Full Council

Thursday, 9th February, 2017, at 1.30 pm in the Council Chamber, County Hall, Preston.

Agenda

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B. Matters for Information

There are no matters to be reported at this meeting.

C. Notice of Motion

To consider any Notices of Motion submitted under Standing Order No. 14.2.1.

Jo Turton
Chief Executive

County Hall
Preston

01 February 2017

Lancashire County Council

Agenda Item 3

Meeting of the County Council
Meeting to be held on 9 February 2017

Report submitted by the Cabinet

Part A

Electoral Division affected:
All

The County Council's Budget

Revenue Budget 2017/18 and Financial Strategy 2017/18 to 2020/21
Capital Investment Programme 2017/18 and beyond
Council Tax and Precept 2017/18
(Appendix 'A' refers)

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Executive Summary

To consider the recommendations of the Cabinet on 8 December 2016 and 19 January 2017 regarding:

1. The Revenue Budget 2017/18 and Financial Strategy 2017/18 to 2020/21: section 1 of this report and Appendix 'A';
2. The Capital Investment Programme 2017/18 and beyond: section 2 of this report and Appendix 'A'; and
3. The Council Tax and Precept 2017/18: section 3 of this report.

Please note: The reports on the County Council's Budget for 2017/18 considered by Cabinet at the meetings on 8 September 2016, 8 December 2016 and 19 January 2017 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 at:
http://council.lancashire.gov.uk/ieListMeetings.aspx?CommitteeId=122

Recommendation
The Full Council is asked to consider the proposals of the Cabinet from its meetings on 8 December 2016 and 19 January 2017 and then approve: • The Revenue Budget for 2017/18 and Financial Strategy 2017/18 to 2020/21; • The Capital Investment Strategy 2017/18 and future years; and • The Council Tax Requirement and Precept for 2017/18.

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

1. The Revenue Budget 2017/18 and Financial Strategy 2017/18 to 2020/21: section 1 of this report and Appendix 'A';
2. The Capital Investment Programme 2017/18 and beyond: section 2 of this report and Appendix 'A'; and
3. The Council Tax and Precept 2017/18: section 3 of this report.

1. Revenue Budget 2017/18

The Cabinet **recommends** the adoption of the revenue budget 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 savings proposals agreed at Full Council in February 2016 for the financial year 2017/18 totalling £43m were agreed to be supported by £24.2m of one-off reserves, however due to early delivery of savings it is forecast that only £16.3m is required. In addition, £57.1m of reserves are proposed to meet the funding gap, resulting in £73.4m reserves being utilised for the 2017/18 budget.

Revenue Budget 2017/18	Net Budget £m
Adult Social Care	344.933
Chief Executive	1.823
Children's Services	132.788
Community Services	131.976
Corporate Commissioning	13.241
Corporate Director Operations and Delivery	3.660
Development and Corporate Services	34.611
Governance, Finance and Public Services	26.328
Corporate & Other	33.120

Public Health	22.729
Sub-Total	**745.209**
Financing Charges	36.718
Use of one off resources	-57.106
Revenue budget 2017/18	**724.821**

2. Capital Investment Strategy 2017/18 and beyond

The Cabinet **recommends** the adoption of the proposals for the Capital Investment Strategy 2017/18 and future years as set out at Appendix 'A'.

3. Council Tax and Precept 2017/18

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 2017/18.

a) Budget, Council Tax Requirement and Precept for 2017/18:

That the band D Council Tax for 2017/18 is increased by:

- Adult Social Care Precept 2% being an increase of £23.50
- General Council Tax 1.99% being an increase of £23.38

This gives an overall position of:

	£m
Budget Requirement	**724.821**
Less RSG	81.508
Less Retained Business Rates	181.391
Less New Homes Bonus grant	5.244
Less Better Care Fund	3.210
Less Adult Care Support Grant	5.543
Less Transitional Grant	1.154
Less Capital Receipts	12.500
Equals council tax cash	**434.271**
Divided by tax base	355,452.51

Gives Band D council tax for 2017/18	£1,221.74
2016/17 council tax	£1,174.86
Percentage increase	**3.99%**

Council Tax (on the basis of a budget requirement of £724.821m and the Council Tax base for each property valuation band:

Council Tax Band	£
Band A	814.49
Band B	950.24
Band C	1,085.99
Band D (basic)	**1,221.74**
Band E	1,493.24
Band F	1,764.74
Band G	2,036.23
Band H	2,443.48

c) The share for each District Council of the net total raised from the Council Tax of £434,270,550:

District	£
Burnley	27,585,668
Chorley	43,901,565
Fylde	35,777,434
Hyndburn	24,675,483
Lancaster	49,236,122
Pendle	28,525,552
Preston	43,822,592
Ribble Valley	27,465,937
Rossendale	24,432,357
South Ribble	43,112,272
West Lancashire	42,015,883
Wyre	43,719,685
Total raised from the Council Tax	**434,270,550**

Jennifer Mein
Leader of the Council, County Hall, Preston

Consultations

The contents of this report are subject to an ongoing consultation with a variety of stakeholders and partners. At the time of writing this report there were no substantive responses, however Members will be kept informed of any further feedback received.

Implications:

This item has the following implications, as indicated:

These are set out in Appendix 'A'.

List of Background Papers

Paper	Date	Contact/Tel
Money Matters 2016/17 Financial Position and Medium Term Financial Strategy	8 September 2016	Neil Kissock/(01772) 536154
Money Matters – The County Council's Re-profiled Capital Programme for 2016/17 to 2018/19 and later years	6 October 2016	Eddie Sutton/(01772) 533475
Money Matters 2016/17 Financial Position and Medium Term Financial Strategy	8 December 2016	Neil Kissock//(01772) 536154
Money Matters – The Financial Strategy	19 January 2017	Neil Kissock//(01772) 536154

Reason for inclusion in Part II, if appropriate

N/A

Appendix 'A'

The County Council's Revenue Budget and Council Tax for 2017/18 and Capital Investment Programme for 2017/18 and future years

1. Introduction

The Council has faced an unprecedented period of financial challenge since austerity began in 2010. The Cabinet report in December 2016 identified £12.320m of additional savings, including £8.120m relating to 2017/18, that are in addition to the c£142m of previously agreed savings to be made during 2016/17 and 2017/18. Taking account of updated resources information a funding gap of £57.106m remains and, in order to set a balanced budget, reserves of £57.106m are required to fund the gap. However, this is clearly dependent on all budget options agreed by Cabinet 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 achieved they will need to be replaced with alternative savings to avoid increasing the size of the gap. There also remains a funding gap of £88.040m in 2018/19 and an urgent need to identify proposals for additional savings early in 2017/18 that can be delivered in 2018/19.

Whilst the principle has been agreed of reviewing each and every continuing service using a zero based approach, with reference to our benchmark unit costs, and moving towards the lowest quartile of the most appropriate comparator group, this will need to make early progress during 2017/18 to meet the 2018/19 shortfall and consider whether a sustainable financial position will be achievable over a longer period. Taking everything into account, there remains a strong likelihood that the Council will, during the course of this financial strategy period (in 2018/19 at the earliest), be in the position of being unable to set a budget which will meet the cost of its statutory responsibilities, as they are currently delivered.

