Full Council

Thursday, 13th February, 2020, on the rising of the Extraordinary General Meeting, in the Council Chamber, County Hall, Preston.

Agenda

Index

Angie Ridgwell
Chief Executive and
Director of Resources

County Hall
Preston

05 February 2020

Lancashire County Council

Agenda Item 3

Meeting of the Full Council
Meeting to be held on Thursday, 13 February 2020

Report submitted by: the Cabinet and Audit, Risk and Governance Committee

Part A

Electoral Divisions affected:
(All Divisions);

Revenue Budget 2020/21 and Financial Strategy 2020/21 to 2023/24
Capital Delivery Programme 2020/21
Capital Strategy 2020 - 2040
Council Tax and Precept 2020/21
Treasury Management Strategy and Non-Treasury Investment Strategy 2020/21
(Appendices 'A', 'B', 'C', 'D' and 'E' refer)

Contact for further information:
Angie Ridgwell, (01772) 536260, Chief Executive and Director of Resources
angie.ridgwell@lancashire.gov.uk

Executive Summary

To consider the recommendations of the Cabinet on 6 February 2020 regarding:

1. The revenue budget 2020/21 and financial strategy 2020/21 to 2023/24: section 1 of this report and Appendix A;

2. The capital delivery programme 2020/21: section 2 of this report and Appendix A;

3. The capital strategy 2020-2040 section 3 of this report and Appendix B; and

4. The council tax and precept 2020/21: section 4 of this report.

5. The treasury management strategy and non-treasury investment strategy and the minimum revenue provision policy statement for 2020/21, as recommended by the Audit, Risk and Governance Committee at its meeting on 27 January 2020 Appendices C, D & E

6. An increase to the Authorised Borrowing Limit from £1,375m to £1,600m for the remainder of the 2019/20 financial year, as recommended by the Audit, Risk and Governance Committee at its meeting on 28 October 2019.

Lancashire County Council

Recommendation

The Full Council is asked to consider the proposals of the Cabinet from its meeting on 6 February 2020 and then approve:

- The revenue budget for 2020/21 and financial strategy 2020/21 to 2023/24;
- The capital delivery programme for 2020/21;
- The capital strategy 2020-2040
- The council tax requirement and precept for 2020/21

The Full Council is asked to consider the proposals of the Audit, Risk and Governance Committee from its meeting on 27 January 2020 and then approve:

- The treasury management strategy, non-treasury investment strategy and minimum revenue provision policy statement 2020/21 (as set out at Appendices C, D & E).

The Full Council is asked to consider the proposals of the Audit, Risk and Governance Committee from its meeting on 28 October 2019 and then approve:

- An increase to the Authorised Borrowing Limit from £1,375m to £1,600m for the remainder of 2019/20 financial year.

The Full Council is asked to note and have regard to the advice of the Chief Executive and Director of Resources in relation to the robustness of the budget and the adequacy of reserves.

Consultations

As part of the budget process the contents of the report to cabinet has been subject to a consultation with a variety of stakeholders and partners, including with the trade unions.

For the budget consultation, an email was sent out on behalf of the county council on 28 January 2020 outlining the proposal for Council Tax and an Adult Social Care Precept and containing a link to the relevant reports with respondents then able to e-mail or send in their written feedback. The closing date for the consultation was 12 February 2020, and responses will be shared at the meeting. We recognise that this is a short timeframe to consult, but the timing of the consultation has been impacted by the General Election held in December 2019 and there being very little to consult on by way of new budget reductions for this year.

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

Paper	Date	Contact/Tel
None		

Reason for inclusion in Part II, if appropriate

N/A

Report of the Cabinet

This report for Full Council has been published in advance of the meeting of the Cabinet on 6 February, therefore Full Council will be advised of any changes to Cabinet's recommendations at the meeting that are shown below.

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

1. The revenue budget 2020/21 and financial strategy 2020/21 to 2023/24: section 1 of this report and Appendix A;

2. The capital delivery programme 2020/21: section 2 of this report and Appendix A; and

3. The Council Tax and Precept 2020/21: section 3 of this report.

1. Revenue Budget 2020/21

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. In reports throughout the financial year to cabinet, it is clear that the council is remains committed to the delivery of a significant savings programme (c£58m over the period 2020/21 to 2022/23). There are inherent risks with saving plans of this scale and scope and any significant under-delivery of agreed savings will further increase the 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. Following the Provisional Settlement and the announcement of additional funding for social care and the flexibility to raise an Adult Social Care Precept, the council is able to set a balance budget without recourse to reserves.

Revenue Budget 2020/21	Net Budget £m
Adult Services	365.591
Chief Executive Services	16.317
Children's Social Care	149.510
Corporate Services	18.790
Education and Skills	49.546
Finance Services	42.154
Growth, Environment and Planning	4.787
Waste Management	65.956
Highways and Transport	63.436
Public Health and Wellbeing	1.155
Strategy and Performance	33.903
Sub-Total	**811.145**
Financing Charges	27.455
Available resources	6.251
Revenue budget 2020/21	**844.851**

2. Capital Programme Delivery 2020/21

The Cabinet recommends the adoption of the proposals for the capital programme delivery 2020/21 as set out at Appendix A.

3. Capital Strategy 2020-2040

The Cabinet recommends the adoption of the proposals for the capital strategy 2020-2040 as set out at Appendix B.

4. Council Tax and Precept 2020/21

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 2020/21.

a) Budget, Council Tax Requirement and Precept for 2020/21:

That the band D council tax for 2020/21 is increased by:

- 2% for the adult social care precept being an annual increase of £26.93 for band D council taxpayers.

- 1.99% for general council tax being an annual increase £26.80 for band D council taxpayers.

This gives an overall position of:

	£m
Budget Requirement	**844.851**
Less Revenue Support Grant	33.430
Less Business Rates	202.318
Less New Homes Bonus	3.503
Less Improved Better Care Fund	45.532
Less Social Care Grant	33.417
Less Collection Fund Surplus	7.003
Equals council tax cash	**519.648**
Divided by tax base	371,092.21
Gives Band D council tax for 2020/21	£1,400.32
2019/20 council tax	£1,346.59
Percentage increase	**3.99%**

b) Council Tax (on the basis of a budget requirement of £844.851m and the Council Tax base for each property valuation band:

Council Tax Band	**£**
Band A	933.55
Band B	1,089.14
Band C	1,244.73
Band D (basic)	1,400.32
Band E	1,711.50
Band F	2,022.68
Band G	2,333.87
Band H	2,800.64

c) The share for each district council of the net total raised from the council tax of £519,647,844:

District	**£**
Burnley	32,745,083
Chorley	52,425,908
Fylde	42,904,404
Hyndburn	29,333,903
Lancaster	58,393,344
Pendle	33,968,402
Preston	54,772,116
Ribble Valley	33,079,759
Rossendale	28,895,603
South Ribble	50,514,724
West Lancashire	50,382,015
Wyre	52,232,580
Total raised from the Council Tax	**519,647,844**

Geoff Driver CBE
Leader of the Council
County Hall, Preston

The County Council's Revenue Budget and Council Tax for 2020/21 and Capital Delivery Programme for 2020/21

1. Introduction

The council has faced an unprecedented period of financial challenge since austerity began in 2010. Like all councils, we are facing financial pressures across the period of our medium term financial strategy. Whilst good progress has been made to date in addressing the forecast financial shortfall over the strategy period as a result of significant savings programmes and the improved funding envelope for social care, further work is required to ensure the council can achieve a financially sustainable position over the medium term.

In reports throughout the financial year to cabinet, it is clear that the council is committed to the delivery of a significant savings programme (c£58m over the period 2020/21 to 2022/23) primarily agreed in the 2019/20 budget cycle following the initial service challenge process.

We are now investigating the scope for further savings. The initial service challenge process necessarily focused on individual service reviews supported by benchmarking data which identified a number of areas where the council was high cost compared to a number of other county councils. The aim was to deliver the same or better outcomes at reduced cost wherever possible and phase 1 of the service challenge process identified a range of savings proposals which were included both within the 2019/20 budget and the MTFS position.

Phase 1 also identified a number of cross-cutting work streams and areas for investigation and review which is being taken forward as part of the service challenge phase 2 process. These work streams are more complex, requiring a fundamental challenge of, in many cases, longstanding organisational wide approaches, systems and processes to enable both service improvements and cost savings to be identified. Work is progressing on phase 2 with demand management, commissioning, organisational development, property management, commercialisation, schools traded services, transport and digital being key areas of focus. Projects on these areas and the savings options will be shared with cabinet for consideration as and when available and when timescales for their delivery are agreed. Relevant projects will be a focus for relevant finance monitoring boards as appropriate.

There are inherent risks with saving plans of this scale and scope and any significant under-delivery of agreed savings will further increase the 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.

Should any of our existing savings proposals ultimately not be achieved they will need to be replaced with alternative savings to avoid increasing the size of the funding gap.

The medium term financial strategy (MTFS) includes government funding as announced in the provisional settlement on 20th December 2019, and we await the final settlement which is expected in mid-February 2020.

The announcement confirmed that there would be a one year settlement in 2020/21 and that the fair funding review would be delayed until April 2021. There are no funding levels confirmed post 2019/20. Assumptions have therefore been made based on the provisional finance settlement for funding levels from 2020/21 – 2023/24.

During 2020, a multi-year spending review will take place which will allow more time for the impact of funding changes to be effectively planned for.

The provisional settlement confirmed that 2020/21 would effectively be 'rolled over' from 2019/20, giving councils the stability they need to set a budget.

In the provisional settlement, the Chancellor announced that councils will have access to new social care funding of £1.5bn in 2020/21. This consists of grant funding and up to a 2% adult social care precept.

The provisional settlement also confirmed that revenue support grant would continue at 2019/20 inflated amounts, and that the social care funding allocated in 2019/20 would continue into 2020/21. It was also confirmed that the 2019/20 75% business rates pilots would not continue into 2020/21

The MTFS reported to cabinet in February 2020 included a 2% adult social care precept in 2020/21 as a result of flexibilities offered by Government. This flexibility is not currently being offered in subsequent years.

