REPORT OF:	**DIRECTOR OF FINANCE & IT**
TO:	**FINANCE COUNCIL**
ON:	**27th FEBRUARY 2017**

SUBJECT : TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY 2017/18

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1. PURPOSE OF THE REPORT

1.1 The Council is required to approve a Treasury Management Strategy before the start of each financial year. It must also set Treasury and Prudential Indicators and a policy for determining a "prudent" level of Minimum Revenue Provision for repayment of debt which is consistent with the Council's Medium Term Financial Strategy (MTFS).

2. RECOMMENDATIONS

2.1 The Council is recommended to approve:

(a) the proposed Treasury Management Strategy for 2017/18, including Treasury Management Indicators, as outlined in Appendix 1;

(b) the proposed Prudential Indicators for 2017/18, as outlined in Appendix 2;

(c) the proposed policy for determining the Minimum Revenue Provision (MRP) for repayment of debt, as outlined in Appendix 3.

3. BACKGROUND

3.1 The Council has adopted CIPFA's latest *Code of Practice on Treasury Management in the Public Services* and associated Guidance Notes. The proposed Treasury Management Strategy at Appendix 1, complies with both the CIPFA Code (2011 edition) and with the current guidance on Investments from the Department of Communities and Local Government (CLG) issued in March 2010.

3.2 CIPFA also issues the *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code), a professional code of practice to support local authorities in taking capital investment decisions. The current requirements of the Prudential Code have been followed in determining a range of proposed Prudential Indicators for 2017/18, as outlined in Appendix 2.

4. RATIONALE

4.1 The CIPFA *Code of Practice on Treasury Management in the Public Services* requires the Council to approve a Treasury Management Strategy, including various Treasury Management Indicators, before the start of each financial year.

4.2 The Council must also set Prudential Indicators to assess and measure the

affordability, sustainability and prudence of its capital investment plans. These, together with the policy for setting a “prudent” level of Minimum Revenue Provision for repayment of debt, must be consistent with the Council’s Medium Term Financial Strategy.

5. KEY ISSUES

5.1 Working within the regulatory and professional frameworks, the Council usually considers and agrees an Annual Treasury Strategy before the start of each year. This is followed up with a mid-year Strategy Review, considered alongside the Annual Outturn Report, summarising the position for the previous financial year. The key requirements for the Council are to maintain its two investment priorities:

1. the security of capital and
2. the liquidity of its investments

and to seek the most cost effective way of managing its debt portfolio.

5.2 The Prudential Code provides a framework to ensure that the capital investment plans of the Council are affordable, prudent and sustainable. The prudential indicators required by the Prudential Code are designed to support and record local decision making in a manner that is publicly accountable.

6. POLICY IMPLICATIONS

The policy implications from this report are contained within the Budget Strategy.

7. FINANCIAL IMPLICATIONS

7.1 The financial implications arising from the proposed recommendations contained within this report have been incorporated into the 2017/18 Budget, the Medium Term Financial Strategy and Council Tax recommendations to be considered by the Council.

8. LEGAL IMPLICATIONS

Under the Local Government Act 2003, local authorities must determine their levels of capital investment and associated borrowing. The Prudential Code has been developed to support local authorities in taking these decisions, and the Council is required, under Regulation 2 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as originally published), to have regard to the Code when carrying out its duties under Part 1 of the Local Government Act 2003.

Local authorities are required each year to set aside resources as provision for debt repayment. Previous detailed rules setting out how to calculate such a Minimum Revenue Provision (MRP) have been replaced by the requirement to make a ”prudent” provision, under regulations 27 and 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008.

9. RESOURCE IMPLICATIONS

None as a direct consequence of this report.

10. EQUALITY IMPLICATIONS

The decisions to be taken do not change policy and do not require any further consideration in respect of equality issues

11. CONSULTATIONS

The issues raised in this report have been discussed previously with Audit Committee and the Treasury Management Group.

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Contact Officer: Ron Turvey, Deputy Finance Manager – Ext 5303

Date: 15h February 2017

Background Papers: Capital programme 2017-2021 and associated papers

Appendix 1

TREASURY MANAGEMENT STRATEGY 2017/18

1. Introduction

CIPFA Treasury Management Codes require the Council to approve a Treasury Management Strategy before the start of each financial year. This requirement is also set out in the guidance issued by the Department for Communities and Local Government (CLG). This report fulfils the Council's obligations under both of these sets of guidance.

The Authority both borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

In accordance with the CLG Guidance, should the assumptions on which this report is based change significantly, it may be necessary to seek approval to a revised Treasury Management Strategy. Such circumstances could include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of investments made or borrowing required.

2. Economic Context

2.1 Economic Overview

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, but the Bank is expected to continue to exercise caution over increasing interest rates so as to avoid derailing the economy. The prospect of leaving the single market has dented business confidence and delayed new business investment and, unless counteracted by higher public spending or retail sales, this is expected to weaken economic growth in 2017/18.

