variable rate loans will be borrowed to either offset short-term and variable rate investments or to contribute to the County Council's stated objective of providing cost efficient capital funding. The County Council will also constantly evaluate debt restructuring opportunities of the existing portfolio.

The County Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities 2011* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year. The County Council also has regard to other relevant Cipfa publications such as 'Treasury Risk Toolkit for Local Authorities' (2012) and 'Using Financial Instruments to Manage Risk' (2013.)

Cash Backing of Reserves
The County Council is committed to the prudent management of its finances. In pursuit of this objective the County Council should ensure that it holds investment balances sufficient to meet the value of those balance sheet items such as reserves and provisions which will be drawn down as cash. These investment balances will have due regard to the anticipated timing for the drawdown of the cash backed reserves and provisions. In particular the planned use of reserves in the County Council revenue budget will impact on the level of investments held.

Investment policy
The County Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, through either credit events or loss of value by inflation erosion or interest rate changes, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The County Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

Appendix B

The County Council's Treasury Management Strategy 2016/17

1. Introduction and Legislative Framework

Under the Local Government Act 2003, local authorities must have regard to Statutory Proper Practices in their Treasury Management activities. In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code.) These together require the County Council to set out its strategy in relation to key aspects of its treasury management operations on an annual basis.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the County Council to approve an investment strategy before the start of each financial year. The strategy also has regard to other CIPFA treasury management publications such as risk management in 'Treasury Risk Toolkit for Local Authorities' (2012) and the use of derivatives in 'Using Financial Instruments to Manage Risk' (2013.)

In line with these various requirements this strategy includes:

- The Annual Borrowing Strategy
- The Council's Policy on Borrowing in Advance of Need
- The Annual Investment Strategy
- Policy on Use of Financial Derivatives
- The Prudential Indicators (Annex A to this Appendix)
- The Annual MRP statement (Appendix C to this report.)

In conjunction with the treasury management policy statement and the detailed treasury management practices approved by the section 151 officer, these provide the policy framework for the engagement of the County Council with the financial markets in order to fund its capital investment programme, maintain the security of its cash balances and protect them and ultimately the County Council's operations from credit, liquidity, inflation and interest rate risk.

2. Strategic Objectives of the Treasury Management Strategy

The County Council's treasury management strategy is designed to achieve the following objectives:

a) To ensure the security of the principal sums invested which represent the County Council's various reserves and balances
b) To ensure that the County Council has access to cash resources as and when required
c) To minimise the cost of the borrowing required to finance the County Council's capital investment programme, and manage interest rate inflation rate risks appropriately.

d) To maximise investment returns commensurate with the County Council's policy of minimising risks to the security of capital and its liquidity position.

In the context of these objectives it will be the County Council's policy to hold as investments a sum as close to the cash value of its balance sheet as possible, matching both value and duration as closely as possible.

3. Setting the Treasury Management Strategy for 2016/17

In setting the treasury management strategy, the County Council must have regard to the following factors which will have a strong influence over the strategy adopted:

- economic forecasts – the economic and legislative context
- the level of the approved capital programme which generates the borrowing requirement,
- the current structure of the County Council's investment and debt portfolio
- prospects for interest rates and market liquidity

3.1 Economic Forecast

Economic context

Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012. Probably need to refer to weaken data towards the end of the year and forecast GDP growth cuts by OBR and others also the recent CIPD reduced wage growth estimates.

In international markets China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course and consequently the Federal Reserve raised policy rates at its December 2015 meeting. In contrast the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

The outcome of the 2015 UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

Legislative Context

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in.

3.2 The Current Structure of the Portfolio

The Council's treasury portfolio (net of transferred debt) as at 31st December 2015 was as follows.

	Principal Amount £m	Current Interest Rate %
Call accounts	20.39	0.25
Local Authority Deposits	56.50	1.63
Gilts & Other Core Bonds	366.03	1.74
Floating Rate Notes (short term liquidity)	226.56	0.91
Total Investments	**669.48**	**1.97**
Short-term loans	472.90	0.66
Long-term loans (Local Authorities)	167.50	1.53
Shared Investment Scheme*	68.39	0.65
Long-term PWLB loans	338.85	3.07
Long-term market loans (LOBOs)	51.78	5.23
Total Borrowing	**1,099.42**	**1.75**
Net Borrowing	**429.94**	

* Please refer to the Glossary in Appendix C for further information.

3.3 Prospects for Interest Rates and Market Liquidity

In planning the treasury management strategy, the Council will consider the prevailing and forecast interest rate situation. Regular forecasts of interest rates are provided by Arlingclose Ltd, treasury management advisers to the County Council. The Chief Investment Officer for the Council also provides a view on interest rate forecasts based on current and future market data.

Arlingclose Ltd projects the first 0.25% increase in UK Bank Rate for the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
3-month LIBID rate													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
1-yr LIBID rate													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
5-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
10-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
20-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
50-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

In addition uncertainty surrounding the in/out EU referendum is likely to prove a drag on growth during 2016 with the threat of large market risks involved in any Brexit resulting in slower/negative growth, currency weakness and therefore further rate suppression.

Arlingclose have based this forecast on the following underlying assumptions:

- UK economic growth softened in Q3 2015 but remained reasonably robust; the first estimate for the quarter was 0.5% and year-on-year growth fell slightly to 2.3%. Construction falls were offset by fairly strong services output although survey estimates suggest upwards revisions to construction may be in the pipeline.

- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth. Consumption will continue to be supported by real wage and disposable income growth.

- Annual average earnings growth was 3.0% in the three months to August. Given low inflation, real earnings and income growth continue to run at relatively strong levels and could feed directly into unit labour costs and households' disposable income. Improving productivity growth should support pay growth in the medium term. The development of wage growth is one of the factors being closely monitored by the MPC.

- Business investment indicators continue to signal strong growth. However the outlook for business investment may be tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.

- Inflation is currently very low and, with a further fall in commodity prices, will likely remain so over the next 12 months. The CPI rate is likely to rise towards the end of 2016. If there are no further oil and commodity price declines

- China's growth has slowed and its economy is performing below expectations, which in turn will dampen activity in countries with which it has close economic ties; its slowdown and emerging market weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.

- Strong US labour market data and other economic indicators suggest recent global turbulence has not knocked the American recovery off course. The December rate rise was accompanied by a very dovish statement and indications of slower than expected upward path for future rises.

- Longer term rates will be tempered by international uncertainties and weaker global inflation pressure.

These factors will maintain the current direction of the MPC in the medium term.

3.5 Impact of these factors on the Borrowing Strategy

In view of the above assessment of the economic context within which the Council is operating, wherein despite the continuing improvement in the economic outlook, it could be 2017 before there is a rise in official UK interest rates, and the UK's safe haven status and minimal prospect of rate rises are expected to keep gilt yields in check through the near term, there is likely to be no significant change in the County Council's overall borrowing strategy in the current year.

The Council’s chief objective when borrowing money is to strike an appropriate 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 Council’s long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Council’s borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to continue to borrow short-term whilst taking advantage of the new Municipal Bond Agency facility for some longer term borrowing. By doing so, the Council is able to keep net borrowing costs at very low levels, reduce overall treasury risk and still respond to the transformation agenda in reducing the overall size of the balance sheet.

The benefits of short term and internal borrowing are 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 Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2016/17 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Also, if it became apparent that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the possible action that significant fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Whilst it is expected that the current low rate environment will continue for a further period, the Council have taken steps to ensure that the Council is protected from the impact of rate rises when they do occur. In support of this strategy full council have approved in principle the following actions:

- the establishment of a Lancashire County Council Euro Medium Term Note (EMTN) programme to facilitate access to secure long term debt in readiness for interest rate rises.

- Preparations for borrowing through the Municipal Bond Agency to enable access to an alternative economic funding source.

- The necessary changes to the Council's Prudential Indicators to facilitate the switch from a programme of rolling short term debt to longer term debt financing.

3.6 Impact of these factors on the Investment Strategy

In view of the above assessment of the economic context within which the Council is operating the County Council's investment strategy will be based upon the following information:

- The Bail-in legislation described above, which ensures that in future large investors including local authorities will rescue failing banks instead of taxpayers. In particular the additional legal protections afforded to private sector investors means that the credit risk associated with making unsecured bank deposits has increased dramatically relative to the risk of other investment options available to the Council, whilst returns from cash deposits remain stubbornly low.
- Given the level of risk involved in dealing with bank counterparties the County Council will continue to diversify its portfolio further away from bank credit while maintaining the highest credit quality of counterparties. Unsecured term deposits or certificates of deposit with banks are no longer an appropriate investment instrument for the County Council.
- The Investment Strategy will also react to the planned use of reserves as outlined in the County Council's revenue budget.

4. Borrowing Strategy

4.1 The Level of the Approved Capital Programme – the Borrowing Requirement

The County Council's estimated borrowing requirement for financing the capital programme in the current and the next three years is as follows:

	2015/16 Revised £m	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Capital Programme Expenditure	**250.521**	**103.805**	**77.024**	**49.621**
Financed by:				
Capital Receipts	21.297	1.036		0.000
Grants and Contributions	143.350	54.540	58.974	39.143
Revenue Contributions	24.869	4.000	4.500	0.000

Borrowing	**61.005**	**44.229**	**13.550**	**10.478**
Add Maturing Debt to be replaced:				
Long Term PWLB	0.000	0.000	0.000	0.000
Long term fixed Borrowing	0.000	100.000	100.000	100.000
Short Term Market Borrowing	579.950	479.950	479.950	479.950
Less Transferred Debt	1.899	1.687	1.629	1.629
Less Statutory Charge to Revenue	19.967	20.749	20.877	21.537
Total Borrowing Requirement	**619.089**	**601.743**	**570.994**	**567.262**

At 31st March 2015 the County Council held £1.036bn of short and long-term loans as part of its strategy for funding previous years' capital programmes. The County Council's borrowing requirement as at 31st March 2016 including short term renewals is expected to be £619.089million, and is forecast to fall to £567.262million by March 2019 assuming the current debt portfolio will need to be renewed. In addition, the County Council may borrow for short periods of time to cover unexpected cash flow shortages.

The County Council's borrowing position over the coming years includes the need to provide cash flow support for the Preston, South Ribble and Lancashire City Deal to cover the gap between the construction of infrastructure and the payment over of contributions from other organisations including the Government and developers. It is estimated that some £28m of borrowing will be required in 2016/17. This borrowing is temporary.

There are a range of options available for the borrowing strategy in 2016/17.