From 2021/22 onwards, it is therefore assumed that the maximum increase will revert back to 1.99%, as the option to raise an adult social care precept will no longer be available. Council tax increases are subject to a full council decision each year when setting the budget, but any decisions taken not to increase council tax as per the assumptions above would increase the financial gap.

Taking account of updated resources information a balanced budget position with no recourse to reserves is forecast for 2020/21. However, this is clearly dependent on all service challenge savings agreed and delivered fully within the timeframes identified, along with the other savings agreed in previous budget cycles.

There also remains an overall funding gap of £33.299m by 2023/24. Current forecasts indicate that that there will be sufficient funds within the transitional reserve to support the identified budget gap through to and beyond 2023/24. However the intention is to identify further savings and thereby reduce any call on the transitional reserve, for 2021/22 and beyond.

This report presents for consideration by the full council the recommendations of the cabinet for:

- The revenue budget for 2020/21;
- A revised capital delivery programme for 2020/21;
- The council tax and precept for 2020/21.

In addition the report sets out the advice of the Chief Executive and Director of 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.

Reports will be provided regularly to cabinet in 2020/21 to update the financial position for the county council based on the latest information.

2. The Budget Process

The county council's approach is driven by a formal requirement to deliver a balanced budget in 2020/21. This needs to be undertaken whilst recognising the position for future years. The cabinet has considered the budget for 2020/21 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 Revenue Budget 2020/21 to 2023/24

The county council's medium term financial strategy (MTFS) was approved by full council in February 2019 covering the 2019/20 budget and the forecast position for 2020/21 to 2022/23. This identified the funding gap in each year as follows:

Table 1

Aggregated Funding Gap	2019/20	2020/21	2021/22	2022/23
2019/20 (£m)	10.245	10.245	10.245	10.245
2020/21 (£m)		20.125	20.125	20.125
2021/22 (£m)			5.518	5.518
2022/23 (£m)				11.438
Total	**10.245**	**30.370**	**35.888**	**47.326**

During 2019/20 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 including an additional year of 2023/24. The latest MTFS shows a revised spending gap of £33.299m. The profile of the funding gap is shown in table 2:

Table 2

Aggregated Funding Gap	2020/21	2021/22	2022/23	2023/24
2020/21 (£m)	-6.251	-6.251	-6.251	-6.251
2021/22 (£m)		7.926	7.926	7.926
2022/23 (£m)			13.548	13.548
2023/24 (£m)				18.076
Total	**-6.251**	**1.675**	**15.223**	**33.299**

Although the financial gap has reduced, from the £47.326m reported last February, the county council's budget is still facing a challenging future with savings of £58m to achieve as part of the 2020/21 budget and beyond, with significant additional pressures. These include the impact of the national pay award, national living wage and inflationary and demand pressures across children's social care and adult social care.

4. The level of resources available to support the 2020/21 revenue budget

The level of resources reflected in the MTFS for 2020/21 and future years is as follows:

Table 3

	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m
Revenue Support Grant	33.430	33.430	33.430	33.430
Business Rates	202.318	200.947	203.182	205.453
Council Tax	519.648	538.999	559.070	579.889
New Homes Bonus	3.503	2.405	1.635	0.799
Better Care Fund	45.532	45.532	45.532	45.532
Social Care Grant	33.417	33.417	33.417	33.417
Collection Fund Surplus	7.003	3.750	3.750	3.750
Total	**844.851**	**858.480**	**880.016**	**902.270**

As the final settlement has not been announced, these figures reflect the provisional settlement and have been adjusted for the impact of the final council tax base figures and surplus and deficit position (across council tax and business rates collection funds) as discussed below.

4.1 The resources received through the local government finance settlement

The Secretary of State announced the provisional local government finance settlement on 20th December 2019, and at the time of writing the final settlement has not been announced. This is expected in mid-February. It is important to note that the settlement only covers the period up to 2020/21, therefore assumptions have been made for 2021/22 onwards. It is currently anticipated that a new system of local government finance will be in place in 2021/22, which involves local government retaining 75% of the business rates and a review of the funding formula. However, details of the scheme and the impact on Lancashire are not known at this stage.

4.2 Council Tax in 2020/21

On 6th February 2020 cabinet recommended to full council that Band D council tax for 2020/21 has a 3.99% increase, including 2% to be used for the adult social care precept. The council tax figures within the MTFS include the impact of a 3.99% increase in council tax in 2020/21, 1.99% increase in 2021/22, 2022/23 and 2023/24.

There is a requirement for section 151 officers in those authorities levying the adult 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.

As part of the budget setting process district councils must confirm both the council taxbase and the surplus/deficit on the collection fund by 31st January 2020. The information provided by district councils has resulted in a tax base increase of 1.18% for 2020/21. This is less than the taxbase growth that has been built into the MTFS, therefore the reduced growth has been reflected in this report, with reduced funding of £2.699m. The growth for future years remains at 1.7% with future year council tax base increases kept under review with district councils.

As part of the budget setting process district councils must confirm the surplus/deficit on the council tax collection fund by 31st January 2020. The information received from district councils state that a surplus has been achieved on the council tax collection fund of £6.036m. This has therefore been included in the funding position for 2020/21.

4.3 Business Rates in 2020/21

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 £202.318m from business rates. This amount is an improvement on the forecast and includes an estimated £0.680m the authority should receive as part of the Lancashire Business Rates Pool.

As part of the budget setting process district councils must confirm the surplus/deficit on the business rates collection fund by 31st January 2020. The information received from district councils state that a surplus has been achieved on the business rates collection fund of £0.967m. This has therefore been included in the funding position for 2020/21, and is an improvement of £0.429m from the amount reported in the Quarter 3 MTFS.

4.4 Specific Grants and contributions to be received by the County Council in 2020/21

The following table summarises the more significant specific grants to be received by the council in 2020/21:

Table 4

Grant	Estimated Allocation 2020/21 £m	Description
Improved Better Care Fund	45.5	The Better Care Fund is a pooled budget to help improve the integration of health and care services.
Public Health	66.6 (unconfirmed)	Ring fenced funding only able to be spent in accordance with the conditions of the grant.

4.5 Reserves

The latest reserves position agreed by Cabinet is shown in Table 5 this does not include the impact of the forecast revenue outturn.

Table 5

Reserve Name	Opening balance 2019/20	2019/20 Forecast Expenditure	Forecast Contribution to/from Reserves (Other Revenue e.g. Schools)	2019/20 forecast transfers to/from other reserves	Forecast Closing balance 2019/20	2020-21 Forecast Spend	2021-22 Forecast Spend	Forecast closing balance 31 March 2022
	£m	£m	£m	£m	£m	£m	£m	£m
County Fund	-23.437	0.000	0.000	0.000	-23.437	0.000	0.000	-23.437
SUB TOTAL - COUNTY FUND	**-23.437**	**0.000**	**0.000**	**0.000**	**-23.437**	**0.000**	**0.000**	**-23.437**
Strategic Investment Reserve	-2.096	-1.491	0.000	0.000	-3.586	2.305	0.246	-1.036
Downsizing Reserve	-7.445	4.605	0.000	0.000	-2.840	2.840	0.000	0.000
Risk Management Reserve	-2.804	1.241	0.000	0.000	-1.562	0.763	0.800	0.000
Transitional Reserve	-164.254	16.278	0.000	-0.013	-147.989	3.086	0.244	-144.659
Service Reserves	-13.251	7.846	0.000	-2.266	-7.671	5.959	0.921	-0.791
Treasury Management Reserve	-10.000	0.000	0.000	0.000	-10.000	0.000	0.000	-10.000
SUB TOTAL - LCC RESERVES	**-199.849**	**28.479**	**0.000**	**-2.279**	**-173.648**	**14.953**	**2.211**	**-156.485**
Schools/Non-LCC Service Reserves	-17.528	1.740	0.000	0.000	-15.788	-0.018	1.790	-14.015
SUB TOTAL SCHOOLS/NON LCC RESERVES	**-17.528**	**1.740**	**0.000**	**0.000**	**-15.788**	**-0.018**	**1.790**	**-14.015**
GRAND TOTAL	**-240.814**	**30.219**	**0.000**	**-2.279**	**-212.873**	**14.935**	**4.001**	**-193.937**

The county fund shown at the top of table 5 is the balance set aside to cover the authority against a serious emergency situation (e.g. widespread flooding); a critical and unexpected loss of income to the authority and for general cash flow purposes. In considering these various factors the county council is forecast to maintain its County Fund balance at £23.437m.

The value of the uncommitted transitional reserve is currently forecast to be £144.659m by the end of March 2022 providing there is no requirement for structural funding support from reserves to the 2020/21 or 2021/22 budgets.

The current forecast position for 2019/20 outturn has not been reflected in the transitional reserve position.

The transitional reserve is forecast to be sufficient to meet the identified funding gaps through to and beyond 2023/24 as set out in table 6. However, the intention is to identify further savings to reduce the gap, and hence the call on reserves, in the future.

Table 6

Transitional Reserve	2020/21	2021/22	2022/23	2023/24
Opening Balance	147.989	151.154	149.235	134.012
Gap funding	-6.251	1.675	15.223	33.299
Commitments	3.086	0.244	0.000	0.000
Closing balance	**151.154**	**149.235**	**134.012**	**100.713**

Whilst the forecast for 2020/21 shows available resources of £6.251m there is currently a forecast provision to utilise these resources in 2020/21 to support the organisational improvement journey review work which is currently underway.

5. The Overall Revenue Budget Position for 2020/21

5.1 Summary of cabinet's revenue budget proposals

The overall impact of the cabinet's recommendations to full council for the 2020/21 revenue budget and the potential changes are set out in Table 7.

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 2020/21; and
- the provision of estimated figures by the city and borough councils in respect of council tax base and business rates income.