The Local Government Settlement on 17th December 2015 included the Government offering any council the opportunity to take up a four year funding settlement to provide greater certainty around financial planning. The offer only covers Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. These grants in 2017/18 will represent c11% of the County Council's resources and are forecast in the Medium Term Financial Strategy (MTFS) to reduce further and finish completely by the end of this Parliament when full Business Rate Retention comes in. This will be accompanied by an updated funding formula for local authorities and new responsibilities which are yet to be determined. Whilst the principle of a longer-term settlement was welcomed, the Council did not take up the offer as previous reports to Cabinet have clearly identified an impending scenario whereby the Council will have insufficient resources to meet statutory responsibilities as they are currently provided.

The County Council continues to face significant challenges from rising costs; from National Living Wage, contractual inflation and an increasing demand for its services, particularly in both adult and children's social care services and waste services.

The current Medium Term Financial Strategy estimates that in 2020/21 the County Council will have a net budget available of £762m. This compares to £725m in 2017/18. From 2017/18 to 2020/21 the County Council needs to make further savings of c£156m in addition to previously agreed savings over 2015/16 – 2017/18 of c£224m.

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

- The revenue budget for 2017/18;
- A revised capital investment programme for 2017/18 and future years;
- The Council Tax for 2017/18.

In addition the report sets out the advice of the 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 2017/18. This needs to be undertaken whilst recognising the position for future years and that there will be a requirement for a significant level of reserves to support the 2017/18 budget. The Cabinet has considered the budget for 2017/18 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 2017/18 Budget

The Cabinet's recommendations for the 2017/18 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 2017/18 budget includes c£51m of savings relating to 2017/18 although some of which will not be fully delivered until 2018/19 as it was agreed that these would be covered by the use of reserves. Despite these reductions, the MTFS shows that there is still a funding gap of £57.106m in 2017/18. Over the period 2017/18 to 2020/21 it is estimated that the County Council needs to make further savings of £155.953m. 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 2017/18 with the final local government finance settlement expected to be announced during February 2017. However, the provisional settlement has indicated that funding will be as expected with further reductions in 2017/18 to the Revenue Support Grant. In addition the Government announced adjustments to business rates (inflationary), New Homes Bonus and the inclusion of a one-off 2017/18 Adult Care Support Grant (£5.543m – funded nationally from changes to New Homes Bonus). The provisional settlement has been reflected in the MTFS approved by Cabinet in January 2017 and it is not anticipated that there will be a major change in the final announcement.

As part of the provisional settlement the Secretary of State announced some adjustments in relation to the referendum limit for the Adult Social Care Precept. When the precept was introduced in 2016/17 the limit was a 2% increase. However, in recognition of the pressures facing Local Authorities responsible for Adult Social Care it was announced that Local Authorities could bring forward the additional precept (with a cap of 3% rather than 2% each year) but could still only increase Council Tax by a maximum of 6% over the financial years 2017/18 – 2019/20. The settlement also announced that there would be no Adult Social Care Precept in 2020/21. The MTFS assumes a 2% increase for the Adult Care Precept in 2017/18, 2018/19 and 2019/20. In addition the MTFS also assumes a 1.99% increase in general council tax in each year from 2017/18 to 2020/21. It is important to note that the Adult Social Care Precept and the Adult Care Support Grant in 2017/18 broadly covers the cost of fee increases, but does not provide sufficient funds for increasing demand overall.

On reviewing the flexibility given by the Secretary of State the impact is minimal on the financial gap over the 4 years. The more significant impact on the MTFS was the announcement as part of the provisional settlement that it is not permitted to apply the social care precept in 2020/21 and therefore it could no longer be forecast that a 2% Adult Social Care Precept could be applied in 2020/21 and this has therefore been removed from projected income levels, this effectively removes £9.679m of resources included in the MTFS, reported and agreed, earlier in the year.

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 future funding remains a risk.

Reports will be provided to Cabinet in 2017/18 to update the financial position for the County Council based on the latest information.

4. The Revenue Budget 2017/18 to 2020/21

4.1 The financial challenge

The County Council's Medium Term Financial Strategy (MTFS) was approved by Full Council in February 2016 covering the 2016/17 budget and the forecast position for 2017/18 to 2019/20. This identified the funding gap in each year as follows:

Table 1

	Total £m
2017/18 (£m)	**46.518**
2018/19 (£m)	**51.733**
2019/20 (£m)	**50.614**
2020/21 (£m)	**47.779**
Total	**196.644**

During 2016/17 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 2017 showed a revised spending gap of £153.389, however with an amendment to reflect the latest information in relation to the Council Taxbase and confirmation of a reduction in Education Services Grant (ESG) the spending gap has been revised to £155.953m (by 2020/21) with details of this in each financial year shown below:

Table 2

					Total £m
2017/18 (£m)	57.106	57.106	57.106	57.106	**228.424**
2018/19 (£m)		30.934	30.934	30.934	**92.802**
2019/20 (£m)			30.037	30.037	**60.074**
2020/21 (£m)				37.876	**37.876**
Total	**57.106**	**88.040**	**118.077**	**155.953**	**419.176**

Although the financial gap has reduced, from the £196.644m reported last February, it is important to note that this reflects different funding assumptions to those presented previously in that the impact of a 3.99% increase (including the 2% Adult Social Care precept) for each of the next 3 financial years is included. The County Council's budget is still facing a hugely challenging future with savings of c£51m to achieve as part of the 2017/18 budget and significant additional inflation and demand pressures across Children's Social Care, Adults Social Care and Waste Service.

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 were assessed as not being 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 was prepared based upon these revenue decisions, with the outcome of any consultations being reported to Full Council. As reported to Cabinet during 2016/17, the MTFS has been adjusted to take

into account those savings, but also reflects those that have now been assessed as being non-deliverable (c£2m).

Throughout 2016/17 work has continued to identify further savings with efficiencies totalling £12.320m identified predominantly through the Zero Based Budget Review (ZBBR) and the ongoing transformation work within Adults Social Care. These have been included within the MTFS reports presented to Cabinet during 2016/17.

Delivery of the significant savings programme has been identified as a key risk area and the savings plans are subject to detailed regular scrutiny by the Programme Office and Finance.

As part of the process of redesigning its services the County Council has previously explicitly recognised that it will need to utilise its reserves to support the transformation. Reports to Cabinet have clearly identified that the revenue budget for 2016/17, 2017/18 and potentially 2018/19 will need to 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, based on current forecasts, will not therefore be available after 2018/19 to support managing future year budget pressures.

5. The level of Resources Available to support the 2017/18 Revenue Budget

The revenue resources which support the County Council's 2017/18 budget are:

- Revenue Support Grant;
- Business Rates;
- Council Tax;
- New Homes Bonus;
- Better Care Fund;
- Adult Care Support Grant;
- Transitional Grant 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 2017/18 and future years is as follows:

Table 3

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Revenue Support Grant	81.508	56.979	32.894	26.928
Business Rates	181.391	186.747	193.323	198.540
Council Tax	434.271	456.115	479.056	493.475
New Homes Bonus	5.244	3.679	3.530	3.530
Better Care Fund	3.210	22.656	40.014	40.014
Adult Care Support Grant	5.543	0.000	0.000	0.000
Transitional Grant	1.154	0.000	0.000	0.000
Capital receipts	12.500	5.000	0.000	0.000
Total	**724.821**	**731.176**	**748.817**	**762.487**

These figures are subject to change once the final settlement is given but have been adjusted for the impact of the final Council Taxbase figures as discussed below.

