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SUBJECT : TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS, AND MINIMUM REVENUE PROVISION POLICY 2012/13

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 is also required to determine a range of Prudential Indicators and a policy for a “prudent” level of Minimum Revenue Provision for repayment of debt, both of which should be consistent with the Council’s Medium Term Financial Strategy.

2. RECOMMENDATIONS

2.1 The Council is recommended to adopt the CIPFA’s 2011 Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, and an updated Treasury Management Policy Statement, as outlined in Appendix 1.

2.2 The Council is recommended to approve:

(a) the proposed Treasury Management Strategy for 2012/13, including Treasury Management Indicators, as outlined in Appendix 2;

(b) the proposed Prudential Indicators for 2012/13, as outlined in Appendix 3;

(c) the policy proposals for determination of Minimum Revenue Provision for repayment of debt, as outlined in Appendix 4.

3. BACKGROUND

3.1 The Council has previously adopted CIPFA’s *Code of Practice on Treasury Management in the Public Services.* CIPFA has in 2011 published new editions of the Code of Practice and Guidance Notes, which it is recommended the Council adopt. The proposed Treasury Management Strategy, at Appendix 2, complies with both the latest CIPFA Code and with current CLG guidance on Investments.

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 2012/13, as outlined in Appendix 3.

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 for 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 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 - the security of capital, and liquidity of its investments - and to seek the most cost effective way of managing its debt portfolio.

5.2 CIPFA published a revised version of the Treasury Management Code in November 2011, in light of the additional financial freedoms available to local authorities in the *Localism Act 2011*. The Council is therefore asked to formally adopt the *Treasury Management in the Public Services: Code of Practice 2011 Edition.* The new Code of Practice requires some amendments to the Council's Treasury Management Policy Statement, and the Council is asked to formally adopt the new Policy Statement in Appendix 1.

The changes to the CIPFA guidance do not materially impact on the Treasury Strategy to be adopted.

5.3 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

The financial implications arising from the proposed recommendations of this report have been incorporated into the Budget report and Council Tax recommendation to be considered by the Council.

8. LEGAL IMPLICATIONS

Under the Local Government Act 2003, local authorities determine locally 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 by Regulation 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, under Statutory Instrument 2008 no 414, by the requirement to make a ”prudent” provision.

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 the Audit Committee and the Treasury Management Group.

Chief Officer	Elizabeth Hall, Director of Finance – Ext 5482
Contact Officer:	Joanne Holt, Finance Manager – Ext. 5478 Ron Turvey, Deputy Finance Manager – Ext. 5303
Date:	15th December 2012
Background Papers:	Draft capital programme 2012/15 and associated papers

Appendix 1

TREASURY MANAGEMENT POLICY STATEMENT

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

Definition
The Council defines its treasury management activities as: the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Risk management
The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

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

Borrowing policy
The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy
The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

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

Appendix 2

TREASURY MANAGEMENT STRATEGY 2012/13

1. Introduction

The Council has adopted successive CIPFA Treasury Management Codes, requiring the approval of a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments, in March 2010, that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's obligations under both of these sets of guidance.

2. Economic Context

2.1 Economic Overview

The UK economy is continuing its weak recovery from the 2008/09 recession, with GDP growth forecast to be around just 1.0% in 2011 and likely to remain sluggish throughout much of 2012. Government spending cuts, rising unemployment and uncertain export markets are keeping demand low, and a "double dip" recession cannot be ruled out. Consumer price inflation, which peaked at 5.2% in September, is expected to fall sharply as one-off factors like 2010's VAT increase and fuel price rises fall out of the annual comparison.

2.2 Projected Interest Rates

In these circumstances, the Bank of England is unlikely to raise Bank Rate for several months, and additional quantitative easing is seen by many as being more likely than rate increases in the near future. However, once a more robust recovery appears to be taking root, the Bank may prefer to gradually raise interest rates earlier, rather than wait and then need to make a sharp correction.