Overseas, the US economy and its labour market show steady improvement, so the Federal Reserve is projected to increase interest rates a little. However the Eurozone has continued to struggle with very low inflation, and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The potential for political uncertainty to continue to impact on financial markets remains high, with significant elections due in France and Germany in 2017.

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

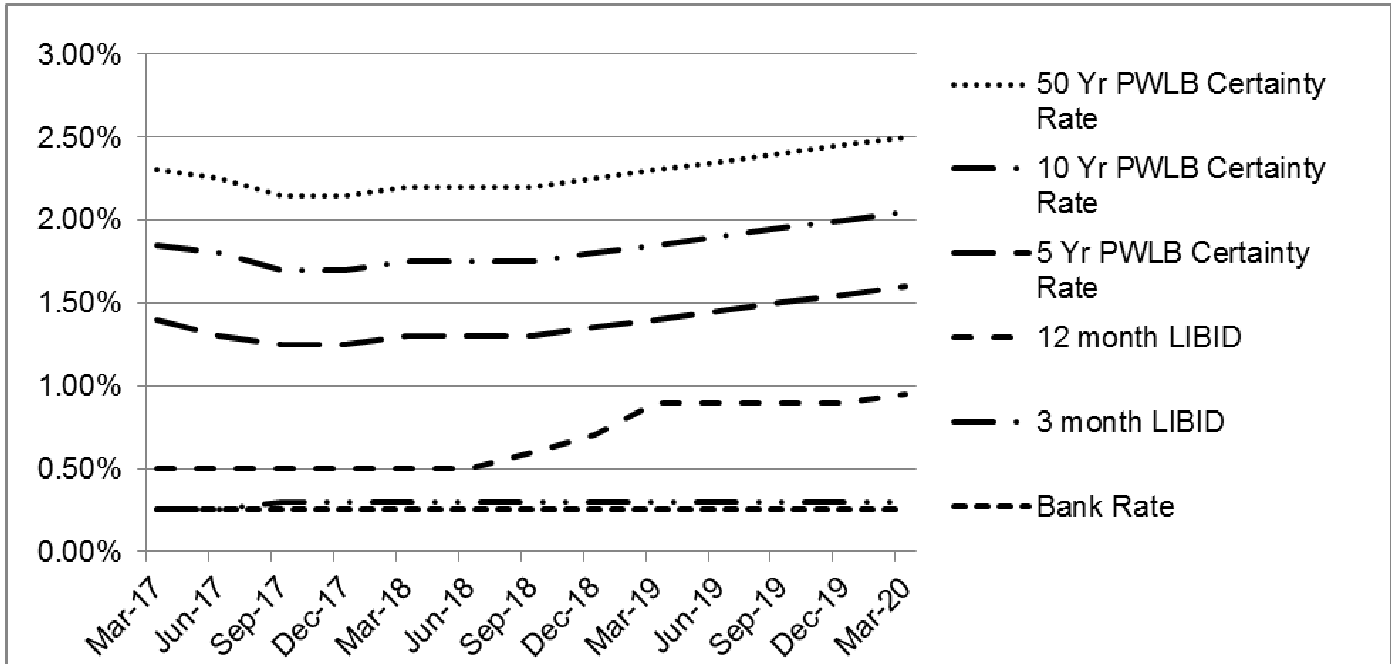
Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. Therefore the credit risk for the Council associated with making unsecured bank deposits is higher, relative to the risk of other investment options.

2.2 Projected Interest Rates

Arlingclose, the Authority's treasury advisor, forecast that the UK Bank Rate will remain at 0.25% during 2017/18. A negative Bank Rate is thought to be unlikely, but cannot be entirely ruled out, while rising inflation and/or continued economic growth could result in an earlier than expected increase in rates.

Arlingclose's projections for gilt yields, that is the price paid by the Government for borrowing, and Public Works Loan Board (PWLB) borrowing rates, are for a fall when the Government triggers Article 50, and then a slow and limited increase over the next few years. Some short term volatility is to be expected.

Our latest forecast of interest rates is shown below.



The PWLB rates relate to potential long term borrowing, and the LIBID (London Interbank Bid Rate) to short term borrowing and investment.

This is a realistic view of potential rates, however it must be recognised that there is significant uncertainty and risks to both the upside and downside.

For the purpose of setting the budget for 2017/18, it has been assumed that:

- any new investments will be at low rates, averaging around 0.2%,
- short-term borrowing will be available at an average of around 0.5% and
- new long-term loans will be available, if required, at rates below 2.0%.