5.1 The resources received through the Local Government Finance Settlement

The Secretary of State announced the Provisional Local Government Finance Settlement on 15th December 2016. This has resulted in some amendments to the MTFS in relation to council tax, adult care support grant, business rates and new homes bonus. It is important to note that the Settlement only covers the period up to 2019/20. It is currently anticipated that a new system of local government finance will be in place in 2020/21 which involves local government retaining all of the business rates and the impact of a review of the funding formula. (However, details of the scheme and the impact on Lancashire are not known.)

5.2 Council Tax and Adult Social Care Precept Resources

In the provisional settlement issued on 15th December 2016 one of the significant changes confirmed by the Secretary of State was in relation to the referendum limit for the Adult Social Care Precept. When it was introduced in 2016/17 the limit was a 2% annual increase. However, in recognition of the pressures facing Local Authorities responsible for Adult Social Care it was announced that Local Authorities could bring forward the additional precept (with a cap of 3% rather than 2% each year) but could

still only increase Council Tax by a maximum of 6% over the financial years 2017/18 – 2019/20. The settlement also announced that there would be no Adult Social Care Precept in 2020/21.

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.

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

5.2.1 Options for Council Tax in 2017/18

On 19th January 2017 Cabinet recommended to Full Council that the Band D Council Tax for 2017/18 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 2017/18 - 2019/20.

Since producing the MTFS the District Councils have confirmed both the Council Tax-base and the surplus/deficit on the Collection Fund. The confirmed tax base shows a higher increase than anticipated (1.855% compared to a forecast of 1%). The impact of the change in the tax-base gives an on-going increase in the Council Tax income received of £7.606m. This is £3.506m higher than previously forecast.

A £7.720m surplus on the Council Tax Collection Fund in 2016/17 has also been identified giving a one-off additional resource in 2017/18.

The table below shows the different council tax levels that could be generated given the flexibility that was announced by the Secretary of State. Table 4 demonstrates that the impact is minimal on the impact on the financial gap over the 4 years despite the different levels of increases available in in each year:

Table 4

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m		Total £m
MTFS December 2016 (2% 2017/18 - 2020/21)	434.271	456.115	479.056	503.154		**1,872.596**
MTFS January 2017 (2% 2017/18 - 2019/20, 0% 2020/21)	434.271	456.115	479.056	493.475		**1,862.917**
Increase/decrease in income	0.000	0.000	0.000	9.679		
Impact on financial gap	0.000	0.000	0.000	9.679		**9.679**
Scenario A (3% 2017/18 - 2018/19, 0% 2019/20 -2020/21)	438.447	464.928	478.922	493.335		**1,875.632**
Increase/decrease in income	-4.176	-8.813	0.134	-9.819		
Impact on Funding Gap	-4.176	-4.637	8.947	9.685		**9.819**

**includes a change in tax base figures as detailed above that were not included in figures provided to Cabinet in January 2017*

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. It is estimated that the County Council will receive funding of £181.391m from Business Rates (including top up grant) and Small Business Rates Relief in 2017/18.

Information received from the Districts to date has confirmed a deficit in 2016/17 on the Business Rates collection of £1.195m. This will reduce the one-off resources as shown in Table 8. It is important to note that at the time of writing this report all information had not been received from District Councils and therefore the deficit position will change from that stated above, for information the deficit in the previous year was £2.334m.

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 introduced the flexibility for capital receipts to be used to fund revenue expenditure which meets certain criteria. To meet the qualifying criteria the revenue expenditure needs to relate to activity 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, and utilised in supporting revenue expenditure, are as follows

Table 5

	2017/18 £m	**2018/19 £m**	**Total £m**
Capital receipts generated	12.500	5.000	17.500

An estimated £22.500m has previously been agreed to be applied to the revenue budget across 2016/17 – 2018/19. It should be noted that the 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 at these levels 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 in any given year the receipts actually received will be less than assumed and therefore the situation will be monitored closely. However, receipts received as at 31st December 2016 totalled £7.269m with capital receipts over £5.000m (2016/17 target) being able to be carried forward to support the £12.500m target in 2017/18.

There is suitable forecast expenditure within the revenue budget to enable the estimated £17.500m to be applied. These receipts would normally be applied to the Capital Programme and therefore the impact is to effectively increase the level of borrowing required to support the approved Capital Programme.

5.5 Specific Grants and contributions to be received by the County Council in 2017/18

The following table summarises the more significant specific grants to be received by the Council in 2017/18:

Table 6

Grant	Estimated Allocation 2017/18 £m	Description
Better Care Fund	25.7	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. An additional £3.210m in relation to improved better care fund is shown in Table 3.
Public Health	70.2	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 2017/18 in the table overleaf:

Table 7

Additional one off revenue resources in 2017/18	£m
Council Tax Collection Fund surplus	7.720
Business Rates Collection Fund deficit	-1.195
Total one-off revenue resources	**6.525**

In order to balance the 2017/18 revenue budget a contribution from reserves is required. It is proposed that these one-off resources are transferred to the transitional reserve.

5.7 Reserves

As at 1st April 2016 the County Council had total reserves of £400.669m. Of this, £86.022m was held for schools and its use is restricted.

On a quarterly basis Cabinet has received an updated position in relation to the County Council's reserves and commitments. During 2016/17 an improved position has been reported to Cabinet due to a thorough review of commitments and significantly a reassessment of the funds set aside for voluntary redundancy commitments. The latest positon agreed by Cabinet is shown in Table 8.

Table 8

Reserve Name	Opening Balance as at 1 April 2016	2016-17 Forecast Spend	2016-17 Transfers to / from other reserves	2016-17 Forecast Closing Balance	2017-18 Forecast Spend	2018-19 Forecast Spend	2019-20 Forecast Spend	Total as at 31 March 2020
	£m	£m	£m	£m	£m	£m	£m	£m
County Fund (3.1)	-36.000	0.000	0.000	-36.000	0.000	0.000	0.000	-36.000
Strategic Investment Reserve (3.2)	-10.971	2.351	5.194	-3.426	1.543	0.883	0.060	-0.940
Dow nsizing Reserve (3.3.1)	-64.841	14.171	28.062	-22.608	13.548	9.060	0.000	0.000
Risk Management Reserve (3.3.2)	-15.784	3.155	4.872	-7.757	7.757	0.000	0.000	0.000
Transitional Reserve (3.4.1)	-141.837	59.863	-54.712	-136.685	70.661	0.530	0.000	-65.495
To facilitate the transition of services (3.4.2)	0.000	0.000	-3.000	-3.000	0.000	0.000	0.000	-3.000
Service Reserves (3.5)	-45.214	8.893	10.800	-25.521	10.325	-0.340	-0.683	-16.219
TOTAL	**-314.647**	**88.434**	**-8.784**	**-234.997**	**103.834**	**10.133**	**-0.623**	**-121.653**
Forecast underspend 2016/17	0.000	0.000	-15.298	-15.298	**0.000**	**0.000**	**0.000**	-15.298
MTFS Funding Gap						*88.040*	*118.077*	*206.117*
Available reserves to support financial gap	0.000	0.000	0.000	0.000	0.000	86.714	0.000	86.714
TOTAL	**-314.648**	**88.434**	**-24.082**	**-250.295**	**103.834**	**96.847**	**-0.623**	**-50.238**

Note 1: the Service Reserves reflect the inclusion of the actual income and committed expenditure for the Growth Deal of £52.825m. This cannot be seen in the table above as these are funds that come into reserves and are spent during the year and therefore have a net nil impact.