- Variable rate borrowing is expected to be cheaper than fixed rate long term borrowing and will be attractive during the financial year, particularly as variable rates are closely linked to bank rates.
- Under 10 years rates are expected to be substantially lower than long term rates, so this opens up a range of choices that may allow the County Council to spread maturities away from concentration on long dated debt.
- Although it is not felt best pricing can be achieved at the present time through issuance under the County Council's euro medium term note programme (EMTN), a commercial paper issue which has a much shorter maturity, typically 270 days, may be appropriate.
- Approval is also being considered to add the LGA's Municipal Bond Agency to the County Council's list of approved borrowing counterparties

Against this background, the section 151 officer will, in conjunction with the County Council's advisors, monitor the interest rate situation closely and will adopt a pragmatic approach to delivering the objectives of this strategy within changing economic circumstances. Arlingclose forecast the first rise in official interest rates in Q3 2016 and careful monitoring will ensure that borrowing is taken at the most appropriate time. The table above reflects this forecasted rise and the fixing of £100m of the short term debt in 2016/17.

All decisions on whether to undertake new or replacement borrowing to support previous or future capital investment will be subject to evaluation against the following criteria:

a) Overall need, whether a borrowing requirement to fund the capital programme or previous capital investment exists;
b) Timing, when such a borrowing requirement might exist given the overall strategy for financing capital investment, and previous capital spending performance;
c) Market conditions, to ensure borrowing that does need to be undertaken is achieved at minimum cost, including a comparison between internal and externally financed borrowing.
d) Scale, to ensure borrowing is undertaken on a scale commensurate with the agreed financing route.

All long term decisions will be documented reflecting the assessment of these criteria.

The table below is an estimate of the relationship between the borrowing capital financing requirement and total borrowing during the current year and over the next three years. The shared investment scheme is assumed to contribute £120m to the borrowing total. The operation of the scheme is reviewed annually, but this table assumes it will operate for the next three years and shows the position if take-up reaches the limits of the scheme.

	31 Mar 2016 £m	**31 Mar 2017 £m**	**31 Mar 2018 £m**	**31 Mar 2019 £m**
Capital Financing Requirement	1,043	1,061	1,046	1035
Less PFI liability	172	168	164	160
Borrowing CFR	**871**	**893**	**882**	**875**
Loans Borrowed (31March estimate)	1,039	1,058	1,044	1,031
Borrowing Above CFR	**168**	**165**	**162**	**156**
Comprising:				
Premiums	48	45	42	36

Shared Investment Scheme	120	120	120	120
Total	**168**	**165**	**162**	**156**

4.2 Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- LGA Municipal Bond Agency (subject to approval of a separate report by cabinet)
- Special purpose companies created to enable joint local authority bond issues, using the format of a euro medium term note programme or a commercial paper programme
- UK Local Authorities
- any institution approved for investments including high quality supranational banks such as the European Central Bank
- UK public and private sector pension funds
- any other financial institution approved by the Prudential Regulation Authority
- capital market bond investors either over the counter or through electronic trading platforms

4.3 UK Municipal Bond Agency PLC

The Municipal Bond Agency was established by the Local Government Association in June 2014 with the primary objective of setting up an alternative capital funding source for the local government sector and reducing UK local authority financing costs by becoming the most efficient and cost effective provider of finance. The Cabinet agreed on 15th July 2014 to invest £250,000 to become a shareholder in the company which should lead to preferential dealing charges and eventually dividends from the MBA when it is in full operation. County Council are one of 56 local authority shareholders, the 57th is the LGA who are the founder shareholder.

It is expected that the MBA will make the first tranche of borrowing available to local authorities in 2016. In order to borrow from the MBA the County Council is required to sign a joint and several guarantee contained within a framework agreement.

Signing off the framework agreement and borrowing from the MBA is the subject of a separate report to cabinet.

4.4 Borrowing Instruments

The County Council may only borrow money by use of the following instruments:

- bank overdrafts
- fixed term loans

- callable loans or revolving credit facilities where the county council may repay at any time (with or without notice)
- callable loans where the lender may repay at any time, but subject to a maximum of £150 million in total
- lender's option borrower's option (LOBO) loans, but subject to a maximum of £100 million in total
- bonds, notes, bills, commercial paper and other marketable instruments
- sale and repurchase (repo) agreements

Loans may be borrowed at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate risk approved each year in the *Treasury Management Strategy*.

4.5 Debt Restructuring

The County Council continuously monitors both its debt portfolio and market conditions to evaluate potential savings from debt restructuring.

5. Policy on Borrowing in Advance of Need

The County Council will not borrow more than or in advance of need with the objective of profiting from the investment of the additional sums borrowed.

However, borrowing in advance of need is appropriate in the following circumstances:

a) Where there is a defined need to finance future capital investment that will materialise in a defined timescale of 2 years or less; and

b) Where the most advantageous method of raising capital finance requires the County Council to raise funds in a quantity greater than would be required in any one year, or

c) Where in the view of the section 151 officer, based on external advice, the achievement of value for money would be prejudiced by delaying borrowing beyond the 2 year horizon.

Having satisfied any of these criteria any proposal to borrow in advance of need would also need to be reviewed against the following factors:

a) Whether the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered and reflected in those plans and budgets, and the value for money of the proposal has been fully evaluated.

b) The merits and demerits of alternative forms of funding.

c) The alternative interest rate bases available, the most appropriate periods over which to fund and repayment profiles to use.