3. Current and Expected Treasury Portfolios

3.1 Current Portfolio

The Council's Treasury portfolio as at 31st December 2016 was as follows:

		Principal Amount £M	Interest Rate %
External Debt			
Debt directly managed by Blackburn with Darwen BC			
	Short Term borrowing - maturing in 2016/17	23.0	0.32%
	Short Term borrowing - maturing in 2017/18	16.0	0.44%
	PWLB maturing in 2016/17	0.8	2.65%
	PWLB maturing in 2017/18 or later	105.3	4.19%
	Market Debt maturing in 2017/18 or later	21.8	4.68%
Total directly managed by Blackburn with Darwen BC		**166.9**	**3.35%**
Other Long Term Liabilities	Debt managed by Lancashire County Council (LCC)	16.3	2.00%
	Debt re Private Finance Initiative (PFI) Arrangements	68.9	9.04%
Total Gross External Debt		**252.1**	**7.02%**
Investments	- maturing in 2016/17	16.4	0.23%
	- maturing in 2017/18 or later	-	
Total Investments		**16.4**	**0.23%**
Net Debt		**235.7**	**7.50%**
Net Debt excluding LCC/PFI Debt		***150.5***	**3.69%**

3.2 Expected Changes

No long-term borrowing is included in current cash flow forecasts across the remainder of 2016/17 and across 2017/18. A significant and growing level of short-term borrowing will be required as the gap between long-term debt and the Capital Financing Requirement continues to widen, and as Council resources are squeezed. Accordingly Net Debt, excluding LCC/PFI debt, is expected to increase to over £160 million by 31st March 2017 and to over £180 million by 31st March 2018.

The decision as to when to take external borrowing will depend upon the level of cash balances available and on current and forecast interest rates.

3.3 Budget Implications

Excluding PFI costs (which are offset by Government grant funding), the budget for debt interest payable in 2017/18 is £6.2 million (including the interest element of payments to LCC for debt managed on our behalf), reflecting:

(a) £5.8 million interest payable on the long-term debt portfolio of £142 million, at interest rates averaging circa 4%, and
(b) up to £0.4 million for short-term borrowing, at interest rates of around 0.5%.

The budget for investment income in 2017/18 is around £30,000, based on an average investment portfolio of circa £15 million, and interest rates averaging 0.2%.

If actual levels of investments and borrowing and/or actual interest rates differ from those forecast, performance against budget will be correspondingly different.

4. Investment Strategy

4.1 Context

On a day to day basis the Council can hold significant surplus funds representing income received in advance of expenditure requirements in addition to balances and reserves held. In the past 12 months, the Council's investment balance has ranged from around £7 million to £33 million, reflecting in particular the profiles of capital spending, grant funding, short term borrowing levels and long term debt repayments.

Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.

4.2 Liquidity Management

The Council uses a cash flow model to determine the period for which funds may prudently be committed. The forecast is compiled on a prudent basis, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Furthermore, a prudent level of funds is maintained in 'instant access' investments, to cover most likely eventualities. However to mitigate risk further, it is possible to borrow funds to cover short-term needs.

Long-term investments are made with due regard to the Council's medium-term cash flow forecast and financial plans.

4.3 Setting and Applying Investment Criteria

The Council's surplus cash is currently invested in short-term unsecured bank deposits, building society deposits and money market funds, along with fixed term deposits with other local authorities and the Debt Management Office (DMO). Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council will consider the options to diversify into more secure and/or higher yielding asset classes during 2017/18, particularly if it finds itself with funds to invest for longer.

In order to prioritise the security of investments, the Council sets limits on the amounts placed with different institutions and as to the duration of the investment. This is to maintain a diversified investment portfolio and to align amounts and durations of investments to the perceived risks associated with different counterparties.

When deteriorating financial market conditions give cause for concern, the Council will further restrict its investments to those institutions of higher credit worthiness and reduce the duration of its investments to seek to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government (via the DMO or invested in government treasury bills for example) or with other local authorities. This may reduce the level of investment income earned, but will protect the principal sum invested.

The Council uses credit ratings from all the three main rating agencies (Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC) to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality. In order to make the limits straightforward to manage, limits are based on the Long-term ratings, as these ratings are those that address credit risk directly. Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade.

The ratings are obtained and monitored by the Council's Treasury Advisers, who will notify the Council of changes as they occur.

Credit ratings are a significant factor in assessing the creditworthiness of organisations however the Council understands that they are not perfect predictors of investment default. Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements, information on potential government support and other market information. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the specified criteria.

Investment limits are applied at the point at which new investments are made. They are set at cautious levels, allowing for the fact that circumstances may change while investments run their course.

It is proposed that if the investment criteria for a counterparty are no longer met, then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading, and as a result it is likely to fall below the specified minimum criteria, then no further investments other than into instant access accounts will be made until the outcome of the review is announced. This policy will not apply to negative outlooks which indicate a long-term direction of travel rather than an imminent change of rating.