Note 2: £0.415m has transferred from Service Reserves to Schools Reserves which are not included in the table above.

Table 8 demonstrates that following the application of the remaining available reserves of £86.714m to support the financial gap/shortfall within the 2018/19 budget the only remaining balance on reserves are County Fund (£36.000m), non LCC reserves (£13.898m) and 2019/20 commitments (£0.340m). This draw down from reserves in 2018/19 is not sufficient to cover the whole financial gap in this financial year and provides confirmation that there are no reserves left to support the financial gap in future years.

Full Council in February 2016 agreed the financial strategy to support the revenue position heavily from reserves. A significant number of the saving proposals were agreed that would take some lead-in time to deliver, therefore Cabinet and Full Council agreed that the cost incurred during this lead in time will be met from reserves.

However, as part of the quarterly reports to Cabinet, details have been provided to Members that indicate a reduced level of reserves are required as a result of early delivery of some savings. The table below sets out the summary of the agreed use of the Transitional Reserve in both 2016/17 and 2017/18 and the revised forecast use of reserves as at 31st December 2016 and reported to Cabinet specifically supporting agreed savings:

Table 9

	2016/17 Agreed use of reserve £m	2016/17 Forecast	2017/18 Agreed use of reserve £m	2017/18 Forecast
Reserves required to support budget proposals	46.5	34.2	24.2	16.3

6. The Overall Revenue Budget Position for 2017/18

6.1 Summary of Cabinet's Revenue Budget Proposals

The overall impact of the Cabinet's recommendations to Full Council for the 2017/18 revenue budget and the potential changes are set out in Table 10.

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 2017/18,
- The anticipated use of one-off resources in 2017/18,
- The provision of final figures by the City and Borough Councils in respect of Council Tax base and Business Rates income, and

Table 10

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Spending Gap as reported to Cabinet December 2016	60.350	26.497	31.032	28.254	**146.133**
Add change to forecast of spending:					
Pay and Pensions	0.000	0.000	0.000	0.000	**0.000**
Price Inflation and Cost Changes	0.502	0.179	0.009	0.115	**0.805**
Service Demand and Volume Pressures	-0.606	-0.536	-0.140	0.030	**-1.252**
Adjustments to Savings Programme	-0.414	0.000	0.000	0.000	**-0.414**
Total change to forecast of spending	**-0.518**	**-0.357**	**-0.131**	**0.145**	**-0.861**
Funding	-5.787	4.977	-0.671	9.598	**8.117**
Total change to forecast of resources	**-5.787**	**4.977**	**-0.671**	**9.598**	**8.117**
Revised funding gap reported to Cabinet 19th January 2017	**54.045**	**31.117**	**30.230**	**37.997**	**153.389**
Funding – change to Council Tax Base	-3.644	-0.183	-0.193	-0.121	**-4.141**
Loss of specific grant	6.705	0.000	0.000	0.000	**6.705**
Revised funding gap	**57.106**	**30.934**	**30.037**	**37.876**	**155.953**

The above table reflects the latest information available in relation to the Council Taxbase and also an updated position on the Education Services Grant (ESG), where confirmation has been received that the grant will be reduced but remaining funding

will be provided from a transitional grant allocation, retained duties funding via dedicated schools grant and a grant to support statutory intervention functions and services.

The updated position for reserves used to help meet the funding gap are shown in Table 8 demonstrating that there are insufficient reserves to fully support the 2018/19 budget.

6.2 Revenue Budgets for Services in 2017/18

The budget outlined above results in net expenditure on services of £724.821m. The budget by service is summarised below:

Table 11

Revenue Budget 2017/18	**Net Budget £m**
Adult Social Care	344.933
Chief Executive	1.823
Children's Services	132.788
Community Services	131.976
Corporate Commissioning	13.241
Corporate Director Operations and Delivery	3.660
Development and Corporate Services	34.611
Governance, Finance and Public Services	26.328
Corporate & Other	33.120
Public Health	22.729
Sub-Total	**745.209**
Financing Charges	36.718
Use of one off resources	-57.106
Revenue budget 2017/18	**724.821**

7. The Capital Investment Programme

This section of the report sets out the following:

- an outline of the 2017/18 – 2020/21 capital programme including known projects;

- summary of the proposed funding of the 2017/18 capital programme and the revenue implications of the increased use of prudential borrowing;

7.1 Capital Programme for 2017/18 – 2020/21

Table 11 below details the proposed provisional capital programme for the period 2017/18 to 2020/21.

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 12

	2017/18 (£m)	**2018/19 (£m)**	**2019/20 & 2020/21 (£m)**	**Total (£m)**
Schools (excluding Devolved Formula Capital)	29.686	28.562	2.580	60.828
Schools Devolved Formula Capital	2.634	2.634	0.000	5.268
Children and Young People	3.014	4.560	3.586	11.160
Waste and Other	2.023	0.100	1.665	3.788
Adult Social Care	0.562	7.808	6.061	14.431
Corporate	12.276	13.661	11.349	37.286
Vehicle Replacement	3.930	3.460	0.000	7.390
Transport	26.082	14.641	0.840	41.563
Highways	45.977	19.567	0.000	65.544
TOTAL	**126.184**	**94.993**	**26.081**	**247.258**

The table above does not include the impact arising from variances in expenditure and funding during 2016/17. Analysis of this impact will be undertaken as part of the year end accounting process.

Please note that an additional amount of £6.383m has been included in the capital programme compared to Cabinet in January 2017 due to confirmation of additional grant funding from the Department for Transport in relation to the Pothole Action Fund and the National Productivity Investment Fund.

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.

7.2.1 Capital Receipts

In line with Government legislation that took 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.

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;
- 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 13 provides details of funding sources for the capital programme up to 2020/21:

Table 13

	2017/18 (£m)	2018/19 (£m)	2019/20 & 2020/21 (£m)	Total (£m)
Capital Programme as per Table 12	**126.184**	**94.993**	**26.081**	**247.258**
Funded by the following:				
GRANTS RECEIVABLE (shown in year to be received)				
DfT Street Lighting Challenge Fund	-4.800	0.000	0.000	-4.800
DfT Annual Highways Maintenance Grant	-20.514	-18.567	0.000	-39.081
DfT Pothole Action Fund	-1.718	0.000	0.000	-1.718
DfT National Productivity Investment Fund	-4.655	0.000	0.000	-4.655

