

Blackburn with Darwen Borough Council

Treasury Management Strategy
2014/15

Including the Council's Investment and Borrowing
Strategy, Prudential Indicators and Minimum
Revenue Provision Guidance and Policy

TREASURY MANAGEMENT STRATEGY 2014/15

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.

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.

2. Economic Context

2.1 Economic Overview

The Bank of England's Monetary Policy Committee (MPC) indicated that it would keep policy (interest) rates low for an extended period, using the Labour Force Survey unemployment rate of 7% as a threshold for further consideration as to whether to raise rates. Unemployment has fallen much faster than expected, and is now 7.2%, but this has not led to any wage growth and productivity remains stagnant. The MPC has made it clear that reaching 7% will not be a policy trigger.

The fall in consumer price inflation from the high of 5.2% in September 2011 to 1.9% in January 2014 will allow real wages (i.e. after inflation) to slowly increase, aiding consumer spending.

Stronger data in 2013 showed GDP growing by 1.9% in 2013. There is clearly some momentum in the economy, although some weaknesses remain, particularly in the levels of business investment, notwithstanding increased demand for credit from larger enterprises. The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. With jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts still to fully impact, further growth may still be gradual.

In the US expectations for the slowing in the pace of asset purchases ('tapering') by the Federal Reserve and the end of further asset purchases will remain predominant drivers of the financial markets. The Fed has indicated it will scale back bond-buying in 2014 which will be supportive of bond and equity markets in the interim.

Credit outlook: The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery

process - this is already manifest in relation to holders of subordinated debt issued by the Co-op. There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

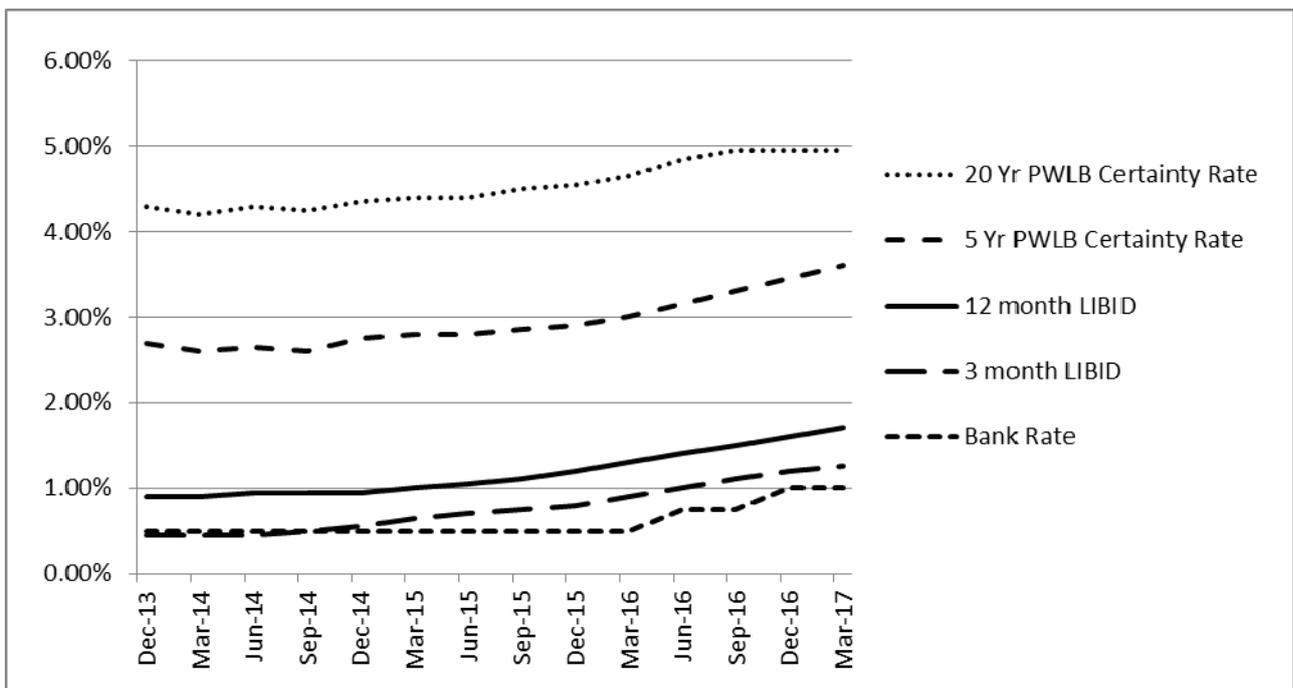
2.2 Projected Interest Rates

The last HM Treasury Survey of Forecasts (November 2013) showed the following range of projections for Bank Rate over the next four years:

	Average annual Bank Rate %			
	2013	2014	2015	2016
Highest	0.50	0.90	1.80	2.20
Average	0.50	0.52	0.80	1.46
Lowest	0.50	0.50	0.50	0.69

The Council's treasury adviser, Arlingclose, forecasts the MPC will maintain its resolve to keep interest rates low until the recovery is convincing and sustainable, and that Bank Rate will remain flat until mid-2016, with more significant risk to the upside into later years. Gilt yields, which drive the interest rates charged by the Public Works Loan Board (PWLB), are expected to rise over the forecast period, with medium and long-dated gilts expected to rise by between 0.5% and 1.0%. A faster economic recovery would likely see rates rise more quickly.

Our latest forecast of interest rates is shown below.



This is a "central" view of potential rates, with significant uncertainty, and risks to both the upside and downside.

For the purpose of setting the budget for 2014/15, it has been assumed that new investments will be made at an average rate of 0.42%, and that new long-term loans will be borrowed at an average rate of 4.40%.

3. Current and Expected Treasury Portfolios

3.1 Current Portfolio

The Council's current treasury portfolio (as at 31st December 2013) is as follows.

		Principal Amount £m	Interest Rate %
External Debt			
Borrowing by Blackburn with Darwen BC	PWLB maturing 2013/14	0.8	2.72%
	PWLB maturing 2014/15 or later	114.4	4.57%
	Market Debt maturing 2014/15 or later	23.9	5.24%
Other Long Term Liabilities	Debt managed by Lancashire County Council	18.5	2.40%
	Debt re PFI Arrangements	74.5	9.13%
Total Gross External Debt		232.1	5.92%
Investments	- maturing 2013/14	25.8	0.43%
	- maturing 2014/15	-	
	- maturing 2015/16 or later	-	
Total Investments		25.8	0.43%
Net Debt		206.3	6.61%

Net Debt excluding LCC/PFI Debt **113.3** **5.64%**

3.2 Expected Changes

Built into current cash flow forecasts is planned long-term borrowing of around £36 million across the remainder of 2013/14 and across 2014/15. This includes an element of "catch up" against previous under-borrowing for the capital programme, as revenue cash balances are squeezed, and allows for potential increases in the cost of borrowing. Accordingly net debt excluding LCC/PFI debt is expected to increase to over £120 million by 31st March 2014 and to over £140 million by 31st March 2015.

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 elements, largely offset by Government grant funding, the budget for debt interest payable in 2014/15 is £ 7.8 million (including the interest element of payments to LCC for debt managed on our behalf), based on an average debt portfolio of £180 million (including the LCC at an average £17.7M) and interest rates averaging c. 4.3%.

The budget for investment income in 2014/15 is £0.12 million, based on an average investment portfolio of c. £27 million, and interest rates averaging c. 0.42%.

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 from £20 million to over £70 million, mainly as a result of uneven government grant funding profiles, and a similar range is anticipated in the next year. 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**.

The Authority'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 unsuitably low investment income.

4.2 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.

4.3 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 cautious levels and broadly the same as for 2013/14.

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 Debt Management Office for example, or with other

local authorities. This will cause a reduction in 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 changes as they occur.

Credit ratings are a significant factor in assessing the creditworthiness of organisations. However 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, 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 above 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 it, so that 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.

The Council's investments are normally senior unsecured liabilities of the borrower, and the credit rating of the investment is therefore normally identical to the credit rating of the counterparty. However, where a credit rating agency awards a different rating to a particular class of investment instruments, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

4.4 Investment Criteria for 2014/15

4.4.1 Approved Investment Counterparties

The Council may invest its surplus funds with any of the counterparties in the table immediately below, subject to the cash and time limits shown, AND to any other investment limits also set out in successive paragraphs below.