All decisions will be documented reflecting the assessment of these circumstances and criteria.

6. Investment Strategy

In making any investments of the reserves and other cash items held within its balance sheet the County Council must have regard to the relevant regulations under the Local Government Act 2003, the CLG Guidance on Local Government Investments, and the latest revision of the CIPFA Treasury Management in Public Services Code of Practice (2011) and other relevant publications such as 'Treasury Risk Toolkit for Local Authorities' (2012) and 'Using Financial Instruments to Manage Risk' (2013.)

However it is the opinion of LCC treasury management, along with treasury advisors Arlingclose Ltd, that the CIPFA TM Code of Practice should be revised to properly categorise the risk to local authorities of investing using unsecured term bank deposits and remove the emphasis the code places on them as a low risk specified investment instruments.
The CIPFA TM Panel has requested from CLG consideration of this issue with regard to investment regulation and CLG have agreed to give the issue consideration.

The Council's investment priorities are: -

(a) The security of capital, and
(b) The liquidity of its investments.

The County Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the County Council is low in order to give priority to security of its investments.

The counterparty credit matrix is at the heart of Lancashire County Council's Treasury Management Policy and Strategy and has always been conservatively constructed to protect the County Council against credit risk whilst allowing for efficient and prudent investment activity.

However, the County Council does not rely solely on credit ratings in assessing counterparties. Other market information is also monitored such as information from the credit default swap (CDS) market and any press releases in general, thus ensuring the Council transacts with only the highest quality counter-parties.

The Council requires very high credit ratings for an organisation to be considered a suitable counterparty for investment purposes. Despite a number of downgrades within the financial sector the County Council has not reduced the credit ratings required of its counterparties, but has maintained the existing very high ratings required for short, medium and long term investments. These are set out below:

- **For short term lending of up to 1 year** - that the short term ratings from the ratings agencies be used and that a counter-party must have a minimum of the following:

  Moody's. P1
  S&P A1
  Fitch. F1

Short term ratings were specifically created by the agencies for money market investors as they reflect specifically the liquidity positions of the institutions concerned.

- **For medium term investments** in the form of tradeable bonds or certificates of deposit (1yr to 5yrs, where immediate liquidation can be demonstrated), a blended average of the ratings will be taken (averaging across all available ratings) , with a minimum of:

  - Long term AA3/AA-, and
  - Short term P1/F1+/A1+

- **For longer term investments (5yrs and above)** in the form of tradeable bonds where immediate liquidation can be demonstrated, a blended average of the ratings will be taken, with a minimum of:

  - Long term AA2/AA
  - Short term P1/A1+/F1+

The detailed calculation methodology of the blended average will be agreed with the council's advisers and set out in the treasury management practices document.

The limits for scale and duration of investment in specific categories which form the 2016/17 investment strategy are set out in the table below.

If the counterparty of an existing investment falls outside the policy due to a change in credit rating, full consideration will be made, taking into account all relevant information, as to whether a premature settlement of the investment should be negotiated.

The minimum sovereign rating for investment is AA-.

The table below shows the approved investment Counterparties and Limits

Instrument	Minimum Credit Rating (blended average)	Maximum individual Investment (£m)	Maximum total Investment (£m)	Maximum Period
UK Government Gilts, Treasury Bills & bodies guaranteed by UK Govt	UK Government	500	unlimited	50 yrs
Sterling Supranational Bonds & Sterling Sovereign Bonds	AA-	150	500	50 yrs
Corporate Bonds (Short Term less than 1yr to maturity)	P1/A1/F1	40	200	1yr

Instrument	Minimum Credit Rating (blended average)	Maximum individual Investment (£m)	Maximum total Investment (£m)	Maximum Period
Corporate Bonds (Medium term up to 5 years)	AA- P1/A1/F1	100	500	5yrs
Corporate Bonds (Long term)	AA P1/A1+/F1+	50	250	50yrs
Government Bond Repurchase Agreements (Repo/ Reverse Repo)	UK Government AA	500	750	1yr
Repurchase Agreements (Repo/ Reverse Repo)	Other AA+	200	200	1yr
Bond Funds with weighted average maturity maximum 3 yrs	AA Rated weighted average maturity 3yrs	100	250	These investments do not have a defined maturity date.
Bond Funds with weighted average maturity maximum 5 yrs	AAA Rated	100	250	These investments do not have a defined maturity date.
UK Local Authorities (incl Transport for London)	Implied Government support	100	500	50yrs
Collateralised lending agreements backed by higher quality government or local government and supra national sterling securities.	AA- with cash or AA- for any collateral	250	500	25yrs

Instrument	Minimum Credit Rating (blended average)	Maximum individual Investment (£m)	Maximum total Investment (£m)	Maximum Period
Call accounts with UK and Overseas Banks (domiciled in UK)	P1/A1/F1 Long term A Government support	100	100	Overnight in line with clearing system guarantee (currently 4 years.)

The County Council's day to day transactional bank National Westminster lies outside the investment credit matrix but emergency overnight deposits may be placed with them from time to time. In practice they are minimised on a daily basis to typically below £1million.