DfT Highways Maintenance Incentive Funding 2017/18 to be determined	TBC	TBC	TBC	TBC
DfT LTP/Integrated Transport Block annual grant	-6.054	-6.054	0.000	-12.108
DfE School Basic Need annual grant	-29.006	-2.580	0.000	-31.586
DfE Schools Condition annual grant	-11.209	0.000	0.000	-11.209
Schools Devolved Formula Capital	-2.634	-2.634	0.000	-5.268
Growing Places	0.000	0.000	-2.479	-2.479
Sub Total	**-80.590**	**-29.835**	**-2.479**	**-112.904**
GRANTS UNAPPLIED BALANCES as at 31st March 2016				
DfT Flood Damage Funding received in 2015/16	-0.911	0.000	0.000	-0.911
Adult Social Care grant	-2.386	0.000	0.000	-2.386
School DfE grants brought forward	-11.690	0.000	0.000	-11.690
Sub Total	**-14.987**	**0.000**	**0.000**	**-14.987**
GROWTH DEAL FUNDING				
Burnley Pendle Growth Corridor	-4.000	-4.000	0.000	-8.000
East Lancs Cycle Network	0.000	-1.550	0.000	-1.550
Sub Total	**-4.000**	**-5.550**	**0.000**	**-9.550**
DISTRICT CONTRIBUTIONS				
Burnley Town Centre	-0.550	0.000	0.000	-0.550
Burnley Pendle Growth Corridor	0.000	-0.485	0.000	-0.485
Blackpool Borough Council contribution to Waste projects (held in designated reserve)	-0.194	0.000	0.000	-0.194
Sub Total	**-0.744**	**-0.485**	**0.000**	**-1.229**
CONTRIBUTIONS FROM OTHER EXTERNAL BODIES				
BDUK re SFBB Phase 2	-0.965	0.000	0.000	-0.965
Sub Total	**-0.965**	**0.000**	**0.000**	**-0.965**
USE OF RESERVES				
Asset maintenance earmarked reserve	-0.727	0.000	0.000	-0.727

Sub Total	**-0.727**	**0.000**	**0.000**	**-0.727**
CAPITAL RECEIPTS				
Funding for School Playing Field programme from sale of school approved via Cabinet report	-1.036	0.000	0.000	-1.036
Sub Total	**-1.036**	**0.000**	**0.000**	**-1.036**
TOTAL FUNDING	**-103.049**	**-35.870**	**-2.479**	**-141.398**
NET BORROWING REQUIREMENT	**23.135**	**59.123**	**23.602**	**105.860**

Table 14 identifies the revenue implications of the changes in the borrowing requirements (excluding City Deal cash flow support):

Table 14

Borrowing costs of existing and new re-profiled capital programme	**2017/18** **£m**	**2018/19** **£m**	**2019/20** **£m**	**2020/21** **£m**
MRP				
Current Debt	19.986	19.788	20.188	20.603
New Capital Programme	1.397	2.040	3.683	4.431
Interest				
Current Debt	18.135	17.809	17.458	17.076
New Capital Programme	0.953	1.565	2.186	2.363
Total				
Current Debt	38.121	37.597	37.646	37.679
New Capital Programme	2.350	3.605	5.869	6.794
Grand total borrowing costs old and new programmes	**40.471**	**41.202**	**43.515**	**44.473**

The interest calculations are based upon an interest rate of 1.5%. 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 broadly based on the life of an asset. The revenue implications of this borrowing have been included within the MTFS.

8. Council Tax for 2017/18

The recommendation of the Cabinet to Full Council on the council tax requirement is that the Band D Council Tax for 2017/18 be increased by 3.99% which includes the 2% social care precept. The impact of these increases are:

Table 15

	Band D Council Tax	Council Tax income
Adult Social Care Precept at 2%	£23.50	£8.353m
General Council Tax increase at 1.99%	£23.38	£8.310m

The overall position is summarized as follows:

Table 16

	£m
Budget Requirement	**724.821**
Less RSG	81.508
Less Retained Business Rates	181.391
Less New Homes Bonus grant	5.244
Less Better Care Fund	3.210
Less Adult Care Support Grant	5.543
Less Transitional Grant	1.154
Less Capital Receipts	12.500
Equals council tax cash	**434.271**
Divided by tax base	355,452.51
Gives Band D council tax for 2017/18	£1,221.74
2016/17 council tax	£1,174.86
Percentage increase	**3.99%**

9. 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 must have regard to the advice of the Council's Chief Finance Officer (in the case of the County Council the Director of Financial Resources) on the robustness of the estimates and the adequacy of the Council's reserves.

Robustness of the Estimates

This section is concerned with the scale of financial risks faced by the 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 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:

- **Government Funding**

The Local Government Settlement on 17th December 2015 included the Government offering any council the opportunity to take up a four year funding settlement to provide greater certainty around financial planning. The offer only covers Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. These grants in 2017/18 will represent c11% of our resources and are forecast in the MTFS to reduce further and finish completely by the end of this Parliament when full Business Rate Retention comes in, which will be accompanied by an updated funding formula for local authorities and new responsibilities which are yet to be determined.

Whilst the principle of a longer-term settlement is welcome, the Council has not taken up the offer as previous reports to Cabinet have clearly identified an impending scenario whereby the Council will have insufficient resources to meet statutory responsibilities as they are currently provided. Not accepting the multi-year settlement will mean the level of Revenue Support Grant being confirmed on an annual basis and therefore may be subject to change from the assumptions included within the MTFS, although 2017/18 RSG has been confirmed as being in line with the level forecast within the MTFS.

The Statutory Services Budget Review undertaken by PwC and reported to Cabinet in October validated the financial position as reported through the MTFS and confirmed that even should the County Council reduce its expenditure to the median of lowest quartile by 2020/21 an in-year deficit of £79m would remain. One of the considerations raised within the report was whether the current funding model of the Council is disproportionately contributing to the funding gap. The County Council has continued to lobby Central Government and relevant stakeholders regarding the extreme challenges being faced as a result of the local government finance system.

The most significant financial challenge facing upper tier Local Authorities is Adult Social Care. Additional funding has been provided via the Adult Care Support Grant (£5.543m) in 2017/18 and the flexibility to raise an additional Adult Social Care

precept. Whilst these are a welcome recognition of the significant cost pressures being faced, the Grant is only for one year and together they do not meet the full cost of additional demographic demand and cost pressures within the Care Sector particularly impacted by the National Living Wage.

- **Service Demand**

This is a key risk facing the 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 and waste services continues to see increases despite the impact of demand management measures.

Over the period 2017/18 to 2020/21 £91m has been provided in the MTFS for demand pressures of which c58% relates to adult social care, c24% children's social care and c15% waste services. These have been identified based on current and historical trends and population projections where appropriate (particularly linked to the ageing population in respect of Adult Social Care). Whilst for Adult Social Care the estimates are based on assumptions that have previously been a reasonable prediction of demand, during the current financial year significant and unanticipated increased costs in relation to Children's Social care and Waste have been reported to Cabinet in revenue monitoring reports.

Detailed work is being undertaken in all three areas focused on a better understanding of the causes of the increased demand and what steps can be taken to mitigate the financial impact, which, along with funding reductions, is a major contributing factor towards the funding gap reported in the MTFS.

- **Pay**

The MTFS makes provision for pay of a 1% increase each year. Most of the pay bill will continue to be driven by the national pay agreement and this assumption will be kept under ongoing review. The County Council is committed to paying its employees as an accredited member of the Living Wage Foundation who have announced a 5% increase in the Living Wage. The impact of this initial increase and further 5% increases in subsequent years for those staff directly impacted has been factored into the MTFS. This does not address maintaining current differentials in pay grades which will need to be considered in future years.

- **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 Council has no choice but to pay increased prices e.g. 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 than the methodology previously used. 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.

A particular issue concerns care markets, primarily residential and homecare, the funding of which is recognised as being a significant issue regionally and nationally. Whilst a significant amount of resource has been included within the MTFS to fund price increases and the estimated impact of the national living wage on care providers, there remains capacity and sustainability issues within the market which the Adult Social Care Precept and Adult Care Support Grant will only partly help mitigate given the scale.