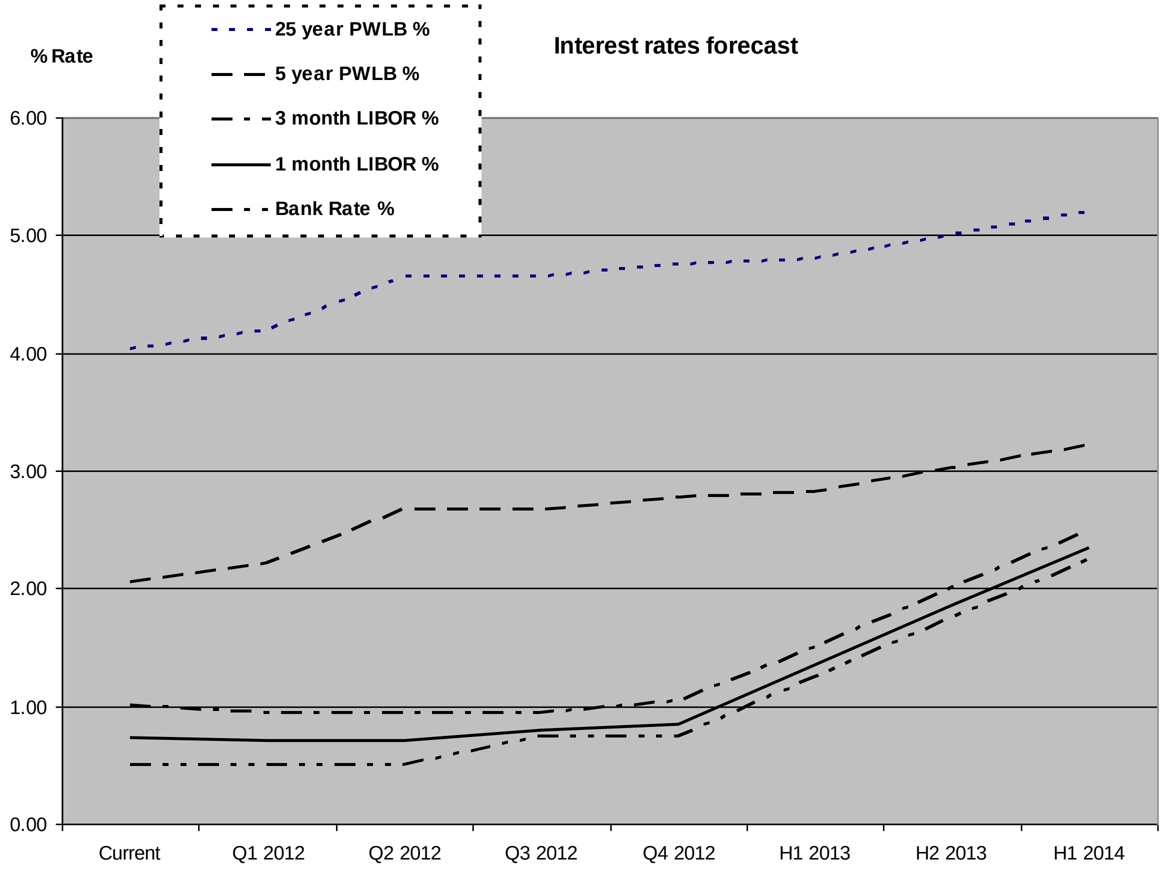
The Eurozone sovereign debt crisis remains a major driver of market sentiment and with the UK seen a safe haven, gilt yields and hence PWLB rates have fallen markedly this year. Assuming that there is some resolution to the crisis, long-term rates are likely to climb back to more normal levels in 2012/13.

A second UK recession or a European sovereign default would see short and long term interest rates remaining lower for longer, while a faster economic recovery and a bold solution to the Eurozone crisis would likely see rates rise more quickly.

The current HM Treasury Survey of Forecasts shows the following range of projections for Bank Rate over the next four years:

	Average annual Bank Rate %			
	2012	2013	2014	2015
Highest	1.1	2.6	3.0	3.7
Average	0.6	0.9	1.7	2.7
Lowest	0.5	0.5	0.9	1.4

Our forecast of interest rates is shown below.



This is a "central" view of potential rates, taken after consultation with our treasury advisors, with risks to both the upside and downside risk.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.70%, and that new long-term loans will be borrowed at an average rate of 4.75%.

3. Current and Expected Treasury Portfolios

3.1 Current portfolio

The Council's current treasury portfolio (as at 31st December 2011) is as follows.

		Principal Amount £m	Interest Rate %
Investments	- maturing 2011/12 - maturing 2012/13 or later	26.1 None	0.70%
Total Investments		**26.1**	**0.70%**
Borrowing by Blackburn with Darwen BC	PWLB maturing 2011/12 PWLB maturing 2012/13 or later Market Debt maturing 2012/13 or later	0.3 95.3 23.9	3.04% 4.90% 5.25%
Other Long Term Liabilities	Debt managed by Lancashire County Council	19.8	3.50%
Total Debt		**139.3**	**4.76%**
Net Debt		**113.2**	**5.69%**

3.2 Expected changes

Built into current cash flow forecasts is planned long-term borrowing of around £60 million across the remainder of 2011/12 and across 2012/13. This is primarily to "catch up" with borrowing to fund the capital programme, as revenue cash balances are squeezed, and ahead of potential increases in the cost of borrowing. Accordingly net debt is expected to increase to £140 million by 31st March 2012 and to £165 million by 31st March 2013.