6.1 Types of Investment

The CLG Guidance defines two types of investment, firstly specified investments which are those:

- denominated in pound sterling,
- due to be repaid within 12 months of the arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of “high credit quality”.

Any investment not meeting the definition of a specified investment is classed as non-specified. The County Council will not make any investments with low credit quality bodies, nor any that are defined as capital expenditure by legislation, such as company shares.

The operational total limit on long-term investments is £600 million. This reflects the portfolio structure adopted by the County Council in order to reduce credit risk and ensure liquidity.

Core investments are held in government and supranational securities, which although highly liquid have maturities in excess of 364 days. In addition the County Council holds a secondary liquidity investment book of very high quality covered floating rate notes (FRNs) which are typically issued for a 3 to 5 year term. Because these instruments have their rates re-fixed, at current market rates every 3 months, their price shows a very low sensitivity to changes in market rates, so that although under the current accounting regulations they are classified as long term instruments, in practice they operate as fixed instruments with a maximum of 3 months to maturity and can be liquidated with one or two days notice. Therefore the 'long term investments' total contains instruments which operate with a short term horizon and which are central to achieving the County Council's security and liquidity objectives.

In recent times, a wider range of investment instruments within the area of sterling deposits has been developed by financial institutions. All of these afford similar security of capital to basic sterling deposits but they also offer the possibility, although never of course the certainty, of increased returns. The section 151 officer will, in liaison with the County Council's external advisers, consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the County Council. Because of their relative complexity compared to straightforward term deposits, most of them would fall within the definition of non-specified investments. Decisions on whether to utilise such instruments will be taken after an assessment of whether their use achieves the Council's objectives in terms of reduction in overall risk exposure as part of a balanced portfolio.

7. Policy on Use of Financial Derivatives

The County Council will only use financial derivatives (such as swaps, forwards, futures and options) on a standalone basis, where it can be clearly demonstrated that as part of the prudent management of the Council's financial affairs the use of financial derivatives will have the effect of reducing the level of financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk.

Many embedded derivatives are already used by local authorities across England and Wales including Lancashire County Council, although unlike the government, commercial sector and other public service areas stand-alone derivatives have not generally been used.

A derivative is a financial instrument with three main features:

- The value changes in response to an underlying variable.
- The transaction requires no initial investment, or an initial net investment smaller than would be required for other types of contract with a similar expected response to market changes.
- The contract is settled at a predetermined future date.

The underlying variable represents an existing external risk for which the hedge is required. Examples are a specified interest rate, a commodity price, a credit rating, a foreign exchange rate or any other variable, however as the County Council treasury activity is not directly exposed to all of these risks, for example foreign exchange or commodity prices, the County Council's use of derivatives will be restricted to the management and hedging of interest and inflation rate risk only.

The embedded and standalone derivatives which can be used by the County Council to manage interest rate risk are summarised below:

CLASS	USE	STANDALONE	EMBEDED
Forwards	To fix an interest or inlation rate for a single period in the future.	Forward Rate Agreement (FRA), gilt lock, interest rate or gilt futures	Forward Deal
Swaps	To exchange interest or inflation rate exposures (eg. fixed to floating)	Interest or inflation rate swap (IRS), Basis swap.	Variable rate deposit, Floating rate note.
Purchased Options	The right but no obligation to fix an interest or inflation rate in exchange for paying a premium.	Caps, floors, collars, swaptions, puts, calls	Callable loan Collared deposit

The Council will not sell interest rate or inflation rate options, (i.e. give another party the right to fix a rate) since these cannot reduce the Council's risk. The only exception is where a sold option is combined with a purchased option of equal or higher premium to create a collar.

There are two methods of engaging in derivative contracts, exchange traded or settled derivatives and over the counter (OTC) derivatives. The former are available in public markets and trade over a physical exchange with a clearing house acting as an intermediary and include futures and options. OTC contracts are privately negotiated and traded between two counterparties and can include swaps and forwards.

In a derivative contract both parties are often required to provide collateral (i.e. pools of valuable and liquid assets set aside specifically to back liabilities arising from the contract) to reduce credit risk. The method of assessing counterparty quality and suitability of collateral within the structure of the contracts is shown below:

PRODUCT	COUNTERPARTY QUALITY	SECURITY	
Exchange traded or cleared product	Credit rating of exchange	Credit rating of Clearing agent	Margin netting
Bilateral FRAs and swaps assuming netting	Credit rating of counterparty	Full 2-way collateral arrangements	Types of collateral agreed and any haircuts
OTC Options	Credit rating of counterparty	Agreed full 2-way collateral	Types of collateral and haircuts
Intra LA swaps etc	Assumed Credit rating	2-way collateral (cash)	No haircut

The credit quality of the collateral acceptable to the County Council will be determined by the credit rating of the counterparty or exchange, along with credit default swap prices which react much quicker than credit rating agencies and can be used as early indicators of credit or liquidity problems.

The table below defines the appropriate limits for collateral quality:

Counterparty type	Documentation	Collateral types	CDS levels	Rating
Exchange	MIFCA	Cash margins	<75bp	AA
Banks	ISDA/CSA	Cash and Govt bonds	<100bp	A3
Insurers and Pension Funds	ISDA CSA	Cash, Govt Bonds	<100 (Insurers)	A3 (Insurers)
LAs	Contract	Cash, Govt Bonds	England/Wales None	England and Wales None

The County Council will only use derivative contracts to hedge existing risks. This is reflected in the limits below which in future will form a local indicator as part of the Prudential Indicators agreed by the County Council within the annual Treasury Management Strategy. These are shown in the table below, the 100% upper limit means that the County Council has the option to hedge all of, but not more than, its interest rate risk if felt appropriate.