- **Savings Programmes Delivery**

The Council is already committed to the delivery of a significant savings delivery programme (c£156m over the period 2016/17- 2020/21) including £12m of new savings agreed at Cabinet in December a number of which relate to the outcome of the zero based budget review of services agreed within the financial strategy. There are inherent risks with savings plans of this scale and scope and any significant under-delivery of agreed savings will create an additional funding gap. This has been identified as one of the highest level risks in the Council's Risk and Opportunity Register and there are comprehensive arrangements in place to track delivery of financial savings and take corrective actions as required.

The Level of Reserves

The Council holds reserves for a number of reasons:

- To enable the Council to deal with unexpected events such as flooding or the destruction of a major asset through fire.
- To enable the Council 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 'right' answer to the question of the appropriate level of 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 will be heavily supported by the reserves that are currently available to the County Council. The value of the Council's reserves is currently significant but are non-recurrent and, bar the County Fund, 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.

The level of risk evident within the budget is clearly increasing as set out in the analysis above at a time when it is clear that the revenue budget will have to be supported significantly by reserves. The setting up of a transitional reserve was a recognition of this requirement and the effectiveness of budgetary control is a combination of both systems and processes and the risk environment within which the Council is operating.

Budgetary control procedures are strong, however, based on the evidence of the current year and given the increased level of financial risk there is a greater risk that the processes in place would not be adequate to reduce any significant overspend over the course of the following years.

In relation to the Council's general reserve (County Fund Balance), the forecast level at 31 March 2017 remains at £36m.

Overall, the Council has an appropriate level of reserves available to manage the financial risks it is facing in 2017/18, but this is unlikely to be the case for 2018/19 and subsequent years. Within the MTFS there is a revised funding gap of £88.040m for 2018/19 and, excluding County Fund and committed reserves but including the projected revenue underspend at the end of quarter 3 of £15.298m, there is estimated to be £86.714m of uncommitted reserves remaining at 1st April 2018.

Even if the 2018/19 gap could ultimately be covered by the use of reserves the forecast funding gap increases to £118.077m in 2019/20. It is therefore critical that a significant level of additional savings are identified which can be delivered in 2018/19 to minimise the scale of reserves required to support the revenue budget. Also, utilisation of those reserves remaining should support, wherever possible, activities which reduce ongoing revenue costs. One of the priority areas for new savings will be in seeking to implement the aim within the current financial strategy of seeking to move to lower quartile cost, of the most appropriate comparator group of local authorities, for all services.

The Council has benefited significantly financially over a number of years from its Treasury Management activity including the investment portfolio, with a projected revenue benefit of £26.756m in 2016/17. It is important to note that one of the consequences of utilising reserves is that this effectively reduces the value of cash backed accounts on the balance sheet which support the investment portfolio. Therefore, based on current planned usage of reserves the size of the portfolio will reduce further significantly and it is reasonable to assume that the scope to generate future gains will also therefore reduce.

Conclusion

Following the ongoing detailed budget monitoring, zero base budget review work, identification of £12m of further budget savings proposals and a detailed review of the current reserves commitments, a balanced budget for 2017/18 with the use of £57.106m of reserves can be recommended. However, this is clearly dependent on all budget options agreed at Cabinet in December 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 also remains a funding gap of £88.040m in 2018/19 and an urgent need to identify proposals for additional savings early in 2017/18 that can be delivered in 2018/19.

Whilst the principle has been agreed of reviewing each and every continuing service using a zero based approach, with reference to our benchmark unit costs, and moving

towards the lowest quartile of the most appropriate comparator group, this will need to make early progress during 2017/18 to meet the 2018/19 shortfall and consider whether a sustainable financial position will be achievable over a longer period. Taking everything into account, there remains a strong likelihood that the Council will, during the course of this financial strategy period (in 2018/19 at the earliest), be in the position of being unable to set a budget which will meet the cost of its statutory responsibilities as they are currently delivered.

Meeting of the Full Council
Meeting to be held on 9 February 2017

Report submitted by the Director of Financial Resources

Part A

Electoral Division affected:
All

Treasury Management Policy and Strategy 2017/18
(Appendices 'A' - 'C' refer)

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Executive Summary

This report outlines the proposed Treasury Management Policy Framework for 2017/18 as required by the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (2011). It includes the County Council's borrowing and investment strategies and the 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.

Recommendation

The Full Council is recommended to:

(i) Approve the Treasury Management Policy as set out at Appendix 'A';
(ii) Approve the Treasury Management Strategy for 2017/18 as set out at Appendix 'B';
(iii) In respect of the Minimum Revenue Provision Statement for 2017/18, set out at Appendix 'C':
   a. Approve the Asset Life method for expenditure funded from unsupported borrowing;
   b. For supported borrowing incurred before 1 April 2007 to use the capital financing requirement based upon a 50 year life;
   c. Approve that charges to revenue be a sum equal to the repayment of any credit liability;
   d. Approve the proposed treatment of assets constructed under the Preston, South Ribble and Lancashire City Deal subject to annual review.

Lancashire County Council

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.

The Minimum Revenue Provision (MRP) is a prudent charge Local Authorities are required to make to the revenue account to provide for the repayment of debt and other credit liabilities (mainly finance leases or PFI contracts).

Consultations

Arlingclose, the County Council's external Treasury Management advisers.

Implications:

This item has the following implications, as indicated:

Risk management

The Council, having adopted the "Prudential Code", is required to prudently manage the investments of the Council. The current situation exposes the Council to heightened counterparty concentration risk inconsistent with its duty. As the process of managing the Council's investments is intrinsic to its continuing operations a prudent yet workable policy is necessary.

List of Background Papers

Paper	Date	Contact/Tel
Arlingclose Ltd. Credit Risk Report	December 2016	Paul Dobson, (01772) 534740
CIPFA Treasury Management Code of Practice	2011	Paul Dobson, (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 aims to fund its capital expenditure in a cost effective manner. This will involve using short term and variable rate loans when these are seen as being the most beneficial strategy. However consideration will be given to the long term funding needs of the County Council and the stability to budgets that fixed interest loans provides. 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 2017/18

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 require the County Council to approve a Treasury Management Strategy before the start of the financial year.

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 and 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 2017/18

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 current structure of the County Council's investment and debt portfolio
- prospects for interest rates and market liquidity

3.1 Economic Forecast

The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. In January The Prime Minister made a speech indicating that Brexit means an exit from the Single Market and the Customs Union however the government will seek a trade deal with the EU for the greatest possible access with full reciprocity. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013. However the Bank is expected see this as a temporary impact of the falling currency. Therefore the inflation overshoots during 2017 are unlikely to result in an increase in interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates. In December 2016 The Federal Open Market Committee (FOMC) of the US Federal Reserve increased the target range for official interest rates. The range was increased to between 0.5% and 0.75%, from 0.25% and 0.5%. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. Challenges such as immigration, the rise of populist, anti-establishment parties seem to exist. During the year French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook

Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

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 European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority with returns from cash deposits continuing to fall.

Prospects for Interest Rates and Market Liquidity

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case on Gilts is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low.

3.2 The Current Structure of the Portfolio

The Council's treasury portfolio (net of transferred debt) as at 31st December 2016 was as follows.