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

The budget for investment income in 2012/13 is £0.24 million, based on an average investment portfolio of c. £35 million, and interest rates averaging c. 0.70%. The budget for debt interest payable in 2012/13 is £8.5 million (including the interest element of payments to LCC for debt managed on our behalf), based on an average debt portfolio of £181 million (including the LCC £19M) and interest rates averaging c. 4.7%

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

4. Investment Strategy

4.1 Context

The Council holds significant surplus funds, which represent income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £11 and £49 million. Both the CIPFA Code and the CLG Guidance require to 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**.

4.2 Setting and Applying Investment Criteria

In order to prioritise the security of investments, the Council needs to set limits as to amounts placed with different institutions and as to duration of 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.

The limits proposed are set at the same level as for 2011/12, as we set cautious limits at that stage. 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 security.

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. If the credit rating for a counterparty were to fall while funds were already placed with it, due consideration would then be given as to how the

Council should respond, depending on the nature of the investment, and the nature of any concerns that may arise as to the credit worthiness of the counterparty.

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 of any other existing investments.

Credit ratings are fundamental to setting Investment Criteria, but there are limitations to their usefulness, which are recognised.

4.3 Limits for 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".

The Council defines the following as being of "high credit quality" for making specified investments, subject to the monetary and time limits shown.

	Monetary limit[1]	Time limit
Banks and building societies holding long-term credit ratings no lower than AA or equivalent	£5M each	364 days
Banks and building societies holding long-term credit ratings no lower than AA- or equivalent	£4M each *	6 months*
* of which up to £2M may be placed for up to 364 days		
Banks and building societies not meeting the above criteria, but holding long-term credit ratings no lower than A- or equivalent	£3M each	3 months
UK building societies not meeting the above criteria, with a minimum asset size of £500 million, unless rated below BBB or equivalent	£1M each	3 months
Money market funds1 holding credit ratings no lower than AAA or equivalent	£5M each	1 week
UK Central Government	no limit	364 days
UK Local Authorities[2]	£4M each	364 days

[1] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[2] 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 bank failure.

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.

If the institution providing banking services to the Council does not meet the investment criteria set out above, and below, it will still be permitted to place up to £3M in an overnight call or deposit account to facilitate short run liquidity management. Under these circumstances a high level of monitoring of the credit-worthiness of the institution will be maintained, and this option will not be taken up if there are serious concerns.

The current banking contract, with RBS, runs to the end of 2012-13 and the service is likely to be put out to tender for a new contract across the summer of 2012.

Following the high levels of Government support given to the RBS bank, the RBS group is being required to reduce the scale of its activities and is selling the business based in English RBS branches to the Santander group. It is likely that this will mean the Council's banking services transferring to Santander late in the calendar year 2012.

4.4 Building Societies

UK building societies without credit ratings will be considered to be of "high credit quality", subject to asset size, but subject to more restricted cash and time limits than apply to those societies with satisfactory credit ratings. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. Investments in lower rated and unrated building societies will be reviewed if the insolvency regime is amended.

However, no investments will be made with building societies that hold a long-term credit rating lower than BBB or equivalent, due to the increased likelihood of default implied by this rating.

In order to prevent over-exposure to the building society sector as a whole, no more than 40% of available investment funds should be placed in this sector.

4.5 Money market funds

Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. Only funds that offer same-day liquidity and a constant net asset value will be used. These will be used as an alternative to instant access call accounts.

4.6 Limits for Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares).

Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement.

The maximum duration of the investment will depend upon its lowest published long-term credit rating:

Long-term credit rating	Time limit
AAA	5 years
AA+	4 years
AA	3 years
AA-	2 years *

** subject to a maximum of £2M*

Long-term investments will be limited to £3 million per organisation (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for specified investments in paragraph 4.3 above.

The time limit for any long-term investments in UK local authorities will be five years.

The total limit on long-term investments, and the total limit on non-specified investments, is proposed to be £7 million, to allow for flexibility in taking investment decisions, should the need or opportunity arise.

4.7 Limits for Investment in Foreign Countries

Investments in foreign countries will be limited to those that hold AAA, AA+ or AA sovereign credit ratings from all three major credit rating agencies, and to a maximum of £5 million per foreign country. Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria of and will count against the limit for both countries. There is no limit on investments in the UK.