Exposure Metric	Min Hedge	Max Hedge	Granularity	Tool
Interest rate	0%	100%	0-3 months 3-6months, 6-12m months, 1 to 2 years, 2-5 years and 5 year blocks	FRA, Futures, Options,Swaps Swaption
Inflation rate	0%	100%	1 block	Swap, Swaption, Option

In addition hedge accounting will be used to periodically test the effectiveness of the hedge. It is expected the hedge will work with between 80% and 125% effectiveness in accordance with International Accounting Standards. If the effectiveness is measured as falling outside these parameters, the structure of the hedge be changed in response.

The calculation method of interest rate risk to be hedged and hedge effectiveness will be set out in the Treasury Management Practices document.

At all times the County Council will comply with CIPFA advice and guidance on the use of financial derivatives and have regard to CIPFA publications on risk management. Part of that advice was that the County Council should seek its own legal advice as to the legality of the use of derivatives for risk management purposes.

8. Performance Measurement

With base rates at exceptionally low levels, investment returns are likely to continue to be far lower than has been the case in recent years. However, in the knowledge that a portion of cash invested will not be required in the short term; and to protect against continued low investment rates; investments may be made for longer time periods, depending on cash flow considerations and the prevailing market conditions. The performance target on investments is a return above the average rate for 7 day notice money.

9. Impact on the County Council's Revenue Budget

The table below outlines the budget for the financing charges element of the Council's revenue budget. This reflect the proposed changes to the Minimum Revenue Provision calculation which has been reflected in the Medium Term Financial Strategy., The authority is required by statute to make a prudent charge giving consideration to guidance issued by the Government department. Full Council is required to review and approve its MRP policy annually. The proposed changes to the policy are charging debt incurred prior to 2007/8 on a 50 year straight line basis rather than a 4% reducing balance and the use of an annuity calculation for debt incurred later than this date. A revised MRP policy is set out in Appendix C.

	Revenue Budget 2015/16 £m	Revenue Budget 2016/17 £m	Revenue Budget 2017/18 £m	Revenue Budget 2018/19 £m
Minimum Revenue Provision (MRP)	37.085	19.967	20.749	20.877
Interest Paid	22.308	24.036	27.883	29.312
Interest Earned	-12.710	-10.420	-10.524	-10.733
Grants Received	-0.280	-0.260	-0.240	-0.240
Total	46.403	33.323	37.868	39.216

The revenue budget above reflects a position which takes account of the views of both internal and external advisors, particularly in relation to interest rate movements and the potential timing to move from short term variable rates to fixed rates.

The position will be closely monitored by the S151 officer and any changes to the external view will be reflect in a revised Finance Charges forecast and taken to Cabinet.

Annex A

PRUDENTIAL INDICATORS

In line with the relevant legislation the county council has adopted the Prudential Code for Capital Finance in Local Authorities and the CIPFA Treasury Management in the Public Services Code of Practice as setting the framework of principles for its Treasury Management activities. In accordance with the requirements of these codes the County council produces each year a set of prudential indicators which assist in the process of monitoring the degree of prudence with which the county council undertakes its Capital Expenditure and Treasury Management activities. Certain of these indicators also provide specific limits with regard to certain types of activity such as borrowing. These indicators are a consequence of the borrowing requirements and actions set out within the body of the Treasury Management Strategy.

Adoption of CIPFA Treasury Management Code of Practice (2011)

2015/16	**2016/17**	**2017/18**	**2018/19**
Adopted for all years			

Indicators on Capital Expenditure and Financing

The total capital expenditure in each year, irrespective of the method of financing estimated to be incurred by the County council is as follows:

2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
178.016	250.521	103.805	77.024	49.621

The estimated capital expenditure stated above will be financed by a mixture of borrowing, capital receipts, revenue contributions, grants and other contributions. A key control of the prudential system is the underlying need to borrow for capital purposes, which is represented by the cumulative effect of past borrowing decisions and future plans. This is shown as the capital financing requirement. This is not the same as the actual borrowing on any one day, as day to day borrowing requirements incorporate the effect of cash flow movements relating to both capital and revenue expenditure and income. The estimate of the capital financing requirement for each year is as follows, and includes the impact of PFI obligations.

2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
1,022.485	1,043.945	1,068.207	1,061.008	1,050.609

Prudence and Affordability

CIPFA's Prudential Code for Capital Finance in Local Authorities states the following as a key indicator of prudence:

"In order to ensure that, over the medium term, net borrowing will only be used 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."

The county council's financial plans are prepared on this basis and, indeed the policy on borrowing in advance of need explicitly references this statement as part of the decision making criteria.

It is important to ensure that the plans for capital expenditure and borrowing are affordable in the long term. To this purpose the code requires an indicator which estimates the ratio of financing costs to the net revenue stream.