Table 7

	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m	Total £m
Spending Gap as reported to Cabinet (Quarter 2)	**0.000**	**-5.188**	**14.150**	**19.477**	**28.438**
Add change to forecast of spending:					
Pay & Pensions	-1.195	0.222	-0.042	0.385	**-0.630**
Inflation and Cost Changes	2.104	-0.216	-0.209	-0.057	**1.622**
Service Demand and Volume Pressures	-1.874	-0.999	-0.565	-0.917	**-4.355**
Other	0.372	0.204	-0.144	0.000	**0.432**
Additional Grant	-3.098	1.147	1.070	0.881	**0.000**
Savings Adjustments	0.100	0.100	0.100	-0.300	**0.000**
Total Change to Forecast of Spending	**-3.591**	**0.458**	**0.210**	**-0.008**	**-2.931**
Change to forecast of resources:					
Funding	-0.453	10.463	-0.812	-1.393	**7.805**
Total Change to Forecast of Resources	-0.453	10.463	-0.812	-1.393	**7.805**
Revised Funding Gap reported to Cabinet 6th February 2020 (Quarter 3)	**-4.045**	**5.733**	**13.548**	**18.076**	**33.312**
Funding Update	-2.206	2.193	0.000	0.000	**-0.013**
Expenditure Update	0.000	0.000	0.000	0.000	**0.000**
Revised Funding Gap	**-6.251**	**7.926**	**13.548**	**18.076**	**33.299**

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5.2 Revenue Budgets for Services in 2020/21

The budget outlined below results in a net revenue budget of £844.851m. The budget by service is summarised below:

<u>Table 8</u>

Revenue Budget 2020/21	Net Budget £m
Adult Services	365.591
Chief Executive Services	16.317
Children's Social Care	149.510
Corporate Services	18.790
Education and Skills	49.546
Finance Services	42.154
Growth, Environment and Planning	4.787
Waste Management	65.956
Highways and Transport	63.436
Public Health and Wellbeing	1.155
Strategy and Performance	33.903
Sub-Total	**811.145**
Financing Charges	27.455
Available Resources	6.251
Revenue budget 2020/21	**844.851**

6. The Capital Delivery Programme

This section of the report sets out the following:

- An outline of the 2020/21 capital delivery programme including known projects; and
- A summary of the proposed funding of the 2020/21 capital delivery programme and the revenue implications of the increased use of prudential borrowing.
- An indicative capital delivery programme for the 2 further years 2021/22 and 2022/23

6.1 Capital Delivery Programme for 2020/21

Table 9 below details a summary of the proposed capital delivery programme for 2020/21 with indicative programmes for the further two years.

The proposals for 2020/21 include the provisions to complete works already in the programme, those already approved for inclusion, and those identified for utilising the capital grant funding to be received in 2020/21.

The proposals for 2021/22 and 2022/23 are indicative based on the likely grant funding to be received and will be developed fuller through 2020/21.

Table 9

	2020/21 delivery budget	**2021/22 delivery budget**	**2022/23 delivery budget**
	£m	**£m**	**£m**
Schools	27.089	36.791	24.201
CYP	4.382	0.000	0.000
Highways	40.121	3.455	3.455
Transport	15.302	10.053	0.000
Externally Funded	6.574	1.471	1.456
Waste and Other	0.000	0.000	0.000
Adults	16.231	14.731	14.731
Corporate	19.243	29.000	6.000
Vehicles	4.600	3.000	3.000
Total Delivery Plan	**133.542**	**98.501**	**52.843**

The programmes and projects within the above blocks will be developed fully before the start of the new financial year and will be taken to cabinet for approval before work commences.

6.2 Proposed Funding

The capital delivery programme is currently funded by a variety of funding streams, the funding by block for each of the 3 years is shown below

Table 10

	Draft 2020/21 delivery budget	**Draft 2021/22 delivery budget**	**Draft 2022/23 delivery budget**
	£m	**£m**	**£m**
Borrowing	26.472	35.455	12.455
Grant	91.796	60.508	38.932
Contributions	15.274	2.538	1.456
Total Funding	**133.542**	**98.501**	**52.843**

6.3 Revenue Implications

The table below identifies how the revenue budget implications for financing charges are reflected within the medium term financial strategy.

Table 11

	2020/21 **£m**	**2021/22** **£m**	**2022/23** **£m**
Minimum Revenue Provision	14.936	16.316	17.389
Interest Paid	24.962	24.768	23.104
Grants Received	-0.200	-0.200	-0.200
Total	**39.698**	**40.884**	**40.293**

The revenue budget above reflects a position which takes account of the views of both internal and external advisers, 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 in 2020/21.

The position will be closely monitored by the Director of Finance and any changes will be reflected in forecasts presented to cabinet.

7. Council Tax for 2020/21

The recommendation of the cabinet to full council on the council tax requirement is that the band D council tax for 2020/21 be increased by 3.99% which includes the 2% social care precept. The impact of these increases are:

Table 12

	Band D Council Tax	Council Tax income
Adult Social Care Precept increase at 2%	£26.93	£9.994m
General Council Tax increase at 1.99%	£26.80	£9.944m

The overall position is summarised as follows:

Table 13

	£m
Budget Requirement	**844.851**
Less Revenue Support Grant	33.430
Less Business Rates	202.318
Less New Homes Bonus	3.503
Less Improved Better Care Fund	45.532
Less Social Care Grant	33.417
Less Collection Fund Surplus	7.003
Equals council tax cash	**519.648**
Divided by tax base	371,092.21
Gives Band D council tax for 2020/21	£1,400.32
2019/20 council tax	£1,346.59
Percentage increase	**3.99%**

8. 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 Chief Executive and Director of 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.

The table below demonstrates the scale of just a small variance in the assumptions made, showing the potential impact of both a positive and negative movement of 1% across the main areas within the MTFS:

	Potential Full - Year Impact (£m)
Funding - Council Tax (1%)	+/- 5.196
Pay (1%)	+/- 2.758
Price Inflation (1%)	+/- 4.974
Demand (1%)	+/- 6.030

A number of specific risks remain within the budget as follows:

- **Government Funding**

The funding included within this report reflects the provisional settlement for 2020/21 that was announced on 20th December 2019. The announcement confirmed that there would be a one year settlement in 2020/21 and that the fair funding review would be delayed until April 2021. There are no funding levels confirmed post 2019/20. Assumptions have therefore been made based on the provisional finance settlement for funding levels from 2020/21 – 2023/24.

During 2020, a multi-year spending review will take place which will allow more time for the impact of funding changes to be effectively planned for.

The provisional settlement confirmed that 2020/21 would effectively be 'rolled over' from 2019/20, giving councils the stability they need to set a budget.

In the provisional settlement, the Chancellor announced that councils will have access to new social care funding of £1.5bn in 2020/21. This consists of grant funding and up to a 2% adult social care precept.

The provisional settlement also confirmed that revenue support grant would continue at 2019/20 inflated amounts, and that the social care funding allocated in 2019/20 would continue into 2020/21. It was also confirmed that the 2019/20 75% business rates pilots would not continue into 2020/21.

As a result of the uncertainty of future funding during Q2 we carried out some scenario analysis around possible funding profiles. In total 9 scenarios were modelled (this is not an exhaustive analysis of all funding options but consisted of the most obvious measures which could be taken) which resulted in forecast funding gaps between a surplus of £6m to a deficit of £85m. Following a review of these scenarios by the corporate management team, including the consideration of advice from external advisors, a core and most likely funding scenario on which to base the medium term financial strategy was agreed and this scenario remains the most appropriate for the MTFS.

As a result of the above the assumptions around funding are that:

- Revenue support grant or funding at the equivalent value through any new fair funding formula will be ongoing for the currency of this plan
- An adult social care precept of 2% will be levied in 2020/21 only
- The social care grant announced in the provisional settlement will continue for the length of the parliament which covers the MTFS period and beyond.

At the time of writing the final settlement has yet to be confirmed. The settlement is likely to be published before parliament rises for half term and so this is expected in mid-February.

- **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 continue to see increases despite the impact of demand management measures and additional funds being built into the budget to reflect forecast pressures.

Over the period 2020/21 to 2023/24 £63m has been provided in the MTFS for demand pressures of which £47.3m relates to adult social care and £11.7m children's social care. 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).

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

- **Pay**

The majority of the pay bill is driven by the national pay agreement. A 2% increase has been factored into the 2020/21 budget and subsequent years MTFS (2021/22, 2022/23 & 2023/24). The county council also remains committed to paying its employees as an accredited member of the Living Wage Foundation, who have announced a 3.33% increase in the living wage. The impact of this initial increase and further 2.90% (2021/22, 2022/23 & 2023/24) increases in subsequent years for those staff directly impacted has been factored into the MTFS.

- **Inflation**

The Monetary Policy Committee (MPC) of the Bank of England has been set an inflation target by the Government of 2% as measured by Consumer Prices Index (CPI). The CPI has been below this level since August 2019 decreasing further to 1.3% in December 2019. The Bank of England anticipate that inflation will be within target in the medium term.

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 or the need to absorb additional inflationary costs in year.

A particularly significant area is the care market, primarily residential, nursing and homecare, the funding of which is recognised as a significant issue regionally and nationally. 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. Given the government's commitment to raise the national living wage to £10.50 by the end of this parliament should economic conditions permit, we will need to monitor the rate at which the national living wage grows and whether there is any additional funding to support this growth. It is fair to say that we would anticipate additional funds would need to be made available to meet these costs. Our current assumption is that we will see net growth of 3.06% per annum in years 2021/22 onwards. This compares with the 6.1% increase announced in December 2019. Should the net impact of any future increase be greater than forecast then there will be an increased pressure in the budget of c£2.200m for each additional 1%.

- **Interest Rates**

The Bank of England base rate remains stable at the rate set in August 2018 of 0.75%.

The base rate continues to be at historically low levels and the Bank of England has maintained expectations for slow and steady rate rises in line with the performance of the economy. The county council's treasury advisors predict stable interest rates for the foreseeable future.

- **Savings Programme Delivery**

The council is committed to the delivery of a significant savings programme (c£58m over the period 2020/21 to 2022/23). There are inherent risks with saving plans of this scale and scope and any significant under-delivery of agreed savings will further increase the 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.

Adequacy 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, and
- 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, and
- the degree to which funds have already been set aside for specific purposes which will reduce the need for general reserves.

In relation to the council's general reserve (County Fund Balance), the forecast level at 31 March 2020 is £23.437m. In addition the council continues to hold £10m as a formal treasury management reserve to reflect that, whilst the council's treasury management performance (covering both investment activity and financing costs) has been positive over an extended period, the outlook post-Brexit is particularly uncertain and volatile. The reserve is there hedge against that volatility, including interest rate changes and associated risks over the short-term without directly impacting the revenue account.