Where a credit rating agency awards a different rating to a particular class of investment instrument as opposed to the credit rating of the counter-party as a whole, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

4.4 Investment Criteria for 2017/18

4.4.1 Approved Investment Counterparties

It is proposed to set the criteria at the same levels as were agreed for 2016/17.
On that basis, the Council may invest its surplus funds with any of the counterparty types in the table immediately below, subject to the cash and time limits shown AND any other investment limits also set out in successive paragraphs below.

Approved Investment Counterparties	Specified Investments		Non-specified Investments		
	Cash limit	Time limit	Cash limit	Time Limit > I year	1 year +
Banks and Building Societies – Secured Deposits					
long-term credit ratings no lower than AA (or equivalent)	£5M each	364 days	£5M each	-	6 years
long-term credit ratings no lower than AA- (or equivalent)	£4M each	364 days	£4M each	-	4 years
long-term credit ratings no lower than A- (or equivalent)	£3M each	364 days	£3M each	-	2 years
long-term credit ratings no lower than BBB+ (or equivalent)	-	-	£3M each	6 months	-
long-term credit ratings of BBB or BBB- (or equivalent)	-	-	£3M each	3 months	-
Banks and Building Societies – Unsecured Deposits					
long-term credit ratings no lower than AA (or equivalent)	£5M each	9 months	£3M each	-	3 years
long-term credit ratings no lower than AA- (or equivalent)	£4M each	6 months	£2M each	-	2 years
long-term credit ratings no lower than A- (or equivalent)	£3M each	4 months	£2M each	-	18 months
long-term credit ratings no lower than BBB+ (or equivalent)	-	-	£2M each	2 months	-
long-term credit ratings no lower than BBB (or equivalent)	-	-	£2M each	next day	-
The Council's **current account banker** - provided long term credit rating no lower than BBB- (or equivalent)	-	-	£3M	next day	-
Corporates or **Registered Providers** with long-term credit ratings no lower than A- (or equivalent)	£3M each	4 months	£2M each	-	18 months
Unrated institutions, such as some building societies	-	-	£1M each	4 months	-
Company Shares where no direct service benefit arising, for the prudent management of its financial affairs - e.g. LCFC	-	-	£100,000	n/a	
Pooled funds (incl. money market funds)					
long-term credit ratings no lower than A- (or equivalent)	£5M each	n/a	-	-	-
unrated or long-term credit ratings under A- (or equivalent)	-	-	£4M each	-	n/a
UK Government	no limit	364 days	no limit	-	50 years
Other Government with long-term-credit ratings no lower than A- (or equivalent)	£5M each	364 days	£3M each	-	5 years
UK Local Authorities* (irrespective of credit rating)	£5M each	364 days	£3M each	-	5 years
* as defined in the Local Government Act 2003					

The maximum that will be lent to any one organisation (other than the UK Government) will be £5 million, to limit the potential loss in the case of any single counterparty failure.

In accordance with the definitions set out in below (at 4.4.2 and 4.4.4)

(a) the combined **Secured and Unsecured Investments** made with any one counterparty will not exceed the cash limit for Secured Investments, and
(b) the combined value of the total of **Specified and Non-Specified Investments** with any one counterparty will not exceed the highest limit for any individual class of investment set out above

Investment in any bank that forms part of a group of banks under the same ownership will be subject to a Group Limit equal to the limit that would apply to the parent company.

4.4.2 Specified and Non-Specified Investments

Specified Investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines Specified Investments as those:

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

High Credit Quality

The definition of “high credit quality” is to be determined by each authority. This Council defines “high credit quality” organisations as those having a credit rating of A- or higher, if either domiciled in the UK ***or*** in foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds, “high credit quality” is defined as those having a credit rating of A- or higher.

Non-Specified Investments

Any investment not meeting the definition of a Specified Investment is classed as Non-Specified. They will only be made in the following categories

(a) shorter term investments in bodies and schemes with low or no credit ratings – these will be closely monitored by the Treasury Management Group (TMG), chaired by the Director of Finance and IT, and will follow advice given by the Council’s Treasury Management Advisers

(b) long-term investments, i.e. those that are due to mature in 12 months or longer from the date of the arrangement (in higher rated counterparties)

(c) treasury investments defined as capital expenditure by legislation, such as company shares, where there is a potential for a beneficial treasury impact.

The Council does not intend to make any investments in foreign currencies.

Overall limits also apply on Non-specified Investments, as shown the table below.

Non-Specified Investments - Overall Limits	Cash limit
Total long-term investments	£7 M
Total investments without credit ratings or rated below A- Building Societies or Banks (subject to additional overview) Council's current account bank (in addition to the above) Pooled Funds and Money Market Funds	 £7 M £3 M £15 M
Total non-specified investments	£30 M

4.4.3 Investment Limits for Foreign Countries

No country limit will apply to investments in the UK, irrespective of the UK's sovereign credit rating.

Investments in foreign countries will be limited to those that hold sovereign credit ratings of AA + or better from all three major credit rating agencies, and to a maximum of £5 million per foreign country.