The financing costs are the interest payable on borrowing, finance lease or other long term liabilities and the amount defined by statute which needs to be charged to revenue to reflect the repayment of the principal element of the county council's borrowing. Any additional payments in excess of the statutory amount or the cost of early repayment or rescheduling of debt would be included within the financing cost. Financing costs are expressed net of investment income.
The net revenue stream is defined as the amount required to be funded from Government Grants and local taxpayers, in effect the budget requirement.
Estimates of the ratio of financing costs to net revenue (or budget requirement) are as follows:

2015/16	2016/17	2017/18	2018/19
Estimate	**Estimate**	**Estimate**	**Estimate**
%	**%**	**%**	**%**
3.22	4.69	5.50	5.76

The Capital Programme is still being considered by the County Council and is not yet finalised. The indicators have been calculated on the assumption that any new starts will be funded from either grants or revenue resources. Including the cost of financing the borrowing already included in the Programme to meet current commitments it is estimated that the Council Tax impact of the whole Programme will be:

2016/17	2017/18	2018/19
Estimate	**Estimate**	**Estimate**
£	**£**	**£**
17.12	20.08	6.26

It is important to note that the figures do not represent annual increases in Council Tax. Both the 2014/15 and 2015/16 figures will include the full year effects of decisions taken in 2013/14. Similarly, all three years include the effect of financing capital expenditure from revenue or internal loans. Provision for these already exists within the revenue budget. The Prudential Code requires the estimated revenue impact of capital investment decisions in Band D Council Tax terms to be calculated. The estimated effect in Band D Council Tax terms of the net cost of the borrowing is:

	£
2015/16	5.48
2016/17	7.01
2017/18	6.26

External Debt
The county council is required to approve an “authorised limit” and an “operational boundary” for external debt. The limits proposed are consistent with the proposals for capital investment and with the approved treasury management policy statement and practices. The limits also include provision for the £150m cap on the shared investment scheme. The indicators are split between borrowing and other long term liabilities, such as PFI projects. It is, therefore, proposed to set a limit for the section 151 to work within.

The authorised limit is a prudent estimate of external debt, but allows sufficient headroom for unusual cash flow movements. After taking into account the capital plans and estimates of cash flow and its risks, the proposed authorised limits for external debt are:

	2015/16 Revised	**2016/17**	**2017/18**	**2018/19**
	£m	**£m**	**£m**	**£m**
Borrowing	1,200	1,250	1,250	1,250
Other long term liabilities	200	200	200	200
TOTAL	1,400	1,450	1,450	1,450

The proposed operational boundary for external debt is based on the same estimates as the authorised limit. However, although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the county council's current plans. As required under the Code, this limit will be carefully monitored during the year. The proposed operational boundary for external debt is:

	2015/16 Revised	2016/17	2017/18	2018/19
	£m	£m	£m	£m
Borrowing	1,120	1,190	1,180	1,160
Other long term liabilities	180	180	180	180
TOTAL	1,300	1,370	1,360	1,340

The debt figures include transferred debt which is managed by the County Council on behalf of other authorities. The transferred debt included within the debt indicators is estimated at the end of each year to be:

2015/16	£36.970 m
2016/17	£35.283 m
2017/18	£33.654m
2018/19	£32.080m

Gross Debt and Capital Financing Requirement

As a measure of prudence and to ensure that over the medium term debt is only used for a capital purpose, the prudential code requires a comparison of gross debt and the capital financing requirement. The comparison for the County Council is shown below:

	31 Mar 2016 £m	**31 Mar 2017 £m**	**31 Mar 2018 £m**	**31 Mar 2019 £m**
Borrowing CFR	**871**	**893**	**882**	**875**
Loans Borrowed (31March estimate)	1,039	1,058	1,044	1,031
Borrowing Above CFR	**168**	**165**	**162**	**156**
Comprising:				
Premiums	48	45	42	36
Shared Investment Scheme	120	120	120	120
Total	**168**	**165**	**162**	**156**

The ratio of gross debt to capital financing requirement shows that gross debt is higher than the capital financing requirement. This is because the shared investment scheme and the replacement overdraft facility are currently accounted for as borrowing but not counted against the capital financing requirement.

Treasury Management Indicators

Interest rate exposure

In order to control interest rate risk the County Council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the county council is exposed to. The one year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.	Upper Limit	Dec 2015
	£m	£m
Net Interest Payable at Fixed Rates	50.4	6.8
Net Interest Payable at Variable Rates	5.0	3.2
One year impact of a 1% rise in rates	10.0	1.7

Maturity structure of debt

Limits on the maturity structure of fixed debt help control refinancing risk

	Upper Limit %	Dec 2015
Under 12 months	75	17
12 months and within 2 years	75	38
2 years and within 5 years	75	19
5 years and within 10 years	75	65
10 years and above	100	19

Investments over 364 days

Limits on the level of long term investments helps to control liquidity, although the majority of these investments are held in available for sale securities.

	Upper limit £m	Dec 2015 £m
Authorised Limit		
Total invested over 364 days	900	577
Operating Limit		
Total invested over 364 days	600	577

Minimum Average Credit Rating
To control credit risk the County Council requires a very high credit rating from its treasury counterparties

	Benchmark	Dec 2015
Average counterparty credit rating	A+	AA

Appendix C

Minimum Revenue Provision Statement 2015/16

1. Introduction

This annual Statement required to be approved by the County Council arises from statutory guidance initially issued by the Department of Communities and Local Government (DCLG) in 2008 and updated in 2010.