Table 1 Treasury Portfolio as at 31 December 2016

	Principal Amount £m	Current Interest Rate %
Call accounts	9.983	0.25
Local Authority Deposits	46.500	1.76
Gilts & Other Core Bonds	312.408	1.40
Senior Secured Bond Fund	30.000	1.67
Floating Rate Notes (short term liquidity)	132.465	1.38
Total Investments	**531.356**	**1.42**
Short-term loans	339.500	0.59
Long-term loans (Local Authorities)	203.500	1.32
Shared Investment Scheme	65.382	0.24
Long-term PWLB loans	338.850	2.97
Long-term market loans (LOBOs)	51.783	6.35
Total Borrowing	**999.015**	**1.82**
Net Borrowing	**467.659**	**2.27**

The average rate for borrowings included in the current Medium Term Financial Strategy of the Council is 2.02% and the average rate for investments is 0.99% in 17-18.

4. Borrowing Strategy

The Borrowing Strategy of the County Council will be determined by the need of the Authority to borrow and the impact of the economic climate outlined above.

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

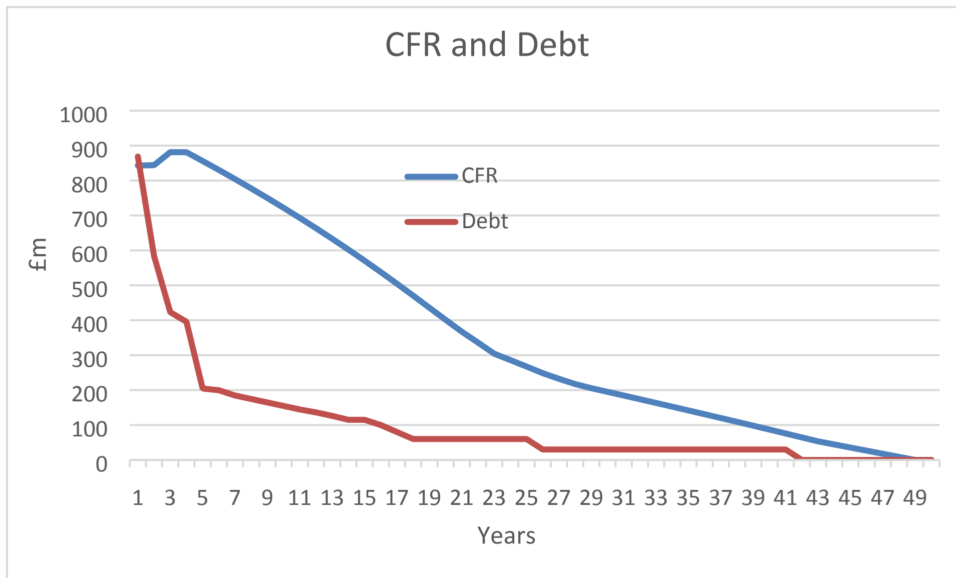
The County Council borrows for capital purposes with the underlying need to borrow for capital purposes being measured by the Capital Financing Requirement (CFR). CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years.

The estimated borrowing requirement in any year will depend upon new borrowing for financing the Capital Programme, replacing existing debt that has matured in the year and the charge made to revenue for the repayment of debt. The position for next three years is as follows:

Table 2: Estimated Borrowing Requirement

	2016/17 Revised £m	2017/18 £m	2018/19 £m	2019/20 £m
Capital Programme Expenditure	**151.510**	**126.184**	**94.993**	**26.081**
Financed by:				
Capital Receipts	0	1.036	0	0
Grants and Contributions	99.151	101.286	35.87	2.479
Revenue Contributions	0	0.727	0	0
Borrowing	**52.359**	**23.135**	**59.123**	**23.602**
Add Maturing Debt to be replaced:				
Long Term PWLB	0	0	-7.500	-7.500
Market Borrowing	67.000	284.500	161.000	27.500
Less Transferred Debt	-1.700	-1.642	-1.586	-1.533
Less Statutory Charge to Revenue (MRP)	-20.046	-21.383	-21.828	-23.871
Total Borrowing Requirement	**97.613**	**284.610**	**189.209**	**18.198**

However, in assessing the need to borrow consideration should be given to the requirement to borrow in the long term. The graph below compares the estimated CFR given the current approved Capital Programme, MRP policy and the debt maturity position at 31 December 2016.



The graph demonstrates that there is a need to borrow over the long term although the amount required reduces over time. There is a large requirement in the early years. This is due to the impact of the approved Capital Programme and the need to replace existing debt as the County Council has followed a policy of taking short term loans to take advantage of existing market conditions. In addition the borrowing for capital there is likely to be borrowing requirements for the shared investment scheme, City Deal and premiums which are outside the CFR.

4.2 Economic position

The County Council's borrowing strategy continues to balance the issues of affordability while ensuring the borrowing needs are met and providing some certainty of cost over the long term.

With short-term interest rates currently lower than long-term rates, it has been more cost effective in the short-term to borrow short-term. Given the economic outlook outlined above increases in interest rates are not forecast in the medium term so this situation is likely to continue. However, there is significant economic uncertainty and rates are at historically low levels. Therefore the benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates may rise. As a result the County Council may borrow additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

There are a range of options available for the borrowing strategy in 2017/18.

- 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 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.
- There is an option to add the LGA's Municipal Bond Agency to the County Council's list of approved borrowing counterparties but this will be subject to approval from the County Council.

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.

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 namely 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;
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.

4.2 Sources of borrowing

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

- Public Works Loan Board
- 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, which is part of the Bank of England and is responsible for the regulation and supervision of around 1,700 banks, building societies, credit unions, insurers and major investment firms
- capital market bond investors either over the counter or through electronic trading platforms

The option remains to add the LGA Municipal Bond Agency and/or 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 to the approved sources of borrowing. These will be subject to Member approval.

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 15 July 2014 to invest £250,000 to become a shareholder in the company which should lead to 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 2017. In order to borrow from the MBA the County Council is required to sign a joint and several guarantee contained within a framework agreement. This agreement has been subject to a report to the Audit and Governance Committee and Full Council.

The County Council on 21 July 2016, referred the proposal to the Audit and Governance Committee for consideration at its meeting on 26 September 2016. The Committee had specifically been requested to consider the potential risks involved and any possible mitigation of those risks.

On 13 October 2016 Full Council noted that, whilst the Committee had recommended Full Council to approve the proposals, further consideration had been given to the proposals and it was resolved that the report be withdrawn until a later date when any outstanding concerns had been resolved.

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.

4.6 *Other borrowing*

In addition, the County Council may borrow for short periods of time to cover unexpected cash flow shortages, to take deposits on the shared investment scheme and to provide cash flow support for the Preston, South Ribble and Lancashire City Deal project. This is to cover the gap between the cost of construction of infrastructure and the payment of contributions from other organisations including the Government and developers. This borrowing is temporary but will be reflected in the Prudential Limits outlined in Annex 'A'.

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

The County Council holds reserves and other cash items on its balance sheet which are invested. In investing these cash balances the County Council follows guidance issued by CIPFA and DCLG which both require the priorities to be:

(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.

6.1 Approved Counterparties

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.

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- with the exception of the UK as outlined below.

