Cabinet
Meeting to be held on 4 February 2016

Report of the Interim Director of Financial Resources

Electoral Divisions affected: All

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

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Executive Summary

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

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

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

Recommendations

Cabinet is asked to:

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

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

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

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

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

Background and Advice

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

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

Minimum Revenue Provision

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

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

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

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

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

Debt accrued post 1 April 2008

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

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

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

Debt accrued pre 1 April 2008

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

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

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

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

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

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

MRP Policy

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

Consultations

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

Implications:

This item has the following implications, as indicated:

Risk management

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

List of Background Papers

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

Reason for inclusion in Part II, if appropriate

N/A