Investments in countries whose lowest sovereign rating is AA+ will be limited to one year's duration, and those whose lowest rating is AA will be limited to three months.

The restriction on foreign investment will not apply to investment in AAA (or equivalent) rated money market funds, which may be domiciled overseas.

4.8 Credit Ratings

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 more straightforward to manage, they have been based on just the Long and Short-term Ratings, as these ratings are those that address credit risk directly.

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur.

Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it, so that it is likely to fall below the specified minimum criteria, then no further investments, other than into instant access funds, will be made until the outcome of the review is announced.

4.9 Other information on the security of investments

The Council understands that credit ratings are good, but 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 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 above criteria.

4.10 Investment instruments

Investments may by made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the Council can demand repayment)
- callable deposits (where the bank can make early repayment) – subject to an overall limit of £5 million
- certificates of deposit
- treasury bills and gilts issued by the UK Government
- bonds issued by AAA rated multilateral development banks (e.g. European Investment Bank)
- shares in money market funds

4.11 Liquidity management

The Council uses purpose-built cash flow forecasting software, along with other, spreadsheet models, to determine the period for which funds may prudently be committed. The forecast is compiled on a cautious 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. Nonetheless, 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.

4.13 Planned investment strategy for 2012/13

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

(a) **Short-term funds** are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it 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** which 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** 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.

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.

5 Borrowing Strategy

5.1 Context and Forecast Needs

Excluding debt managed by LCC, the Council currently holds c. £119 million of long-term loans, as part of its strategy for funding previous and current years' capital programmes. The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2012 is projected to be £170 million, and is forecast to rise to £185 million by March 2013 as capital expenditure is incurred.

The potential new (i.e. additional) long-term borrowing requirement for 2012/13 is:

	£m
Under–borrowed against CFR to end of 10/11	44.9
Projected increase in CFR in 11/12 and 12/13	30.8
Borrowed to date in 11/12	-7.0
Profiled debt repayments 11/12 and 12/13	1.2
TOTAL	**69.9**

However, depending on the pattern of interest rates during the year, it may be more cost effective to defer borrowing until later years, and to continue to keep down the size of the Council's investment balance instead.

In addition, the Council may 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
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues

5.3 Debt instruments

Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest, subject to the limits in paragraph 6, below
- lender's option borrower's option (LOBO) loans, subject to an overall maximum of £32 million overall (existing LOBO debt as at 31st December 2011 is £23.5M)

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

- leases
- Private Finance Initiative

5.4 Borrowing strategy to be followed

Whilst short-term interest rates remain much lower than long-term rates, it may continue to be more cost effective in the short-term to not borrow and reduce the level of investments held instead (in effect "borrowing" internally from the Council's own balances). However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against potential longer-term costs.

Longer term borrowing will be undertaken if it becomes apparent that long term interest rates may increase, or when the level of internal balances to "borrow" from reduces significantly.

The Council has previously raised much of its long-term borrowing from the Public Works Loan Board. However other sources of finance may be available, and will be considered alongside PWLB options

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 where this will lead to an overall saving or reduce risk.

5.5 Policy on 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).

The Localism Bill 2011 includes a general power 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 latest 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 the 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 will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

<u>Derivative counterparties</u>

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.

6 Treasury Management Indicators

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

<u>Adoption of CIPFA Treasury Management Code of Practice</u>

The Council has adopted all previous editions of the Code, and it is proposed that it will adopt the 2011 edition of the CIPFA Treasury Management Code of Practice at its March 2012 meeting.

<u>Interest rate exposures</u>

This indicator is set to control the Council's exposure to interest rate risk.

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

	2012/13 £M	2013/14 £M	2014/15 £M
Upper limit on fixed interest rate exposures	192.7	212.5	228.8
Upper limit on variable interest rate exposures	36.5	40.0	43.5

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

	Upper	Lower
Under 12 months	30%	0%
12 months and within 24 months	15%	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 2012/13, 2013/14 and 2014/15. 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:

	2012/13 £M	2013/14 £M	2014/15 £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, of course, already closely monitored throughout the year. However, working in conjunction with the Council's Treasury advisers, it is intended to investigate options for adding to the formal monitoring of performance in regard to these priorities as well.

Gross and net debt
The upper limit on net debt indicator was introduced in 2011 and is intended to highlight where the Council borrowing in advance of need. Since net debt does not change when loans are borrowed and the proceeds re-invested, it is not yet clear how this indicator will work. CIPFA has not yet produced guidance on its use, and so the Council is being asked to set a deliberately high limit this year.