The restriction on foreign investment will not apply to investment in pooled funds which may be domiciled overseas. Sovereign credit rating criteria and foreign country limits will also not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank).

4.4.4 Secured and Unsecured Deposits and Current Account Bankers

Unsecured Deposits: These include accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits with the Council's Current Account bank. A high level of monitoring of the credit-worthiness of the Current Account banker will be maintained if its ratings fall this low and this option will not be taken up if there are serious concerns.

The Council is still reviewing its banking arrangements, with consideration being given as to how best to procure banking services going forward.

Secured Deposits: These include covered bonds and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits potential losses in the unlikely event of insolvency and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

4.4.5 Investment in Other Government, Corporate and Registered Providers

Other Government – this covers loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency.

Equivalent investments with the UK Government may be made in unlimited amounts.

Corporates – this covers loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

Registered Providers – this covers loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and as providers of public services, they retain a high likelihood of receiving government support if needed.

4.4.6 Unrated Institutions

To allow the option to invest in the Municipal Bonds Agency, and to continue to retain the option to invest in unrated building societies, it is proposed to set the limits as set out in 4.4.1 above. Both would count as Non-Specified Investments.

Equally, should Money Market Funds and other Pooled Funds (see below) be, or become unrated, investment in them would cease to qualify as Specified, and the lower limits as a Non-Specified Investment would apply.

4.4.7 Pooled Funds (including Money Market Funds)

Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.

There remain proposals under development which may change how money market funds operate, and whether they will have credit ratings. In the event that such proposals are enacted, the Council will fully review the risk position regarding future use of money market funds with its Treasury Adviser and act accordingly.

Pooled Fund investments are investments in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee.

Pooled funds whose value changes with market prices, and/or have a notice period, will only be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

4.5 Strategy for 2017/18

Cash flow surpluses can be considered as falling into three categories -

(a) **Short-term funds** that are required to meet cash flows occurring in the next month or so, and for which the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

(b) **Medium-term funds** that may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks.

(c) **Long-term funds** that are not required to meet any liquidity need and can be invested with a greater emphasis on achieving higher returns. Security remains fundamental however, as any losses from defaults will impact on the total return. Liquidity is of lesser concern, although it should still be possible to sell investments with due notice if large cash commitments arise unexpectedly. This is where a wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds could be used to diversify the portfolio.

The overall Investment Strategy therefore, will be to prioritise security of funds and maintain a mix of short-term (largely instant access) and medium-term investments to generate investment income as market conditions permit. There are currently no long-term investments by the Council. If there are sufficient funds at a future date, the Council will consider its options for optimising returns and making more long-term investments.

With short-term interest rates still significantly lower than long-term rates, due consideration will also be given to continuing to use surplus funds to defer making long-term borrowing or even make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the Council's exposure to credit risk and interest rate risk.

The counterparty limits set out in section 4.4.1 above, allow for a wider range of investment opportunities to be taken up than have been used by the Council in the past. This will provide an opportunity to increase the diversification of the overall portfolio and in some instances, increase the security of investments made. The take up of any new investment opportunities will be closely managed by TMG, following advice given by the Council's Treasury Management Advisers.

5 Borrowing Strategy

5.1 Context and Forecast Needs

Excluding debt managed by LCC and that related to PFI arrangements, the Council currently holds circa. £128 million of long-term loans as part of its strategy for funding previous and current years' capital programmes.

Excluding LCC/PFI elements, the Council's Capital Financing Requirement (CFR, or underlying need to borrow for capital purposes) is projected to increase from £211 million at 31st March 2016 to £222 million at 31st March 2017, and thereafter to fall to

around £221 million by 31st March 2018, as capital financed from supported borrowing is exceeded by the MRP made in year.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The authority expects to comply with this recommendation.

The potential new (i.e. additional) **long-term** borrowing requirement for 2017/18 is:

	£M
Under–borrowed against CFR to end of 15/16	76.1
Plus Projected increase in CFR in 16/17 and 17/18	6.4
Less Long Term Borrowing to date in 16/17	0.0
Plus Profiled debt repayments 16/17 and 17/18	10.1
TOTAL	**92.6**

However the Authority has been able to maintain both long-term borrowing and investment below their underlying level, generating interest savings, and it expects to be able to continue that pattern over the next year.

It is likely therefore that the level of short-term borrowing, already significantly up on previous years, will continue to grow, as taking repeated short-term loans is likely to be cheaper than taking out long-term debt.

In addition, the Council may also borrow for short periods of time to cover unexpected cash flow shortages.

5.2 Sources of Borrowing

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments above (including UK local authorities)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

The Council has previously raised much of its long-term borrowing from the PWLB however other sources of finance may be available, and will also be considered.

