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# ASHFIELD DISTRICT COUNCIL

Council Offices,
Urban Road,
Kirkby in Ashfield
Nottingham
NG17 8DA

Agenda

# Extraordinary Cabinet (Tax Setting)

| | |
|---|---|
| Date: | **Monday, 5th March, 2018** |
| Time: | **6.00 pm** |
| Venue: | **Committee Room, Council Offices, Urban Road, Kirkby-in-Ashfield** |

For any further information please contact:

**Julie Robinson**

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01623 457316

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# CABINET

## Membership

| | |
|---|---|
| **Chairman:** | Councillor Cheryl Butler |
| **Vice-Chairman:** | Councillor Don Davis |

**Councillors:**

| | |
|---|---|
| Amanda Brown | Tim Brown |
| Jackie James | Keir Morrison |
| Nicolle Ndiweni | |

## FILMING/AUDIO RECORDING NOTICE

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## SUMMONS

You are hereby requested to attend a meeting of the Cabinet to be held at the time/place and on the date mentioned above for the purpose of transacting the business set out below.

**R. Mitchell**
**Chief Executive**

## AGENDA — Page


| | | Page |
|---|---|---|
| 1. | **To receive apologies for absence, if any.** | |
| 2. | **Declarations of Disclosable Pecuniary or Personal Interests and Non-Disclosable Pecuniary/Other Interests.** | |
| 3. | **Council Tax 2018/19.**<br>Key Decision included in the Forward Plan of Executive Decisions<br>Portfolio Holder: Councillor Jackie James | 5 - 12 |
| 4. | **Council's Treasury Management Strategy.**<br>Key Decision included in the Forward Plan of Executive Decisions<br>Portfolio Holder: Councillor Jackie James | 13 - 68 |

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|---|---|---|---|
| **Report To:** | **CABINET** | **Date:** | **5 MARCH 2018** |
| **Heading:** | **COUNCIL TAX 2018/19** | | |
| **Portfolio Holder:** | **CORPORATE RESOURCES AND FINANCE** | | |
| **Ward/s:** | **ALL** | | |
| **Key Decision:** | **YES** | | |
| **Subject to Call-In:** | **NO** | | |

**Purpose of Report**

To agree and recommend the Council Tax level for 2018/19 to Council.

**Recommendation(s)**

That a 2018/19 Band D Council Tax level of £185.46 for Ashfield District Council is recommended to Council.

**Reasons for Recommendation(s)**

In order to set a balanced budget for 2018/19 in the context of the Council's Medium Term Financial Strategy.

**Alternative Options Considered**

The Council Tax level for 2018/19 can be set at any level up to and including a £5 increase at Band D or 2.99%, whichever is greater. Any proposed increase above this level would be subject to a referendum. Section 2 of the Detailed Information gives details.

**Detailed Information**

**1. Background**

The Council's detailed Revenue Budget for 2017/18 (Revised) and 2018/19 was agreed by Cabinet on 19 February 2018. The purpose of this report is to recommend a Council Tax level for 2018/19 to Council.

The recommended Council Tax at Band D, £185.46, is estimated to generate income to the Council of £6.146 million. This figure was used in the budget which has already been recommended to Council (19 February) and consequently there are no changes proposed to the detailed budget arising from this report.

The Government announced the final Local Government Settlement on 6 February 2018. There have been minor changes to the Business Rates Tariff, but this does not have a material effect on the budget and consequently no changes have been applied.

## 2. Council Tax Options

On 6 February 2018, the Secretary of State for Housing, Communities and Local Government confirmed the Council Tax Referendum Principles for 2018/19. District Councils are permitted to increase Council Tax by 2.99% or £5 on a Band D property for 2018/19. Any proposal to increase Council Tax by more than this would trigger a referendum.

For the purpose of this report an increase of £5 (a rise of 2.77%) at Band D has been applied.

The movement in the Council Tax base equates to 594.3 properties. The movement in the Council Tax base, with no increase in Council Tax would generate £107k. A £5 increase in Council Tax at Band D will add a further £166k to the amount raised via Council Tax bringing the total of additional Council Tax raised compared to last year to £273k. This increase is integral to the future financial standing of the Council and mitigates the amount of savings that are required as set out in the MTFS.