Approved Investment Counterparties	Cash limit	Time limit
Banks and other organisations/securities holding long-term credit ratings no lower than AA (or equivalent)	£5M each	364 days
Banks and other organisations/securities holding long-term credit ratings no lower than AA- (or equivalent)	£4M each	364 days
Banks and other organisations/securities holding long-term credit ratings no lower than A- (or equivalent)	£3M each	6 months
The Council's current account banker - provided long term credit rating no lower than BBB- (or equivalent)	£3M	next day
UK building societies not meeting the above criteria, with a minimum asset size of £500 million, unless rated below BBB (or equivalent)	£1M each	6 months
Money market funds	£5M each	n/a
UK Central Government	no limit	364 days
UK Local Authorities* (irrespective of credit rating)	£4M each	364 days

* as defined in the Local Government Act 2003

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.

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.

As in 2013-14, it is proposed that there is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation providing that it meets the credit rating criteria above. This reflects a lower likelihood that central government will support failing banks following the Independent Commission on Banking report, as well as the removal of restrictions on local authority purchases of corporate bonds in April 2012.

4.4.2 Current Account Bank

If the institution providing banking services to the Council holds a credit rating below A-, but no lower than BBB-, 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 Council's current accounts are held with the Royal Bank of Scotland. The current banking contract has been extended twice, currently to run to September 2014, and further consideration will be given as to how to best procure banking services in the future, in the light of continuing uncertainty in that sphere.

4.4.3 Building Societies

The Authority takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Authority's deposits would be paid out in preference to retail depositors. The Authority will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

No investments will be made with building societies that hold a long-term credit rating lower than BBB, 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.

4.4.4 Money Market Funds

Money market funds are pooled investment vehicles consisting of money market deposits and similar instruments. 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 dividend paid to the Council.

Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period may be used for longer investment periods.

In a change to previous policy, the Council has removed the requirement for AAA ratings as there are currently EU proposals under development which may prevent money market funds from having credit ratings. In the event that these 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.

4.4.5 Specified and Non-specified Investments - Definition of High Credit Quality

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.

The Council will, from 2014/15, define “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. The Council does not intend to make any investments in foreign currencies, nor any new investments 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, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on Non-specified Investments are shown the table below.

Non-Specified Investment Limits	Cash limit
Total long-term investments	£7 M
Total investments without credit ratings or rated below A- Building Societies Council's current account bank Money Market Funds (if credit ratings position amended)	£10 M £3 M £15 M
Total investments in foreign countries rated below AA+	£2 M
Total non-specified investments	£37 M

4.4.6 Long Term Investment Limits

The total limit on long-term investments, as already noted, will be £7 million, to allow for flexibility in taking investment decisions, should the need or opportunity arise.

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

Long-term investments will be limited to £3 million per organisation (except the UK Government), or £2M for organisations with a lowest rating of AA-. The combined value of short-term and long-term investments with any organisation will not exceed the limits for investments set out in paragraph 4.4.1 above.

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

4.4.7 Limits for Investment in 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 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 generally need to meet the rating criteria of and will count against the limit for both countries. However, Santander UK plc (a subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will now be classed as UK banks due to their substantial UK franchises and the arms-length nature of the parent-subsidary relationships.

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. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank).

4.5 Strategy for 2014/15

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. 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.

5 Approved Instruments

The Authority may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Authority may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £5 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

6 Borrowing Strategy

6.1 Context and Forecast Needs

Excluding debt managed by LCC and that related to PFI arrangements, the Council currently holds c. £139 million of long-term loans, as part of its strategy for funding previous and current years' capital programmes.

Again excluding LCC/PFI elements, the Council's capital financing requirement (CFR, or underlying need to borrow for capital purposes) as at 31st March 2014 is projected to be £190 million, and is forecast to rise to beyond £215 million by March 2015 as capital expenditure is incurred.

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 2014/15 is:

	£M
Under-borrowed against CFR to end of 12/13	29.2
Projected increase in CFR in 13/14 and 14/15	52.8
Borrowed to date in 13/14	0.0
Profiled debt repayments 13/14 and 14/15	5.1
TOTAL	87.1

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.