The 2019/20 revenue budget has been supported by £10.245m of reserves. This is significantly improved position when compared with the 2017/18 & 2018/19 financial years which were supported by £57.106m and £47.619m respectively. With the 2020/21 budget set without recourse to reserves this is a much more positive outlook, although we recognise there remains a structural funding gap in the later years of our medium term financial strategy. The value of the council's uncommitted transitional reserve by the end of the financial year is currently forecast to be £144.659m, although this is before the effect of the 2019/20 final outturn position.

The level of risk evident within the budget has been significant in recent years and remains so. The council acknowledges that it needs to move to a sustainable financial position and also that this will take time to implement. The transitional reserve allows decisions to be made in a more measured and considered way but does not of itself negate the need for a sustainable budget to be achieved. While the council's budgetary control procedures are strong in terms of managing in year expenditure, the effectiveness of budgetary control is a combination of systems and processes as well as the risk environment within which the council is operating. It therefore remains an essential requirement that the council continues to ensure that processes are effective in managing in year expenditure and also that there is a clear focus on delivering a balanced and sustainable budget.

As part of the preparation of the MTFS, scenario analysis and stress tests of the current financial gap and reserves position have been undertaken. Given the uncertainty surrounding government funding arrangements beyond 2020/21 a range of potential funding scenarios were identified with the most likely one selected utilising advice from leading sector funding specialists. On the basis of the most likely funding scenario which forms the basis of the current MTFS there are sufficient reserves to support the budget for several years beyond the existing MTFS period. In the two most pessimistic and unlikely scenarios then there would be sufficient reserves to support the budget until part partway through 2023/24.

Overall, the council has an appropriate level of reserves available to manage the financial risks it is facing from 2020/21 to 2023/24. However, despite the ongoing delivery of savings identified through the service challenge process of c£58m in the period between 2020/21 and 2022/23 it is necessary that additional savings are identified to be delivered to bring the council to a financially sustainable position. Any utilisation of remaining reserves should support, wherever possible, activities which reduce ongoing revenue costs.

Conclusion

There has been a significant focus nationally on the financial resilience of councils and one of the key areas of concern has been the utilisation of reserves in supporting budgets and the levels of reserves remaining. A key indicator identified by Chartered Institute of Public Finance and Accountancy (CIPFA) in flagging up potential issues is the level of reserves used by a council to meet any funding shortfall in setting the budget compared to the average level of reserves used to fund any structural deficit over the previous 3 financial years.

The average over the last 3 years in Lancashire has been c£38m, however this does not show the positive direction of travel as the requirement for reserves in setting the 2019/20 budget being much lower than the 3 year average at £10.245m. This and the proposed balanced budget for 2020/21 without recourse to reserves represents a significant improvement in this regard. This follows strong financial control during the current financial year as evidenced by the forecast revenue underspend which would enable a transfer into reserves. However, this is clearly dependent on all the agreed service challenge savings being agreed and 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 financial gap.

Capital Strategy

2020-2040

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Lancashire County Council

1. Background, purpose & aims of the Capital Strategy

1.1 Purpose and aims of the Capital Strategy

The purpose of a capital strategy is to set the long term strategic framework within which the authority will use as the framework and context for capital and investment decisions. It is a requirement of the Chartered Institute of Public Finance and Accountancy (CIPFA)'s Treasury Management Code of Practice and the Prudential Code that authorities have in place a long term capital strategy, the definition of long term is generally accepted to be 15-20 years and as such the strategy cannot set a detailed programme of works to be delivered, or a level of investment to be guaranteed each year, but aims to set a context within which future programmes are developed. The long term funding requirements of the existing asset base should be considered as a priority to maintain the existing asset base required by the services, to the standards set by the individual asset management strategies. This, whilst not being a developed delivery plan, forms an important part of the contextual assessment and provides a background within which individual funding decisions can be made.

The council is keen to ensure that there is efficient and effective usage of its capital assets and the resources tied up in them. This 20 year capital strategy therefore sets out the corporate aims and principles that underpin the production of the rolling 3 year capital programme to be approved each February. The strategy will be reviewed at this time each year to ensure that it reflects the changing regulatory environment and the needs and priorities of the council.

The Capital Strategy aims to support the delivery of the council's Corporate Strategy by investing in our capital asset base within the resources available and with due regard to risk management within our asset management.

Key priorities for application of capital expenditure are:

- Delivering the policy ambitions of the Corporate Strategy
- Managing the risks within the existing asset base
- Exercising financial prudence and maintaining debt levels that are sustainable within the council's revenue budget.
- Investing in schemes which will reduce the council's revenue costs
- Being alert to opportunities to lever in additional resources including external funds to help deliver the Corporate Strategy priorities.

The Capital Strategy should be read in conjunction with the Treasury Management Strategy, Prudential Indicators, Minimum Revenue Provision and Capitalisation policies, as well as the Medium Term Financial Strategy 2020-2024, Capital Programme 2020-2023 and the annual budget 2020-21. The principles of the Capital Strategy are the basis for the development of the Asset Management Strategies.

The Asset Management Strategies will set out the standard to which each class or type of asset will be maintained to and will ensure there is consistency of approach between the types of asset used by different services.

The council has set out this strategy being fully aware that there will be competing pressures on the limited resources to fund the capital programme each year from the diverse range of services that the council provides, the large and diverse asset base that the council needs to maintain as well as the finite amount of funding that is available. The current processes within the setting of the capital delivery programme is to limit the requirements in certain blocks to that of the funding available, this means fixing worse first in terms of condition of buildings.

Additional expenditure for urgent projects has been on a reactive basis which can lead to higher cost projects than could otherwise be the case or repeated visits to the same building over time which is not efficient. This approach does not address all the risks within the asset portfolio and is therefore not sustainable in the long term over which this strategy is to be applied.

A move to a more proactive capital programme delivery, which focuses on managing risks within the asset base and control of demand for capital resources, is required. This will require leadership at all levels to ensure that the resources available are deployed in the most effective and efficient way and a process for the prioritisation of capital expenditure being included in the capital programme has been developed. This will be managed by Capital Board at an officer level to ensure that the development of the capital programme is carried out with due regard to risk management and prudent and sustainable resource management.

1.2 The key objective of Lancashire's Capital Strategy

The key objective of the Capital Strategy is to provide a framework within which the Capital Programme for delivery will be developed. The rolling 3 year programme will:

- Ensure the council's existing asset base is available to support the delivery of services according to the corporate strategy and vision;
- Regularly review the asset base to ensure assets no longer supporting the corporate strategy are disposed of and the capital receipts used to support the investment in remaining asset base;
- Be affordable, financially prudent and sustainable, and ensure that decisions are made with regard to the long running financial implications and potential risks to the authority; and
- Ensure all new capital investment is deployed in such a way to ensure the asset base can be utilised in the most effective way.

The resources employed to fund the deliver the Capital Strategy are allocated through the annual budget process that sets the three year rolling capital programme and will include the following,

- Capital Grants received, due regard will be made to the terms and conditions of the grant funding to apply the grants to the appropriate schemes;
- Capital Receipts;
- Borrowing, to a level which can be sustained through the revenue budget;
- Revenue contributions, where investment schemes can be demonstrated to provide a revenue savings in future years through a business case process.

1.3 The county councils corporate objectives and priorities.

The capital budgets within the capital programme as directed by the capital strategy will support the key priorities laid out in the corporate strategy. Each capital proposal will be required to clearly demonstrate the links to these priorities:

- **Lancashire will be the place to live –** assets will be invested in, to allow provision of first class schools, and good quality reliable roads and public transport, vulnerable people are protected and supported as well as connected to their community. Technology investments will allow digital access to services as well as efficient use of information by services. Investment will be made, subject to prioritisation, where it is necessary to provide the council's services to be delivered or to deliver growth that would otherwise be undeliverable.

- **Lancashire will be the place to work –** capital investments will be made to develop infrastructure and transport links where the private sector alone cannot. By working with partner local authorities, Transport for Lancashire and Transport for the North, as well as the private sector, individual partners' transport and infrastructure priorities can be supported through the council's local highway authority process and grant funding potential by utilising partner funding where this is available as match funding. Any requirement for county council borrowing to match fund a scheme would be subject to the principles of the capital strategy as documented above including the prioritisation process, sustainability of revenue provision to support the investment and the ranking against other proposals.

- **Lancashire will be the place to prosper –** Capital investment proposals will be considered for prioritisation and ranking that support the development of economic growth where they link with the Lancashire Plan and Lancashire Industrial Strategy and the investment or supporting infrastructure cannot be brought forward by the private sector due to viability issues

- **Lancashire will be the place to visit –** Capital investments will be made, where financially prudent to do so, to preserve our cultural, leisure and heritage assets. Where it is not financially prudent to do so the council will work with partners to ensure the long term security of heritage, culture and leisure assets valued by our communities.

- **Lancashire will be the place where everyone acts responsibly** – Capital investments will be prioritised in our asset base including information technology assets that allow services to promote and enable communities to meet their own needs.

2. Approach to investment prioritisation

2.1 The capital programme

There will be a 3 year rolling capital programme agreed every February set within the context of this capital strategy.

2.2 Identification and prioritisation of capital investment needs.

The formulation of the Capital Programme is driven by the budget and service planning process. The size of the Capital Programme is determined by the following,

- The need to incur capital expenditure to protect and preserve the existing asset base;

- To enhance the exiting asset base where this is required to preserve service delivery;
- The proposals for extending the asset base to provide services which deliver the priorities in the corporate strategy;
- The resources available to fund the expenditure; and
- The revenue implications flowing from the capital expenditure, both positive and negative.

As part of the budget setting process, services will be required to submit capital proposals which are considered by Members for investment decisions. This will be after a triage process at officer level led by Capital Board which will have ensured the proposal's strategic fit in line with the principles of the Capital Strategy and will have scored the projects for prioritisation in line with all competing proposals. The capital investment appraisal process will take into consideration:

- Corporate Strategy Visions and Principles
- Affordability and Resources
- Risk Management
- Value for Money, taking into account options appraisals and cost benefit analysis
- Capability and capacity within the council to manage and deliver the project.