The Authority still has £16.5 M of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £11.5 M of these LOBOS have options during 2016/17, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority may take the option to repay LOBO loans at no cost if it has the opportunity to do so. It is not currently expected that the Council will take any further LOBO loans - however in order to allow for some flexibility, the Council will limit its total exposure to LOBO loans to £25 M.

As an alternative to borrowing by taking loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative

The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. Blackburn with Darwen BC was one of a number of local authorities investing in the Agency to help establish it. It plans to issue bonds on the capital markets and lend the proceeds to local authorities.

This will be a more complicated source of finance than the PWLB for two reasons:

- borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans and
- there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

Any decision to borrow from the Agency will be subject to a separate report to Executive Board.

5.3 Strategy for 2017/18

The Authority's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans, should the Authority's long-term plans change, is a secondary objective.

Given the significant cuts to public expenditure, and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources or to borrow short-term loans instead. By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

The benefits of internal and short-term borrowing will be monitored regularly against the risk of incurring long term costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. The Council's Treasury Advisers will be used to help assess the 'cost of carry' of borrowing, to help determine whether the Authority takes on any long-term fixed rate borrowing in 2017/18. This could involve accepting additional costs in the short-term with a view to keeping future interest costs low.

Alternatively, the Authority may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance but the cash is received in later years. This would give certainty of cost without suffering a cost of carry in the intervening period.

In addition, the Authority may take out short-term loans to cover cash flow shortages.

Debt Rescheduling

The Public Works Loan Board allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates, or repay loans without replacement, where this is expected to lead to an overall saving or reduce risk.

6 Use of Derivatives

6.1 Derivatives

A derivative is a financial instrument whose value is derived from changes in the value of an asset or an index. Local authorities (including this Council) have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. deals agreed for future dates) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

Section 1 of the Localism Act 2011 included a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall 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. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall Treasury Risk Management Strategy.

Derivative Counterparties

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

7 Treasury Management Indicators

The Council is asked to approve the following Treasury Management Indicators:

Adoption of CIPFA Treasury Management Code of Practice

The Council adopted the 2011 edition of the CIPFA Treasury Management Code of Practice at its March 2012 meeting.

Gross Debt and the CFR

This indicator is set to ensure that the Council's external debt does not, except in the short term, exceed the accumulated Capital Financing Requirement across 2017/18, 2018/19, and 2019/20. It is not anticipated that this will be the case.

	2017/18 £M	2018/19 £M	2019/20 £M
CFR relating to Blackburn with Darwen Borough Council capital programme	221.3	217.1	212.9
CFR relating to debt managed by LCC	16.0	15.7	15.3
CFR relating to Other Long Term Liabilities re assets acquired through PFI projects	69.8	69.7	69.5
Total Capital Financing Requirement	**307.1**	**302.4**	**297.7**

£M	Current Gross Debt (31 December 2016)
166.9	managed by Blackburn with Darwen BC
16.3	managed by LCC
68.9	related to PFI
252.1	**Current Gross Debt**

Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. It is again set with regard to the debt directly managed by the Council (excluding LCC and PFI debt).

The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2017/18 £M	2018/19 £M	2019/20 £M
Upper limit on **fixed** interest rate exposures	220.2	216.2	212.2
Upper limit on **variable** interest rate exposures	54.2	58.3	57.3

The proposed Upper Limit on Variable Borrowing has been set on a higher basis than in previous years, because of the increased use of short term, variable rate borrowing as part of the Treasury Strategy. There is a resultant greater risk of increased interest costs for the Council in the event of a increase in variable interest rates.

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk - i.e. to prevent too much debt maturing at any one time, with a risk the Council will have to refinance at the rates then prevailing. The limits for up to 24 months have been relaxed in this year's strategy to allow for a higher level of short term borrowing.

The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	35%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and above	95%	25%

This indicator applies to the financial years 2017/18, 2018/19, and 2019/20.

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Where there is a prospect that a LOBO may be called, this has been reflected in setting these limits.

Principal Sums Invested for Periods Longer than 364 Days
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18 £M	2018/19 £M	2019/20 £M
Limit on principal invested beyond year end	7.0	5.0	3.0

The Indicators above are "standard" Treasury Management Indicators that are generally adopted by local authorities, in line with individual circumstances. These indicators have not directly addressed the key treasury priorities of Security and Liquidity, though these issues are already closely tracked throughout the year. However, working in conjunction with the Council's Treasury Advisers, options for the formal monitoring of performance in regard to these priorities remain under consideration.

8 Other Matters

CLG Investment Guidance also requires the Council to approve the following matters each year as part of the investment strategy:

8.1 Investment Consultants

Arlingclose Ltd are currently acting as the Council's Treasury Management Advisers and provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by an annual review.

8.2 Investment Training

The training needs of those staff involved in the Treasury Management function within the Finance Team are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by our Treasury Advisers and CIPFA.