6.2 Sources of Borrowing

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

- Public Works Loan Board
- UK local authorities
- any institution approved for investments above
- any other bank or building society authorised by the Prudential Regulation Authority
- UK public and private sector pension funds (new from 2014/15)
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues

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 Authority holds £23.5 M of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £18.5 M of these LOBOS have options during 2014/15, 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. Total borrowing via LOBO loans will be limited to £32 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

6.3 Strategy for 2014/15

The Authority's chief 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 may be more cost effective in the short-term to either use internal resources, or to borrow short-term loans

instead. This would also have the advantage of reducing overall treasury risk, as it would reduce the level of funds being invested.

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. The Council's treasury advisers will assist with this analysis. It may be the case that long term fixed rate borrowing will be undertaken at additional short term cost with a view to minimising future interest costs.

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

In addition the Council may take short-term borrowing (normally for up to one month) to cover immediate cash flow requirements.

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.

7 Use of Derivatives

7.1 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 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 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.

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.

8 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

	2014/15 £M	2015/16 £M	2016/17 £M
CFR relating to Blackburn with Darwen Borough Council capital programme	222.7	235.6	225.9

This indicator is set to ensure that the Council's external debt does not, except in the short term, exceed the total of the Capital Financing Requirement in 2013/14 plus the estimates of any additional capital financing requirement for 2014/15, 2015/16 and 2016/17. It is **not** anticipated that this will be the case.

Interest Rate Exposures

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:

	2014/15 £M	2015/16 £M	2016/17 £M
Upper limit on fixed interest rate exposures	226.8	239.0	230.0
Upper limit on variable interest rate exposures	43.0	50.5	48.5

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 2014/15, 2015/16 and 2016/17. 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:

	2014/15 £M	2015/16 £M	2016/17 £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 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.

9 Other Matters

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

9.1 Investment Consultants

The Council's treasury management advisers are Arlingclose Limited, who 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.

9.2 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 our treasury advisers and CIPFA.

9.3 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 £416.5 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.

10 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
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

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 2014/15

Estimates of Total Capital Expenditure to be Incurred

	2014/15 £M	2015/16 £M	2016/17 £M
Blackburn with Darwen Borough Council Capital Programme	89.7	39.1	12.9
Impact on Other Long Term Liabilities of assets acquired through PFI projects	0	0	0
Prudential Indicator for Total Capital Expenditure to be Incurred	89.7	39.1	12.9

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

	2014/15 £M	2015/16 £M	2016/17 £M
CFR relating to Blackburn with Darwen Borough Council capital programme	222.7	235.6	225.9
CFR relating to debt managed by LCC	17.4	16.7	16.0
CFR relating to Other Long Term Liabilities re assets acquired through PFI projects	71.5	70.1	68.6
Total Capital Financing Requirement	311.6	322.4	310.5

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 2014-17 capital programme proposals is:-

	2014/15 £	2015/16 £	2016/17 £
Capital financing costs	6.35	6.15	5.96
Impact on revenue running costs	-6.35	-6.15	-5.96
Prudential Indicator for impact of investment decisions on Council Tax	0.00	0.00	0.00

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. The only new schemes financed from unsupported borrowing included in the Capital Programme proposals are “invest to save” schemes whereby any capital financing costs are forecast to be offset by savings on revenue running costs.

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. This has already fallen significantly (from £154.7M in 2011/12) and is projected to fall further.

	2014/15 £M	2015/16 £M	2016/17 £M
Net Revenue Stream	143.8	132.0	129.1

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

	2014/15	2015/16	2016/17
Main Programme capital financing costs as a proportion of Net Revenue Stream	16.92 %	19.76 %	21.83 %
BSF PFI capital financing costs as a proportion of Net Revenue Stream	5.72 %	6.09 %	6.24 %
Prudential Indicator for ratio of financing costs to Net Revenue Stream	22.64 %	25.86 %	28.07 %

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.

However, at a time of severe resource constraints for the Council, the high proportion of the net revenue budget taken up in supporting the Main Programme part of the Capital Programme should be noted.

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
2014-15	317.6	88.9	406.5
2015-16	328.3	86.8	415.1
2016-17	316.4	84.5	400.9

	Authorised limit for borrowing	Long Term Liabilities (LCC Debt & PFI Projects)	Authorised Limit for External Debt
	£M	£M	£M
2014-15	327.6	88.9	416.5
2015-16	328.3	86.8	425.1
2016-17	326.4	84.5	410.9

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 2014/15

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.
- (e) where loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

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.