Capital investment proposals will be presented initially to capital board in a standard form that includes the following sections:

- Description of the proposal
- The outputs and outcomes to be achieved
- The projects fit with council's Corporate Strategy
- Key dates and milestones
- Cost of the Scheme and the funding source to be applied
- Revenue implications over time
- Evaluation comments and recommendations from Capital Board including prioritisation scoring
- Risks associated with the proposal including the implications of not proceeding.

Proposals recommended for approval by capital board will be submitted to members for approval along with any recommended changes to the agreed to delivery plan required to accommodate the proposal.

2.3 Capital projects: evaluation and priority scoring

It is acknowledged that the council has limited resources to meet all the requests for capital investment and will need to prioritise requests and set benchmarks for investment decisions. Members ultimately determine the projects to be included within the capital programme but to assist this decision making process and ensure decisions are not taken in isolation and with full knowledge of the competing priorities the council will implement a priority scoring matrix to be overseen by Capital Board and used to determine which proposals are recommended for Cabinet approval and aid the comparison with other proposals. The criteria will be reviewed on an annual basis to ensure that it continues to provide an effective tool for evaluation and is set out in Annex 1.

2.4 Assessment of proposals and timetable

The council's policy is to agree the rolling 3 year capital programme on an annual basis at the February council budget setting meeting.

In future years capital proposals will be submitted to the Capital Finance Team in autumn of each year to inform the budget setting process. The proposals will be assessed and evaluated, using the matrix as referred to in section 2.3 and included at Annex 1, by officers from Capital Finance and Asset Management and the appraisals considered by Capital Board to identify those proposals that will be recommended to form the basis of the capital delivery programme submitted to Corporate Management Team and members for consideration and approval.

2.5 Invest to save capital proposals

Service departments are to be encouraged to consider innovative ways that service provision can drive efficiency in both the revenue and capital budget provision and help drive cash savings and reduce long term funding commitments where possible. On occasion this may include the identification of assets which are no longer considered to be financially sustainable, or fit for purpose, in relation to the delivery of council services and priorities.

Invest to save bids will be considered for capital funding on the same basis as other proposals, subject to funding resources being available and as long as there is a business case demonstrating the savings and benefits which will be achieved as result of the intervention. Where the benefits of these schemes outweigh the costs including the revenue costs of repaying the borrowing, and taking the lifetime of the intervention into account, there is a greater likelihood of the projects being prioritised using the matrix in annex 1; where the costs outweigh the benefits over the lifetime of the intervention, services may be asked to contribute the funding from their revenue budgets to reduce dependency on the limited borrowing capacity available.

2.6 Charges to the capital programme

Service departments should follow the council's capitalisation policy and only charge allowable expenditure to projects in the capital programme. This will reduce the risk of regulatory infringements and also the burden on capital funding by borrowing as well as increase number of projects that can be funded with the limited resources available. This will ensure the most effective use of the resources as directed by this strategy.

2.7 Approvals outside of the normal budget setting process.

Any additional capital investment proposals received outside of the budget setting process in 2.4 above must in the first instance be submitted to Capital Board to be reviewed at the quarterly approvals meetings. The proposals should be submitted in the standard form and will be scored by Capital Finance and Asset Management, if supported by Capital Board they will then be considered by the Corporate Management Team and on to Cabinet for final approval.

2.8 Loans to external bodies or organisations

The council's capital programme can also provide the facility to loan monies to, or cash flow projects on behalf of, partner organisations where the activities to be funded align to one or more corporate objective or service priorities.
There are statutory regulations which govern the accounting treatment of loans, provided towards expenditure which, if incurred by the authority itself, would be classed as capital expenditure. Loans for this purpose must be State Aid compliant and will be subject to a financial appraisal and due diligence checks, and where possible the council will seek to minimise the risks assessed to the council. This may be in the form of a loan agreement or by security provided by a charge on partner assets.

The rate of interest charged on these facilities will be dependent on the nature and structure of the loan and its assessed risks but will only be provided on the basis that there is no net cost to the council over time.

3. Funding sources and investment decisions

The main sources of capital funding are summarised below:

3.1 Grant funding and external contributions

The Council will endeavour to maximise grant allocations and allocate them to most effectively address the corporate priorities identified and that are highest in the prioritisation scoring matrix, whilst ensuring all conditions of the grant are met.

The majority of 'planned' capital expenditure for maintenance of highway infrastructure and school buildings are funded by the appropriate grants.

Contributions will be sought from developers towards the provision of public or private assets and facilities. This will include agreements with developers to mitigate the impact of their development on communities. This will include using Section 106 (Town and Country Planning Act 1990) agreements or community infrastructure levy towards education infrastructure, as specifically highlighted in Department for Education guidance "securing developer contributions for education" issued in November 2019 and contributions towards Highways infrastructure requirements associated with developments under section 38 and 278 (Highways Act).

Contributions may also be sought from users of the council's asset base where a proposal for investment will generate benefits for that user, this could be a partner organisation, internal service department or school.

3.2 Capital receipts

A capital receipt is an amount of money exceeding £10,000 which is generated from the sale of an asset.

Capital receipts from asset disposals are a finite funding source and it is important to utilise them to the most effective long term advantage of the council be that funding new capital investment or offsetting debt or transitional costs.

The council's policy is to treat all capital receipts as a corporate resource, enabling investment to be directed towards those proposals scoring highest in the prioritisation matrix but where grant funding is not appropriate to be applied to.

The council has a substantial property estate mainly held for operational service requirements, which include administrative buildings and a range of other land and property assets. The estate is to be managed through the asset management strategy which identifies property requirements and where appropriate properties which are surplus to operational requirements which will be disposed of.

The council will continue to work with other organisations to utilise redundant assets and vacant land to bring them into a useful economic purpose and facilitate employment and job creation, subject to the proposals fitting the principles and criteria previously outlined in this strategy.

3.3 Borrowing

The council will seek to minimise the level of borrowing required to finance required capital expenditure by maximising grants and contributions received, minimise the costs charge to each project and ensuring any surplus assets are sold.

The Local Government act 2003 enables local authorities to determine their programmes for capital investment and associated borrowing requirements provided they have regard to the Prudential Code for Capital Finance in Local authorities developed by CIPFA.

The key objectives of the Prudential Code are to ensure, within a clear framework that the capital investment plans of the authority are affordable, prudent and sustainable. To demonstrate that local authorities have fulfilled these obligations the Code sets out a series of indicators – known as prudential indicators – the Council must consider as part of its budget setting process and also give consideration to CIPFA resilience indicators.

3.4 Revenue funding

Capital expenditure may be funded from revenue, for example where a service requests a capital investment to improve its productivity or where funds can be contributed by a school towards improvement or expansion plans. Pressures on the council's revenue budget and council tax limits may restrict the extent to which revenue funding can be exercised as a source of capital funding.

4. Revenue implications and links to MTFS, Treasury Management Strategy, and prudential indicators.

The impact of the revenue implications has to be a significant factor in determining approval of projects. All capital investment decisions should consider the revenue implications both in terms of servicing the finance but also running and maintaining the new asset. Life cycle costing should be a key factor in the rolling capital strategy requirements and feed through into the rolling three year capital delivery programme. It may be more financially beneficial where service requirements change in the short to medium term to pursue a different model for asset holding which reduces the capital requirements for investment. An example of this could be leasing buildings for service delivery when the demand for the service in that area is shorter than the long term financial strategy or the leasing of vehicles.

The use and financing of capital resources has been fully taken into account in the production of the council's annual budget and Medium term financial strategy, and are reflected in both the Treasury Management Strategy Statement for [2020-2021] and Prudential indicators for [2020-21 to 2023-2024].

5. Performance monitoring of the capital programme.

The capital finance team, working with programme and project managers and heads of service for delivery, monitor the progress of the capital programme on a monthly basis and report to Cabinet on a quarterly basis. All delivery projects within the capital programme are managed through the corporate system (PPMS) and reports will be taken to capital board where there are issues that increase the risks in the capital programme.

All processes and procedures relating to the monitoring of the capital programme are set out in the councils Financial Regulations. The key controls are:

- All expenditure must be carried out in accordance with Financial Regulations and the capitalisation policy.
- The expenditure must comply with the statutory definition of 'capital purpose as interpreted in guidance by the Section 151 officer.
- Where the budget setting process approves a programme budget, a further report on individual schemes to be taken from this budget needs to be approved by Capital Board unless delegated powers in the financial regulations apply.
- Budgets and responsibility for each project must be under the control of a nominated project manager.

The monitoring work above will ensure these controls are enforced.

6. Stewardship of assets.

The council's Asset Management Strategy sets out the standard and condition each of its assets should be maintained to and the arrangements for managing these effectively. The implications of that strategy are included in the long term capital strategy requirements and form an important context in which to make future asset management and capital investment decisions.

7. Overview of capital requirements for the existing asset base

The assessment of investment required over the term of the strategy is updated regularly. A detailed capital programme will be set each year to deliver the investments that score the highest in the prioritisation scoring and can be delivered within the funding available. Items which cannot be funded by the available resources will remain unfunded requirements in future strategy assessments and the risk associated with not delivering them will be highlighted in the capital risk register managed by Capital Board.

Annex 1

Capital projects: evaluation and priority scoring

The criteria referred to in section 2.3 of the Capital Strategy to be applied for 2020-2021 is set out below.

- The contribution the proposal will make to one or more of the corporate strategy priorities.
- The impact the proposal will have on the councils revenue budgets either as additional running costs or as a saving including allowing service to be delivered in a more effective way.
- The proposals contribution to maintain existing assets to the standard in the specific assent management strategy or to allow services to be delivered as per directorate strategies for non property assets.
- The proposals ability to assist in attracting a wider investment such as external funds
- The proposals ability to meet statutory compliance and regulatory requirements including those relating to information assets.
- The proposal meets specific government initiatives.
- The proposal addresses non statutory Health and safety risks identified by survey data or mitigates issues included in the corporate capital risk register

Treasury Management Strategy 2020/21

Under the Local Government Act 2003, local authorities must have regard to statutory proper practices in their treasury management activities. In effect this means the council must adhere to the Chartered Institute of Public Finance and Accountancy's 'Treasury Management in the Public Services: Code of Practice' (the CIPFA Code), and the Ministry of Homes, Communities and Local Government guidance on local authority investments.