8.3 Investment of Money Borrowed in Advance of Need

The Council may on occasion borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the Authorised Limit for External Debt of £322.8 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

9 Other Options Considered

The CLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt.

Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

The Director of Finance and IT, having consulted with the Executive Member for Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness.

Appendix 2

PROPOSED PRUDENTIAL INDICATORS

1. Introduction

CIPFA, the Chartered Institute of Finance and Accountancy, issued a fully revised edition in 2011 of the *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code), which underpins the system of capital finance.

Local authorities determine their own programmes for capital investment in fixed assets that are central to the delivery of quality public services. The Prudential Code has been developed as a professional code of practice to support local authorities in taking these decisions. The Council is required by Regulation to have regard to the Prudential Code when carrying out its duties under Part 1 of the Local Government Act 2003.

2. Objectives

The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to provide a framework that will ensure that the capital investment plans of the Council are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. In exceptional circumstances, the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring the above, so that the Council can take timely remedial action.

The prudential indicators required by the Prudential Code are designed to support and record local decision making in a manner that is publicly accountable. They are not designed to be comparative performance indicators, and should be considered in parallel with the treasury management indicators required by the CIPFA *Code of Practice on Treasury Management in the Public Services*.

3. Prudential Indicators for 2017/18

Estimates of Total Capital Expenditure to be Incurred

	2017/18 £M	2018/19 £M	2019/20 £M
Blackburn with Darwen Borough Council Capital Programme	21.2	14.0	13.4
Impact on Other Long Term Liabilities of assets acquired through PFI projects	0	0	0
Prudential Indicator for Total Capital Expenditure to be Incurred	**21.2**	**14.0**	**13.4**

Total capital spend in later years may be higher than currently forecast – however only spend funded from borrowing will impact on the Council's CFR.

Estimates of future Capital Financing Requirement

The Council must make reasonable estimates of the "total Capital Financing Requirement" – that is an estimate of the debt outstanding in respect of capital

expenditure, including Lancashire County Council (LCC) debt and that relating to the recognition of assets acquired under PFI projects, at the end of each of the next three financial years

	2017/18 £M	2018/19 £M	2019/20 £M
CFR relating to Blackburn with Darwen Borough Council capital programme	221.3	217.1	212.9
CFR relating to debt managed by LCC	16.0	15.7	15.3
CFR relating to Other Long Term Liabilities re assets acquired through PFI projects	69.8	69.7	69.5
Total Capital Financing Requirement	**307.1**	**302.4**	**297.7**

The LCC element relates to debt still managed by the County Council in respect of services transferred when Blackburn with Darwen became a Unitary Authority. The Other Long Term Liabilities in relation to PFI schemes are in respect of schools built under the Building Schools for the Future programme.

The authority's total debt over the period is projected to be lower than its highest forecast CFR.

Estimates of the Incremental Impact of Capital Investment Decisions on the Council Tax

The Council has to forecast the impact of the proposed Capital Investment decisions on Council Tax. The relevant cost of the 2017-18 capital programme proposals is:-

	2017/18 £	2018/19 £	2019/20 £
Capital financing costs	0.00	0.00	0.00
Impact on revenue running costs	0.00	0.00	0.00
Prudential Indicator for impact of investment decisions on Council Tax	**0.00**	**0.00**	**0.00**

This reflects the fact that no **new** unsupported borrowing proposals (and associated revenue running costs) are included in the new capital programme.

Estimates of Ratio of Financing Costs to Net Revenue Stream

The Council must estimate the proportion of the revenue budget taken up in financing capital expenditure.

The Net Revenue Stream is the sum of Council Tax, Business Rates and Non-Ring Fenced Central Government funding and represents the total available revenue funding which is under local control.

	2017/18 £M	2018/19 £M	2019/20 £M
Net Revenue Stream	125.9	125.7	126.9

The Indicator below is calculated on the basis that all of the Capital Programme, including Contingent elements, is delivered.

	2017/18	2018/19	2019/20
Main Programme capital financing costs as a proportion of Net Revenue Stream	14.73 %	14.98 %	15.05 %
BSF PFI capital financing costs as a proportion of Net Revenue Stream	5.20 %	5.14 %	5.10 %
Prudential Indicator for ratio of financing costs to Net Revenue Stream	**19.94 %**	**20.12 %**	**20.15 %**

The Council's capital financing costs in respect of BSF PFI schemes – both MRP and financing charges (interest elements) – are included, but this cost is largely covered by central government grant and does not put a pressure on Council resources.

It remains the case that a significant proportion of the net revenue budget is taken up in supporting the Main Programme part of the Capital Programme, but this is at a lower level than previous years' indicators as a result of the changes made to the Council's MRP Policy.

External Debt Prudential Indicators

The Council must set prudential limits for its **total** external debt, gross of investments, separately identifying borrowing from other long-term liabilities (i.e. Lancashire County Council debt and PFI assets completed). These limits are based mainly on the projected CFR, with an extra allowance for other short term borrowing needs. If the Council takes any borrowing from the PWLB, it is asked to confirm that it is operating within the limits it has set.