Following the referendum vote to leave the European Union the rating agencies have reviewed the United Kingdom's sovereign ratings. Fitch has downgraded the United Kingdom’s sovereign rating by one notch to AA from AA+, and Standard & Poor’s has downgraded their corresponding rating by two notches to AA from AAA. The outlook from both agencies is negative. Moody's have also placed the UK on negative outlook.

Although the current ratings still fall within the current strategy it is not impossible as the BREXIT process proceeds or there is an economic downturn that there will be further downgrades which would result in investments in the UK government Gilts, Treasury Bonds and bodies guaranteed by the UK Government falling outside the Treasury Management policy. This is not a desirable, or given the level of investment in Gilts, a sustainable position. Even if there is a further reduction in the credit rating of the UK the UK Government still represents a safe investment. The government has never defaulted on its payments and as an ultimate solution the Government could prevent insolvency by printing money. Therefore it is proposed that the AA- minimum sovereign rating is not applied to the UK. However, given that this is theoretically increasing risk within the portfolio it is proposed that limits on the holdings by maturity is introduced as follows:

	£m
Maximum 1 year to maturity	500
Maximum maturity up to 1-5 years	300
Maximum maturity 5-10 years	250
Over 10 years	250

The table below shows the approved investment Counterparties and Limits

Table 3 Approved Investments

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	1,300	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
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	500	500	1yr
Repurchase Agreements (Repo/ Reverse Repo)	Other AA-	200	200	1yr
Bond Funds with weighted average maturity maximum 3 years	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 years	AAA Rated	100	250	These investments do not have a defined maturity date.

Instrument	Minimum Credit Rating (blended average)	Maximum individual Investment (£m)	Maximum total Investment (£m)	Maximum Period
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
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.)

In addition the County Council can invest with other local authorities. Following the downgrade of the UK, several local authorities saw a reduction in their ratings. Therefore, consideration has been given to reducing the risk associated with the County Council's investment with other local authorities. Arlingclose, the County Council's Treasury Management advisor, state they are "comfortable with clients making loans to UK local authorities for periods up to four years, subject to this meeting their approved strategy. For periods longer than four years we recommend that additional due diligence is undertaken prior to a loan being made". On this basis it is proposed that the investments to local authorities are limited as follows:
Table 4 Local Authority Investments

	Maximum individual investment (£m)	Maximum total investment (£m)	Maximum period
Up to 4 years	20	250	4 years
Over 4 years	20	100	10 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 the balances are considered on a daily basis and kept as near to zero as possible. The balance on any day is typically below £1million.

6.2 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 was £600 million in 2016/17 but with the anticipated reduction in reserves this is to be reduced to £450m in 2017/18. Investment levels can be made above this with the agreement of the section 151 Officer. This revised limit 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 the 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 would 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:

Table 5: Derivative Options

CLASS	USE	STANDALONE	EMBEDED
Forwards	To fix an interest or inflation 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 (e.g. 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:

Table 6: Derivative counter party

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:

Table 7: Collateral quality Limits

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.

Table 8: Hedge Limits

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 will 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. However the County Council may need to 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 as reflected in the Medium Term Financial Strategy. This is based on the proposed Minimum Revenue Provision policy set out in Appendix 'C'.

Table 9: Treasury Management Medium Term Financial Strategy

	Revenue Budget 2016/17 £m	Revenue Budget 2017/18 £m	Revenue Budget 2018/19 £m	Revenue Budget 2019/20 £m
Minimum Revenue Provision (MRP)	20.046	21.383	21.828	23.871
Interest Paid	24.948	26.774	27.886	27.315
Interest Earned	-11.410	-10.524	-10.733	-10.842
Grants Received	-0.260	-0.240	-0.240	-0.240
Total	33.324	37.393	38.741	40.104

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. Provision has also been made for changing some of the borrowing to a long term fixed rate rather than the existing short term rates.

The position will be closely monitored by the section 151 officer and any changes to the external view will be reflect in a revised Finance Charges forecast and included in any monitoring or MTFS reports presented 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)

2016/17	2017/18	2018/19	2019/20
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:

2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
186.077	151.510	126.184	94.993	26.081

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.

2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
978.363	1,006.001	1,002.377	1,034.997	1,030.053

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:

2016/17	2017/18	2018/19	2019/20
Estimate	**Estimate**	**Estimate**	**Estimate**
%	**%**	**%**	**%**
4.64	5.19	5.33	5.38

The Capital Programme is still being considered by the County Council and is not yet finalised. The indicators have been calculated including the cost of financing the borrowing already included in the Programme. It assumes that any further new starts will be funded and borrowing is not required. It is estimated that the Council Tax impact of the Programme will be:

2017/18	2018/19	2019/20
Estimate	**Estimate**	**Estimate**
£	**£**	**£**
5.94	5.42	10.69

Any programmed financing from revenue is included in the figures however 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:

	£
2017/18	3.88
2018/19	5.42
2019/20	10.69

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, proposed that this is an overall limit but the section 151 Officer can approve a switch between borrowing and other long term liabilities.

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:

	2016/17 Revised	2017/18	2018/19	2019/20
	£m	**£m**	**£m**	**£m**
Borrowing	1,100	1,100	1,150	1,150
Other long term liabilities	200	200	200	200
TOTAL	1,300	1,300	1,350	1,350

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 are:

	2016/17 Revised	2017/18	2018/19	2019/20
	£m	**£m**	**£m**	**£m**
Borrowing	1,050	1,075	1,100	1,090
Other long term liabilities	170	170	170	170
TOTAL	1,220	1,245	1,270	1,260

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:

	£m
2016/17	35.650
2017/18	34.008
2018/19	32.421
2019/20	30.889

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 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020
	£m	**£m**	**£m**	**£m**
Borrowing CFR	**842.931**	**843.982**	**881.277**	**881.008**
Loans Borrowed (31March estimate)	1,007.207	1,003.316	1,035.724	1,029.623
Borrowing Above CFR	**164.276**	**159.334**	**154.447**	**148.615**
Comprising:				
Premiums	45.000	42.000	39.000	36.000

Shared Investment Scheme	85.000	85.000	85.000	85.000
Transferred Debt	35.650	34.008	32.421	30.889
Total	165.650	161.008	156.421	151.889

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 2016
	£m	£m
Net Interest Payable at Fixed Rates	50.4	9.7
Net Interest Payable at Variable Rates	5.0	3.2
One year impact of a 1% rise in rates	10.0	1.6

Maturity structure of debt

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

	Upper Limit %	Dec 2016
Under 12 months	75%	9%
12 months and within 2 years	75%	37%
2 years and within 5 years	75%	27%
5 years and within 10 years	75%	7%
10 years and above	50%	20%

Investments over 364 days

Limit on the level of long term investments helps to control liquidity, although the majority of these investments are held in available for sale securities. The limit is an

operational one and if required can be exceeded with the approval of the Chief Financial Officer. The proposed operational limit is

	Upper limit
	£m
Operating Limit Total invested over 364 days	450

Minimum Average Credit Rating

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

	Benchmark	**Dec 2016**
Average counterparty credit rating	A+	AA+

Appendix 'C'

Minimum Revenue Provision Statement 2017/18

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

Assets held under a PFI contract 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. From 2015/16 the charge has still been made in reference to the capital financing requirement but 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. It is proposed to continue this policy in 2017/18.

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. 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 new assets 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, Full Council is recommended to:

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