The CIPFA code requires the treasury management strategy to be produced and approved annually. In addition the Ministry Homes, Communities and Local Government has issued updated statutory guidance on local government investments. This now covers a wider definition of investments and includes those that support local public services by lending to or buying shares in other organisations (service investments), and those made to earn investment income (known as commercial investments where this is the main purpose). Investments held for service purposes or for commercial profit are considered in the non-treasury investment strategy.

In conjunction with the detailed treasury management practices approved by the Director of Finance, the strategy provides the policy framework for the engagement of the council with financial markets in order to fund its capital investment programme, to maintain the security of its cash balances and protect them from credit, liquidity, inflation and interest rate risk.

The strategy includes provisions for borrowing, treasury investments, financial derivatives and the indicators that will be used for monitoring purposes throughout the year. It is designed to achieve the following objectives:

- To ensure the security of the principal sums invested which represent the council's various reserves and balances.
- To ensure that the council has access to cash resources as and when required.
- To minimise the cost of the borrowing required to finance the council's capital investment programme, and manage interest and inflation rate risks appropriately.
- To maximise investment returns commensurate with the council's policy of minimising risks to the security of capital and its liquidity position.

In setting the treasury management strategy, the following factors have a strong influence:

- the economic position
- the council's current investment and borrowing portfolio
- estimates of future borrowing and investment requirements

Economic position

The UK economy has been affected by concerns over the world economy, in particular the trade war between the USA and China, and the uncertainty arising from the UK's exit from the European Union. Gross Domestic Product growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. The Bank of England sets its monetary policy to achieve the government's target of keeping inflation at 2%. The latest inflation rate as measured by the Consumer Prices Index is 1.5%. In the short term, the Bank of England has to balance the target of low inflation with supporting economic growth and jobs. As a result the base rate has remained at 0.75% throughout 2019 with the last movement being a 0.25% increase in August 2018.

The Bank of England monetary policy committee met on 19 December 2019 with the committee's latest projections for activity and inflation being set out in the November Monetary Policy Report and assumed an orderly transition to a free trade agreement between the United Kingdom and the European Union. UK Gross Domestic Product growth was projected to pick up, supported by the reduction of Brexit-related uncertainties, an easing of fiscal policy and a modest recovery in global growth. With demand growth outstripping the subdued pace of supply growth, excess demand and domestic inflationary pressures were expected to build gradually. Consumer Prices Index inflation was projected to rise slightly above the 2% target towards the end of the forecast period.

Interest rate forecast:

In light of the economic position the authority's treasury management adviser, Arlingclose, is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside as although it is anticipated that the UK will leave the European Union by the end of January there is still a need for greater clarity on any trade agreement and the continuing global economic slowdown.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

Current portfolio

The council's treasury portfolio as at 30 November 2019 was as follows.

	£m
Call accounts	60
Local authority deposits	17
Government, local government and supra-national bonds	171
Corporate bonds	223
Total Investments	471
Short term loans	575
Shared investment scheme	81
Long term loans - local authorities	65
Long term loans - PWLB	431
Total Borrowing	1,152
Net Borrowing	681

In addition the authority held some £231m of non-treasury investments.

Estimates of future borrowing and investment requirements

In the medium term the prudential code requires that the council's borrowing adjusted for transferred debt is for capital purposes only. The underlying need to borrow for capital purposes is measured by the capital financing requirement, while usable reserves and working capital are the underlying resources available for investment. The following table compares the estimated capital financing requirement to the borrowing at 30 November 2019. This gives an indication of the borrowing required and the resources available for investment.

The capital financing requirement forecast assumes a capital programme which includes borrowing of £50m a year in each of years 2020/21 to 2022/23. Clearly, this will be subject to change as the capital programme develops.

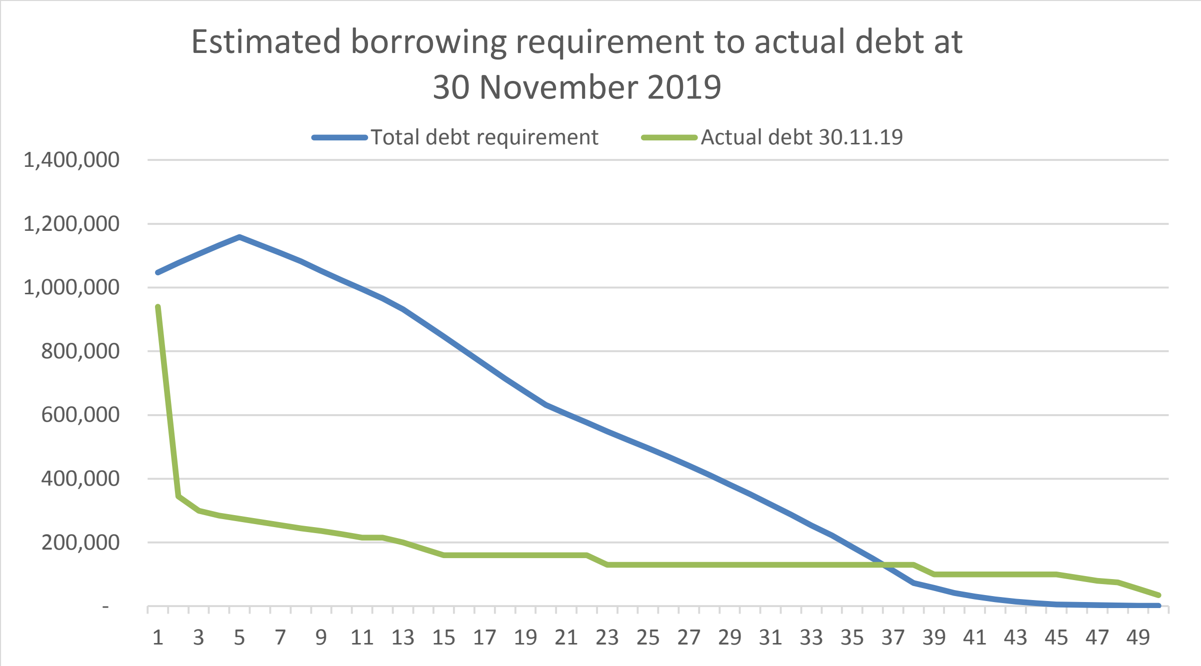
	31/3/2020	31/3/2021	31/3/2022	31/3/2023
	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m
Capital financing requirement	1,105	1,132	1,159	1,184
Other long term liabilities	-146	-139	-133	-126
Borrowing capital financing requirement	959	993	1,026	1,058
External borrowing	-940	-345	-300	-285
Borrowing requirement for capital	19	648	726	773
Other borrowing requirements*	89	84	79	74
Reserves and working capital	-440	-450	-400	-400
Borrowing/ - Investment need	-332	282	405	447

*shared investment scheme, debt held on behalf other local authorities and premiums

Borrowing Strategy

The borrowing strategy will be determined by the need for the council to borrow and the impact of the economic climate on the prevailing cost and availability of borrowing.

The council borrows for capital purposes with the underlying need to borrow for capital purposes being measured by the capital financing requirement. CIPFA's Prudential Code for Capital Finance in Local Authorities, recommends that the council's total debt should be lower than its highest forecast capital financing requirement over the next three years. The council has a borrowing requirement over the next three years, however in assessing the need to borrow, consideration is given to the requirement to borrow for the longer term. The graph below compares the estimated total debt requirement and debt maturity position at 30 November 2019 for the next 50 years given the current capital programme and minimum revenue provision policy.



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 new capital schemes in the programme and the need to replace existing debt as the council has followed a policy of taking short term loans to take advantage of existing market conditions.

The 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 recent past to borrow short-term. Given the economic outlook, significant increases in interest rates are not forecast in the medium term, with this situation 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. As a result the council may borrow additional sums at long-term fixed rates in 2020/21 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 borrowing in 2020/21:

- 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 Rate.
- Under 10 years loan duration rates are expected to be lower than long term rates, so this opens up a range of choices that may allow the council to spread maturities.
- Additionally, borrowing can be achieved through the issuance of a 'commercial paper (an unsecured, short-term debt instrument issued by a corporation) - euro medium term note. This is a flexible debt instrument that facilitates direct issuance into the public or private markets in a range of formats, with fixed or floating payments across a range of maturities from 1-50yrs. The UK Municipal Bonds Agency euro medium term note documentation allows for "Non-Guaranteed" single

council bond issuance under UK Municipal Bonds Agency documentation provided the council has its own long term credit rating. This will represent a cheaper route to market than a stand-alone bond issue and it is proposed that this is a method that is permissible for the council to use should it decide to issue its own bond.

- The UK Municipal Bonds Agency is proposing a new product which does not include a joint and several guarantee. Instead, a council's liability will be proportional to its share of the outstanding borrowing. Consideration as to whether or not this would be an appropriate form of borrowing will be given when the full details are available.

Against this background, the Director of Finance will, in conjunction with the council's advisers, 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.

Sources of borrowing

Traditionally the Public Works Loan Board has been the main source of long term borrowing. The interest rate charged on Public Works Loan Board loans is linked to the gilt yield. In recent years the council has been able to obtain a Public Works Loan Board loan at 0.8% higher than the gilts yield (this rate is referred to as the margin). However, in October 2019 the margin applied to loan rates was increased by 100 basis points (1%). Therefore the new margin above gilts is now 1.80% and it is therefore anticipated that long term loans can now be achieved cheaper by using other sources.

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, (this 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

Borrowing instruments

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

- Bank overdrafts
- Fixed term loans
- Callable loans or revolving credit facilities where the 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 £150m in total
- Lender's option borrower's option loans, but subject to a maximum of £100m 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 benchmark interest rate, such as the Sterling Overnight Index Average (often referred to as SONIA) which is administered by the Bank of England. The balance between fixed and variable rates will be subject to the limits on interest rate risk approved in this treasury management strategy.

Debt restructuring

The council regularly monitors both its debt portfolio and market conditions to evaluate potential savings from debt restructuring.

Other borrowing

The council may borrow for short periods of time to cover unexpected cash flow shortages and to take deposits on the shared investment scheme. Also 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 within the prudential limits

Policy on Borrowing in Advance of Need

The 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 two years or less; and
b) Where the most advantageous method of raising capital finance requires the 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 two year horizon.