It is therefore proposed that the upper limit on net debt (as a proportion of gross debt) be set at 100% for the financial years 2012/13, 2013/14 and 2014/15.

7 Other Matters

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

Investment consultants

The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, 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, reporting to both TMG and Audit Committee.

The exiting contract for treasury advice expires in March 2012 and the service is currently out for tender.

Investment training

The needs of the Council's treasury management staff for training in investment management 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 Sterling Consultancy Services and CIPFA.

Investment of money borrowed in advance of need

The Council may, from time to time, 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 £301.6 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.

8 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. The Director of Finance, having consulted the Executive Member Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Adopt a narrower definition of “high credit quality” and/or shorter time limits	Interest income will be lower	Reduced risk of losses from credit related defaults
Adopt a wider definition of “high credit quality” and/or longer time limits	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

Appendix 3

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* (see Appendix 2).

3. Prudential Indicators for 2012/13

Estimates of total capital expenditure to be incurred

	2012/13 £M	2013/14 £M	2014/15 £M
Blackburn with Darwen Borough Council Capital Programme	69.4	54.7	58.0
Impact on Other Long Term Liabilities of assets acquired through PFI projects	47.0		
Prudential Indicator for Total Capital Expenditure to be Incurred	**116.4**	**54.7**	**58.0**

In later years, particularly, this may not include all projects for which additional grant finance may be approved during the year. However, grant funded spending will not affect the Council's Capital Financing Requirement.

Estimates of future Capital Financing Requirement

The Council must make reasonable estimates of the "total Capital Financing Requirement" - this is effectively the remaining 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 the next three financial years

	2012/13 £M	2013/14 £M	2014/15 £M
CFR relating to Blackburn with Darwen Borough Council capital programme	190.0	207.7	224.7
CFR relating to debt managed by LCC	18.8	18.1	17.4
CFR relating to Other Long Term Liabilities re assets acquired through PFI projects	76.8	73.6	70.5
Total Capital Financing Requirement	**285.6**	**299.4**	**312.6**

The LCC element relates to debt managed by the County Council in respect of transferred services.

The Other Long Term Liabilities in relation to PFI schemes are in respect of schools built under the Building Schools for the Future programme.

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 2012-15 capital programme proposals is:-

2012-13	£1.03
2013-14	£6.16
2014-15	£15.80

This reflects the costs of new unsupported borrowing – calculated using the proposed MRP (Minimum Revenue Provision) policy – and of the associated revenue running costs of the capital programme proposals. These costs are reflected in the proposed Medium Term Financial Strategy.

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.

2012-13	11.6 %
2013-14	13.8 %
2014-15	15.2 %

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). 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 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**
2012-13	196.0	95.6	291.6
2013-14	213.7	91.7	305.4
2014-15	230.7	87.9	318.6

	Authorised limit for borrowing	**Long Term Liabilities (LCC Debt & PFI Projects)**	**Authorised Limit for External Debt**
	£M	**£M**	**£M**
2012-13	206.0	95.6	301.6
2013-14	223.7	91.7	315.4
2014-15	240.7	87.9	328.6

Appendix 4

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. Whereas there were previously detailed rules setting out how to calculate such a Minimum Revenue Provision (MRP), now, under Statutory Instrument 2008 no.414, it is required 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 have to prepare an annual statement of their policy on making MRP 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 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, after 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 adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach may be used for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method

This method may be applied to the debt arising from most 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 Guidance issued by the Government in February 2008.

Blackburn with Darwen BC Annual MRP Policy Statement for 2012/13

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.

Within this framework, the Council proposes:

(a) for **existing capital expenditure financed from debt up to 2007/08** and all new **Government-supported borrowing arising in 2007/08 AND thereafter**, to use the Regulatory Method to determine MRP,

(b) for **capital expenditure financed from debt arising in 2007/08 AND thereafter** that is **self-financed** (i.e. not supported by the Government), to use the Asset Life Method to determine MRP,

(c) when capital expenditure financed from debt arises on major schemes, to make no MRP until the year after the asset becomes operational.

(d) in the case of finance leases and on-balance sheet PFI contracts, to set the MRP requirement at a level equal to the element of the rent/charge that goes to write down the balance sheet liability. This would have the effect of ensuring that the combined effect of MRP and finance charge for finance leases and on-balance sheet PFI schemes would equal the rent or service charge payable for the year.

To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the Guidance, these periods will generally be adopted by the Council. However, the Council will determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the Guidance would not be appropriate.

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

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 taking a more general approach to the remaining unsupported debt taken on.