Local Authorities are required to make a prudent charge to the revenue account in respect of provision to repay debt and other credit liabilities (mainly finance leases or PFI contracts). This is referred to as the Minimum Revenue Provision (MRP).

Guidance issued by the DCLG provides four options which can be used for the purpose of calculating the MRP. However the legal requirement is to set a prudent charge and therefore authorities are free to move away from the guidance if they feel it is appropriate.

2. The Four Options Explained

The first two options, the Regulatory and Capital Financing Requirement methods, can be applied to borrowing which is supported by government via Revenue Support Grants.

For capital expenditure financed by unsupported borrowing, as allowed under the Prudential Code, the guidelines identify the Asset Life method or the Depreciation method as possible alternatives.

• Regulatory Method

Before the Prudential Code system of capital finance was introduced in 2004 the MRP was calculated at 4% of the credit ceiling. On the introduction of the Prudential Code this was changed to a charge of 4% of Capital Financing Requirement, which is derived from the Balance Sheet and broadly represents the outstanding debt used to finance the fixed assets. However, to avoid changes in the charge to revenue in 2004/5 an adjustment figure was calculated which would then remain constant overtime. For technical accounting reasons this methodology would have led to an increase in the MRP, and would therefore have had an impact upon the County Council's budget, so this method has not been used and is not recommended for future use.

• Capital Financing Requirement (CFR) method

This option allows for the MRP to be calculated as 4% of the Capital Financing Requirement. The CFR is derived from the Balance Sheet and represent the value of the fixed assets, for which financing provision has not already been made. This method of calculation has been used at the County Council since the introduction of the MRP in 2004.

• Asset Life Method

Guidelines for this method allow for a MRP to be calculated based on the estimated life of the asset. The actual calculation can be made in two ways as shown below;
A straightforward calculation to set an equal charge to revenue over the estimated life of the asset. This charge will not be varied by the state of the asset or,
By the use of an annuity method. This provides for greater charges in the later years of the assets life and should only be used if it can be demonstrated that benefits are likely to increase in the later years.

• Depreciation method

This requires a charge to be made of depreciation in line with normal accounting purposes. This could include the impact of any revaluations, and would be calculated until the debt has been repaid.

3. Finance Leases and PFI

With changes in accounting regulations in 2009/10 assets held under a PFI contract now form part of the Balance Sheet. This has increased the capital financing requirement and on a 4% basis the potential charge to revenue. To prevent the increase the guidance permits a prudent MRP to equate to the amount charged to revenue under the contract to repay the liability. In terms of the PFI schemes this charge forms part of the payment due to the PFI contractor.

4. Application at LCC

The relevant regulations require that the Council make "prudent provision" for the repayment of debt, and departure from the options outlined above is permissible if an alternative option is considered more appropriate.

From 2008/09 to 2014/15 the Capital Financing Requirement option has been applied to all supported borrowing incurred before 1 April 2007. This charge was based on 4% of the outstanding capital financing. It is now proposed to modify the approach. The charge based on a 4% reducing balance never effectively repays the debt. It is now considered that the 4% charge over-estimates the level of support within the revenue support grant. It is now proposed that the charge should still be made in reference to the capital financing requirement but that it is based upon a 50 year life rather than a reducing balance. It is assumed that there is an equal charge over each of the 50 years.

For 2008/09 to 2014/15 the Asset Life method (Equal Charge approach) has generally been applied to capital expenditure financed by unsupported borrowing. PFI payments will be made in line with the amounts due to repay the liability under the contract. During 2014/15 the Waste PFI contract was terminated and the PFI liability was replaced borrowing and this debt will be paid on an annuity basis. . An alternative approach to the equal charge is the annuity method which is the cheapest

MRP option in the early years, and maintains a constant impact on the revenue account over the useful life of the asset being financed, once interest costs are taken into account. The basis of the charge will still be the asset life and it is considered to be a prudent charge and it is proposed that the annuity basis is used in calculating the MRP.

Minimum Revenue Provision will not be made in relation to the following specific circumstances:

For assets constructed as part of the Preston, South Ribble and Lancashire City Deal where the borrowing will be repaid from other capital financing sources within the life of the City Deal, this is temporary borrowing that will be repaid from sources such as Community Infrastructure Levy and funding from the Homes and Communities Agency when the development facilitated by the construction of County Council assets has taken place. Thus an alternative prudent plan for repayment is in place. However, this position will be reviewed each year in the light of progress with the City Deal.

For borrowing associated with the Homes and Communities Agency Local Infrastructure Fund where the relevant assets and hence repayment are delivered through a Development Company which generates the income stream to ensure repayment of the liability. Again this provides an alternative prudent plan for repayment in line with the loan terms. The position will be subject to annual review.

No MRP will be charged until the financial year after the project is deemed to be complete.

5. Recommendations

In respect of the methodology for applying the minimum revenue provision in respect of the repayment of debt, Cabinet is asked to recommend that the Full Council:

1 Approves the Capital Financing Requirement method and the Asset Life method for expenditure as outlined in section 4.
2 Charges to revenue a sum equal to the repayment of any credit liability.
3 Approves the proposed treatment of assets constructed under the Preston, South Ribble and Lancashire City Deal and the Homes and Communities Agency Local Infrastructure Fund, subject to annual review.
4 Approve the policy of not starting charging revenue until the project is completed.