Having satisfied the criteria above, any proposal to borrow in advance of need would 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, with the value for money of the proposal 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.

Treasury Management Investments Strategy

The council holds reserves and other cash items on its balance sheet which are invested. In investing these cash balances the council follows guidance issued by CIPFA and the Ministry of Homes, Communities and Local Government.

The Ministry of Homes, Communities and Local Government guidance requires treasury management investments to prioritise security, liquidity and yield in that order of importance. The 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 council has in recent years pursued a policy to hold as investments a sum as close as possible to the cash value of its reserves and balances. This policy will continue in 2020/21 but it will be regularly reviewed to ensure value for money is achieved.

Business model for holding investments

Under the IFRS 9 (International Financial Reporting Standard), the accounting for certain investments depends on the council's "business model" for managing them. In general, the authority holds investments to either collect the contractual cash-flows or a mixture of holding for the contractual cash-flows and sale proceeds. Neither of these would result in changes in market value having to be a charge against council tax at year end. However, if investment assets are held for the purpose of trading any changes in the asset value is charged to the accounts. The business model for the main treasury management investments are as follows:

<u>Local authority investments</u> - these are principally investments for a fixed term which are held to maturity. In addition, the authority holds some long term bonds issued by local authorities which are also held to maturity. In both cases interest is received on agreed dates and are held for the contractual cash-flows therefore they will be valued at amortised cost.

<u>Gilts</u> - the holding of gilts represent a key part of the strategy for holding investments to back up the reserves and balances while maintaining a low credit risk portfolio. They are also a liquid asset and periodic sales will be incurred in reaction to market movements to enhance the overall yield of the holdings but this is not the primary aim

of the holding and therefore gilts will be held at fair value through 'other comprehensive income' which means that market value changes will not be charged against council tax.

Other bonds - the council also holds other high credit quality corporate bonds. These are held primarily for the purposes of liquidity providing a low credit risk holding. These are bought and sold in relation to cash needs and therefore the valuation will be such that the market value changes will not be charged against council tax.

Approved counterparties

The counterparty credit matrix is at the heart of the council's treasury management strategy and has always been conservatively constructed to protect the council against credit risk whilst allowing for efficient and prudent investment activity.

However, the 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 market and any press releases in general. In this way ensuring the council transacts with only the highest quality counterparties**.**

The council requires very high credit ratings for an organisation to be considered a suitable counterparty for investment purposes. These are set out as follows:

For short term lending of up to one year, the short term ratings from the ratings agencies will be used and that a counterparty 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 (1 to 5 years, 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-,
Short term	P1/F1+/A1+

For longer term investments (five years 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. The UK's latest rating issued by Moody's is a long term rating of Aa2 which is the third highest grade.

Although the rating still falls within the current strategy it is possible as the Brexit process proceeds or if there is an economic downturn that there will be further downgrades. This could result in investments in UK government gilts, treasury bonds and bodies guaranteed by the UK government falling outside the treasury management strategy. However, even if there is a further reduction in the UK credit rating, the UK government is still deemed a safe investment. The government has never defaulted on its payments and as an ultimate solution it could prevent insolvency by printing money. Therefore it is proposed that the AA- minimum sovereign rating is not applied to the UK.

The table below shows the approved investment counterparties and limits:

Instrument	Minimum Credit Rating (blended average)	Maximum individual Investment (£m)	Maximum total Investment (£m)	Maximum Period
UK Government Gilts, Treasury Bills, Debt Management Office & bodies guaranteed by UK Government	UK Government	unlimited	unlimited	No limit
Sterling Supranational Bonds & Sterling Sovereign Bonds	AA-	150	300	No limit
Corporate Bonds (Short Term less than 1 year to maturity)	P1/A1/F1	50	200	1 year
Corporate Bonds (Medium term up to 5 years)	AA- P1/A1/F1	100	300	5 years
Corporate Bonds (Long term)	AA P1/A1+/F1+	50	200	No limit
Government Bond Repurchase Agreements (Repo/ Reverse Repo)	UK Government	500	500	3 years
Repurchase Agreements (Repo/ Reverse Repo)	Other AA-	200	200	1 year
Bond Funds with weighted average maturity maximum 3 years	AA Rated weighted average maturity 3yrs	50	100	These investments do not have a defined maturity date
Bond Funds with weighted average maturity maximum 5 years	AAA Rated	50	100	These investments do not have a defined maturity date
Collateralised lending agreements backed by higher quality government or local government and supra national sterling securities	AA- with cash or AA- for any collateral	300	300	25 years
Call accounts with UK and Overseas Banks (domiciled in UK)	P1/A1/F1 Long term A Government support	100	200	Overnight in line with clearing system guarantee (currently 4 years)

Unsecured deposits/CDs to Banks and Building Societies	AA	10	50	1 year
Equity, property, multi asset or credit Pooled Funds	Ratings are not produced for such Funds	50	100	These investments do not have a defined maturity date
Local authority fixed term deposits	Government	30	450	50 years
Local authority bonds	Government	50	300	60 years

Other than call account and operational bank accounts the council does not currently make unsecured investments with banks. This is as a result of the risk following the implementation of 'bail-in' legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future. However the option to undertake small scale lending, widely spread, may have some value and is therefore included in the policy.

Regarding investments with other local authorities, Arlingclose state that they are comfortable with clients making loans to UK local authorities for periods up to two years, subject to this meeting the approved strategy. For periods longer than two years they recommend that additional due diligence is undertaken prior to a loan being made. On this basis it is proposed that the nominal value of investments to local authorities are limited as follows:

	Maximum individual investment	Maximum total investment	Maximum period
Up to 2 years	£30m	£450m	2 years
Over 2-10 years	£25m	£300m	10 years
Over 10 years	£25m	£100m	50 years

In addition to fixed term deposits occasionally local authorities issue bonds. The investment policy allows the county council to purchase such bonds as an investment which are generally held to maturity. The holding of the bonds is considered to be outside the limits expressed above but for the purpose of risk management the total of the bonds plus fixed term deposits with any one authority should not exceed £50m.

The 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 £1m. If there was a failure of National Westminster it is anticipated that they would be subject to bank bail-in rather than made insolvent. This increases the chance of the council maintaining operational continuity but any monies in the bank would be at risk of at least a partial loss.

Long term investments

The treasury management code requires where an authority invests, or plans to invest, for periods longer than one year then an upper limit for investments maturing in excess

of one year is set. The authority does have fixed term deposits which are for longer than a year and the bonds usually purchased have a maturity date which is in excess of one year and these could be held to maturity.
However, the investments are held in government and supranational securities, which are highly liquid. In addition the council holds a secondary liquidity investment book of very high quality covered floating rate notes which are typically issued for a three to seven year term. Because these instruments have their rates re-fixed, at current market rates every three months, their price shows a very low sensitivity to changes in market rates, so that although they are classified as long term instruments, in practice they operate as fixed instruments with a maximum of three 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 council's security and liquidity objectives.

As a result of the nature of the assets held it is considered appropriate to have a high limit which is related to the forecast of reserves and balances held (currently forecast to be £450m at 31 March 2021, which is broadly similar to the estimate at 31 March 2020). However, it is anticipated that during the year cash-flow will be positive requiring a higher level of investments to be held. In particular, if a bond is issued for some £300m there will be a cash inflow before the debt it is replacing matures or the capital expenditure incurred and this cash will be invested. Therefore the proposed limit for 2020/21 is £750m.

In recent times, a wider range of investment instruments within the area of sterling deposits have 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 Director of Finance will, in liaison with the council’s external advisers, consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the council. Decisions on whether to utilise such instruments will be taken after an assessment of whether their use achieves the council's treasury management objectives.

Policy on the Use of Financial Derivatives

The council will only use financial derivatives (such as swaps, forwards, futures and options) on a standalone basis, where it can clearly be 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 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, 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 council's treasury activity is not directly exposed to all of these risks, for example foreign exchange or commodity prices, the 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 council to manage interest rate risk are summarised as follows:

Class	Use	Standalone	Embedded
Forwards	To fix an interest or inflation rate for a single period in the future	Forward Rate Agreement, 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 or other structured outcome where maximum is the total premium.

There are two methods of engaging in derivative contracts, exchange traded or settled derivatives and over the counter 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. Over the counter 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 as follows:

Product	Counterparty Quality	Security	Method
Exchange traded or cleared product	Credit rating of exchange	Credit rating of clearing agent	Margin netting
Bilateral Forward rate agreements 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 Local Authority swaps	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 following table defines the appropriate limits for collateral quality:

Counterparty type	**Documentation**	**Collateral types**	**CDS levels**	**Rating**
Exchange	MIFCA	Cash margins	<75bp	AA
Bank	International Swaps and Derivatives Association/Credit Support Annex	Cash and Government bonds	<100bp	A3
Insurer and Pension Fund	International Swaps and Derivatives Association/ Credit Support Annex	Cash and Government bonds	<100 (Insurers)	A3 (Insurers)
Local Authority	Contract	Cash and Government bonds	England/Wales None	England and Wales None

The council will only use derivative contracts to hedge existing risks. This is reflected in the limits below. The 100% upper limit means that the council has the option to hedge all of, but not more than, its interest rate risk if felt appropriate.

Exposure Metric	**Min Hedge**	**Max Hedge**	**Granularity**	**Tool**
Interest rate	0%	100%	0-3 months 3-6 months, 6-12m months, 1 to 2 years, 2-5 years and 5 year blocks	Forward rate agreements, Futures, Options, Swaps Swaption
Inflation rate	0%	100%	1 to 2 years, 2-5 years and 5+ years blocks	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 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 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 council may need to seek its own legal advice.

It is anticipated that there may be occasions when it is appropriate to undertake transactions which seek to reduce the council's specific exposure to interest rate risk. A standard market technique involves selling gilts to be paid for at an agreed date in the future rather than the normal next working day. It is proposed that the advance date is restricted to one month and the limit on the transaction(s) outstanding is £250m in total.

Impact on the council's revenue budget

With base rates at exceptionally low levels, investment returns are likely to continue to be far lower than has previously been the case. 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 seven day notice money.

The following table outlines the budget for the financing charges element of the council's revenue budget as reflected in the medium term financial strategy. However, the budgets will be reviewed in light of changes in the capital programme.