As well as setting an Authorised Limit for External Debt, the Council must also set an Operational Boundary for External Debt, inside the Authorised Limit, that the Council will look to operate within (though may *temporarily* exceed).

	Operational boundary for borrowing	Long Term Liabilities (LCC Debt & PFI Projects)	Operational Boundary for External Debt
	£M	£M	£M
2017-18	227.0	85.8	312.8
2018-19	222.8	85.3	308.1
2019-20	218.6	84.8	303.4
	Authorised limit for borrowing	**Long Term Liabilities (LCC Debt & PFI Projects)**	**Authorised Limit for External Debt**
	£M	£M	£M
2017-18	237.0	85.8	322.8
2018-19	232.8	85.3	318.1
2019-20	228.6	84.8	313.4

Appendix 3

MINIMUM REVENUE PROVISION GUIDANCE AND PROPOSED POLICY

1. Introduction

Local authorities are normally required each year to set aside some of their revenues as provision for debt repayment. Previously there were detailed rules setting out how to calculate such a Minimum Revenue Provision (MRP) but now, under Statutory Instrument 2008 no.414, it stipulates that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

There is not a specific definition of "prudent" provision however the Government issued MRP Guidance, making recommendations to authorities on the interpretation of that term. Authorities are legally obliged to "have regard" to any such guidance. A summary of the options under the Guidance is set out in Section 2, below.

Authorities are required to prepare an annual statement of their policy on their MRP Policy for submission to their full Council. This mirrors the existing requirements to report to the Council on the Prudential Borrowing Limit and Investment Policy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements.

2. Guidance on Options for Prudent Provision

The Guidance offers four main options, set out in outline below, under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

1. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.
2. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, having had regard to the guidance.

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the CFR on a reducing balance method, with some technical adjustments. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

This historic approach may be used for all capital expenditure incurred before 2007/08, and for new capital expenditure up to the amount which was deemed to be supported under the Government's financial settlement.

Option 2: Capital Financing Requirement Method

This is a variation on Option 1, based upon a charge of 4% of the aggregate CFR without the various technical adjustments under Option 1.

Option 3: Asset Life Method

This method may be applied to the debt arising from new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

a. equal instalment method – equal annual instalments
b. annuity method – annual payments gradually increase during the life of the asset

Option 4: Depreciation Method

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

3. Proposed MRP Policy

The following MRP Policy is proposed, acting under amended Guidance issued by the Government in February 2008.

Blackburn with Darwen BC Annual MRP Policy Statement for 2017/18

The Council implemented the new Minimum Revenue Provision (MRP) Guidance in 2007/08 and has, since then, assessed the MRP it will make in accordance with the main recommendations contained within the guidance issued by the Secretary of state under section 21(1A) of the Local Government Act 2003.

At Policy Council in January 2017, the Council made certain changes to its MRP Policy effective from 2016/17. It is proposed to continue on that basis, so that the Policy for 2017/18 is as follows:

(a) *For capital expenditure financed from debt arising up to 2007/08 and all new Government-supported borrowing arising from 2007/08 and thereafter* - to use the Asset Life Method, and spread the cost outstanding at the end of 2014/15 evenly over 50 years (from 2015/16 through to 2064/65)

(b) *For capital expenditure that is self-financed from debt arising in 2007/08 and thereafter* - to use the Asset Life Method, but to use the annuity variant based on the average Public Works Loan Board (PWLB) annuity rates prevailing in the year

of the expenditure (rather than the previous method of charging MRP on a straight line basis over the estimated life of the asset).

(c) *For finance leases and 'on-balance sheet' Private Finance Initiative (PFI) contracts* - to use the annuity variant of the Asset Life Method but use the annuity rates built into the financing arrangements (rather than the previous method of matching the MRP to the value of the rent/charge that is charged each year to write down the balance sheet liability of the respective finance lease or PFI contract).

(d) *For historic debt that was entered into prior to unitary authority status and is managed by Lancashire County Council (LCC)* - to spread the cost on a straight line basis over 49 years, in alignment with the profile for historic supported borrowing

(e) *In those cases where asset lives cannot be readily determined* - to use a default period of 20 or 25 years in line with Government Guidance. However the Council may make its own determination in exceptional circumstances, if the recommendation of the Guidance would not be appropriate.

(f) *Where loans are made to other bodies for their capital expenditure* – to charge no MRP. However, the capital receipts generated by the repayments on those loans will be put aside to repay debt instead.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives

Therefore, in the determination of MRP, the Council will be both:

(a) **prudent** - working within the principle that debt be repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits, and

(b) **practical** - making detailed determinations where the impact of the calculation will be material, but allowing a more general approach if that would be reasonable.