	Revenue Budget 2019/20 £m	Revenue Budget 2020/21 £m	Revenue Budget 2021/22 £m	Revenue Budget 2022/23 £m
Minimum Revenue Provision	15	16	16	17
Interest paid	25	25	25	25
Interest and other income earned	-14	-12	-12	-12
Total	26	29	29	30

The revenue budget above reflects a position which takes account of the views of both internal and external advisers, 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 in 2020/21. The position will be closely monitored by the Director of Finance and any changes will be reflected in forecasts presented to Cabinet.

Treasury Management Indicators

In line with the relevant legislation the county council has adopted the Prudential Code for Capital Finance in Local Authorities and the Treasury Management in the Public Services Code of Practice (2017) as setting the framework of principles for its treasury management activities. In accordance with the requirements of these codes the council produces each year prudential indicators which provide a framework for the prudent management of its treasury management including limits with regard to certain types of activity such as borrowing. The indicators below are a consequence of the activities set out within the treasury management strategy.

Authorised and operational Limits for debt

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

	2019/20 Revised	2020/21	2021/22	2022/23
	£m	£m	£m	£m
Borrowing	1,600	1,600	1,650	1,700
Other long term liabilities	150	650	650	650
TOTAL	1,750	2,250	2,300	2,350

From 1 April 2020 accounting standards are changing in relation to recording leases. In effect more leases will be included on the council's balance sheet and therefore will be included against the other long term liabilities indicators. At this stage work is on-going to quantify the impact of the change and therefore the other long term liabilities limits will be subject to change.

The 'operational limit' 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 council's current plans. As required under the Code, this limit will be carefully monitored during the year. The proposed operational limits for external debt are:

	2019/20 Revised	2020/21	2022/22	2022/23
	£m	£m	£m	£m
Borrowing	1,118	1,190	1,200	1,200
Other long term liabilities	147	400	400	400
TOTAL	1,265	1,590	1,600	1,600

The actual external debt at 31 March 2019 was £1,035m.

Gross debt and the capital financing requirement (capital financing requirement)

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the authority's total debt should be lower than its highest forecast capital financing requirement over the next three years. The county council's borrowing is in excess of the capital financing requirement however, in making this comparison certain borrowing is included in the total borrowing but does not count against the capital financing requirement. These include the premiums paid and the transferred debt.

	As at 31 March			
	2020	2021	2022	2023
	£m	£m	£m	£m
Borrowing capital financing requirement	959	993	1,026	1,058
Estimated total borrowing	1,048	1,077	1,105	1,132
Borrowing in excess of capital financing requirement	89	84	79	74
<u>Represented by:</u>				
Premiums	45	41	38	35
Borrowing relating to other authorities	44	43	41	39

The indicators and limits relating to specific treasury management activities are set out as follows.

Interest rate exposure

In order to control interest rate risk the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the 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
Upper limit on one-year revenue impact of a 1% rise in interest rates	£50m

Maturity structure of debt

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

	Upper Limit
Under 12 months	75%
12 months and within 2 years	75%
2 years and within 5 years	75%
5 years and within 10 years	75%
10 years and above	75%

Investments over 1 year

Limit on the level of long term investments helps to control liquidity, although the majority of these investments are currently held in securities which are readily saleable. The limit is largely determined by the forecast of reserves and balances held at the year-end (currently forecast to be £450m). The level of investments will be managed to be in line with the estimated reserves and balances and cash flow at 31 March 2021 (deemed an operational limit which will be reviewed during the year).

However, it is anticipated that there will be positive cash-flows in year which will require a higher level of investments to be held including bonds held specifically for liquidity purposes. Therefore it is proposed that the limit for maturities in excess of one year is £750m for each of the years.

	Upper limit
Total invested over 1 year	£750m
Operational or forecast limit at 31 March 2021	£450m

Minimum average credit rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark
Average counterparty credit rating	A

Non-Treasury Investment Strategy 2020/21

This covers investments held to:

- support local public services by lending to or buying shares in other organisations, and
- earn investment income

In general, the council will continue its current policies regarding loans and the acquisition of shares. In addition the council will continue to review its services and if the opportunity exists to develop services that will provide opportunities for additional income generation (e.g. providing services to other authorities) these will be considered in the first instance by the appropriate service manager.

In considering any potential activity under the non-treasury investment strategy the council will take into consideration the statement from Rob Whiteman, Chartered Institute of Public Finance and Accountancy Chief Executive, and Richard Paver, Chair of the Chartered Institute of Public Finance and Accountancy Treasury and Capital Management Panel, on 'Borrowing in Advance of Need and Investments in Commercial Properties'. These re-iterate that a local authority should avoid exposing public funds to unnecessary or unquantified risk.

They state that "Both the Prudential Code and the Statutory Guidance on Local Government Investments (3rd Edition) (Statutory Investment Guidance) issued by the Ministry for Housing, Communities and Local Government are very clear that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed".

As part of the statement there is a reminder that the informal commentary on the statutory guidance cautions local authorities against:

- becoming dependent on commercial income;
- taking out too much debt relative to net service expenditure; and
- taking on debt to finance commercial investments.

Service Investments: Loans

The council provides loans as part of its service delivery and not primarily to generate income. The authority has made loans to Lancashire County Development Ltd which is an owned company that promotes economic development within the county; Local Pensions Partnership which provides pension investment and administration services; an arrangement with Blackpool Borough Council with respect to the waste service and Parish Councils. The council also has an employee loan scheme to promote alternatives to travelling by car.

The key risk when making service loans is that the borrower is unable to repay the loan. Currently, the exposure faced by the council is low and therefore it is proposed that the provision of these loans continues in 2020/21.

The table below provides details of the loans outstanding at 31 March 19 and proposed limits for 2020/21.

Category of borrower	Outstanding at 31 March 19 £m	Proposed Limit 2020/21 £m
Subsidiaries	23.3	30.0
Other councils	30.4	35.0
Employees	0.1	1.0
Schools	0.2	5.0
Total	**54.0**	**71.0**

Service investments: shares

The county council holds shares in Local Pensions Partnership and the Municipal Bond Agency for specific service delivery objectives**.**

Commercial activities

The Ministry for Housing, Communities and Local Government defines property to be an investment if it is held primarily or partially to generate a profit. Although the council promotes income generating activity it is generally within the context of providing a service efficiently and covering costs rather than profit seeking. Areas where it is considered the definition is met is in relation to smallholdings and Lancashire County Development Ltd. In 2019/20 the income generated from smallholdings was less than £0.1m while Lancashire County Development Ltd made a contribution to costs of some c£2.5m.

Bonds including gilts - most of the bonds held are for treasury management purposes and not trading purposes as outlined in the treasury management strategy. However, there are occasions when cash flow and market projections make it possible to buy and sell bonds purely on a trading basis.

Bonds purchased for trading reasons will potentially be valued at market value in the accounts. Therefore, any change in market value at year end will be charged against council tax therefore adding volatility to the council's financial position. It is proposed that the Director of Investments can invest in bonds for commercial purposes where cash-flow permits but investments outside the current treasury management credit matrix will only be incurred after agreement with the Director of Finance.

Other investment proposals may arise during the year. The proposals could involve changes to current services or changing the use of existing assets. These will be examined by officers and approval sought from the appropriate council members.

Minimum Revenue Provision Policy Statement 2020/21

This annual statement required to be approved by the county council arises from statutory guidance initially issued by the then Department of Communities and Local Government in 2008. This has been updated with the latest guidance issued by the Ministry for Homes, Communities and Local Government in 2018.

Local authorities are required each year to make a charge to the revenue account in respect of provision to repay capital expenditure financed by borrowing or credit arrangements (mainly finance leases or Private Finance Initiative contracts). The charge to revenue is one that the authority considers to be prudent and is referred to as the Minimum Revenue Provision (MRP).

Guidance issued by the Ministry for Homes, Communities and Local Government continues to identify four options which can be used for the purpose of calculating the Minimum Revenue Provision. 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.

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 the 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 2004/05 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 charge to revenue, 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 method

This option allows for the MRP to be calculated as 4% of the capital financing requirement. This is derived from the balance sheet and represents 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.

<u>Asset life method</u>

Guidelines for this method allow for the charge to be calculated based on the estimated life of the asset. The actual calculation can be made in two ways namely:

1. A 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.
2. 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.

The latest guidance states that the asset lives to be used should not usually exceed 50 years. This maximum can be exceeded if the authority has received an opinion from an appropriately qualified valuer or the asset is leased or acquired under a Private Finance Initiative which is for a duration in excess of 50 years.

<u>Depreciation method</u>

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.

Finance leases and Private Finance Initiative

Assets held under a Private Finance Initiative 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 charge to equate to the amount charged to revenue under the contract to repay the liability.

Application at Lancashire County Council

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

Supported borrowing

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. However, the charge was based on a 4% reducing balance which never effectively repays the debt. It was also 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 with reference to the capital financing requirement but it is based upon a 50 year life rather than a reducing balance. In 2017/18 it was considered that there had been an overpayment of MRP in earlier years and therefore the MRP for years from 2017/18 would be reduced to £1 until the overpayment had been recovered. This will continue to be the case in 2020/21 and therefore the MRP charge for the supported debt will be £1.

Unsupported borrowing

The MRP for capital expenditure financed from unsupported borrowing has been calculated using the asset life method on an annuity basis. It is proposed that this continues for calculating the MRP for 2020/21. This includes expenditure incurred in 2008/09 to 2014/15 when the MRP was initially calculated using asset life method (equal charge approach).

Private Finance Initiative payments will be made in line with the amounts due to repay the liability under the contract

MRP 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 light of progress with the City Deal.

For new assets no MRP will be charged until the financial year after which the project is deemed to be operational.

Overpayments

The guidance does allow for charges in excess of the minimum to be made. It is not proposed that any overpayments will be made in 2020/21.

Summary of recommendations

In respect of the methodology for applying the MRP in respect of the repayment of debt, it is recommend that the Full Council:

- Approves the capital financing requirement method and the asset life method for expenditure.
- Charges to revenue a sum equal to the repayment of any credit liability.
- Approves the proposed treatment of assets constructed under the Preston, South Ribble and Lancashire City Deal subject to annual review.
- Approve the policy of not commencing charges to the revenue account until the capital project is operational.