The overall increase, from £5.873m to £6.146m (£273k) is shown in the budget report recommended to Council on 19 February 2018.

Residents living in a Band D property will pay £5 extra Council Tax over the financial year 2018/19. For those living in a Band A property (around 53% of the district's housing stock is Band A) the annual increase is £3.33.

This is the equivalent of a 6 pence per week increase to those residents.

## 3. Preceptors' Council Tax Levels

These tables give details of the Council Tax levels to be charged by the various other public bodies, or "preceptors" whose charges form part of the Council Tax bills for Ashfield residents.

### a) Ashfield District Council

The following is proposed for Ashfield District Council for 2018/19, as explained in Section 2 above:

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | The Council Tax Base has increased. This mainly reflects new development in the District, but also reflects changes to the numbers of residents supported by the Council's Local Council Tax Support Scheme, and any changes to discounts and exemptions (e.g. Single Person's Discount). |
| Council Tax Requirement | **£6,146,237** | £5,873,287 | The Council is raising an additional £273k for the ongoing funding of its services (see Section 2). |
| Council Tax at Band D | **£185.46** | £180.46 | A proposed increase of £2.77%. This will be considered at the meeting of Council which follows this meeting. |

The relevant bands of Council Tax for Ashfield would be as follows. These represent a 2.77% increase over 2017/18.

| | A | B | C | **D** | E | F | G | H |
|---|---|---|---|---|---|---|---|---|
| *Proportion of Band D* | *6/9* | *7/9* | *8/9* | ***9/9*** | *11/9* | *13/9* | *15/9* | *18/9* |
| Amount of Council Tax (ADC element) | £123.64 | £144.25 | £164.85 | **£185.46** | £226.67 | £267.89 | £309.10 | £370.92 |

**b) <u>Annesley and Felley Parish Council</u>**

Annesley and Felley Parish Council has declared the following for 2018/19:

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **548.4** | 533.3 | The Council Tax Base has increased. This mainly reflects new development in the Parish, but also reflects changes to the numbers of residents supported by the Council's Local Council Tax Support Scheme, and any changes to discounts and exemptions (e.g. Single Person's Discount). |
| Council Tax Requirement | **£55,530** | £54,002 | The Parish Council is raising an additional £1.5k to fund its parish services. |
| Council Tax at Band D | **£101.26** | £101.26 | A 0% increase. This has been formally notified to the Council. |

**c) <u>Selston Parish Council</u>**

Selston Parish Council has declared the following for 2018/19:

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **3,717.7** | 3,661.5 | The Council Tax Base has increased. This mainly reflects new development in the Parish, but also reflects changes to the numbers of residents supported by the Council's Local Council Tax Support Scheme, and any changes to discounts and exemptions (e.g. Single Person's Discount). |
| Council Tax Requirement | **£234,289** | £230,748 | The Parish Council is raising an additional £3.5k to fund its parish services |
| Council Tax at Band D | **£63.02** | £63.02 | A 0% increase. This has been formally notified to the Council. |

## d) **Nottinghamshire County Council**

Nottinghamshire County Council has declared the following for 2018/19. This table shows the whole amount of the Council Tax Precept issued by the County Council, and the whole amount paid at Band D. See also the following tables.

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | The Council Tax Base has increased. See table at (a) above. |
| Council Tax Requirement | **£47,040,620** | £44,001,486 | The County Council is raising an additional £3.039m from the Ashfield area to fund its services. |
| Council Tax at Band D | **£1,419.43** | £1,351.97 | An increase of £67.46 or 4.99%. This increase has been formally notified to the Council. |

Councils providing social care functions are allowed to set an additional element of their precept to provide additional funding towards social care services. These increases are governed by a separate set of rules to those set out in paragraph 2 above and are set out in detail in the County's own budget report. The next two tables show the increases that have been applied to the two elements of their Council Tax. When added together, they equal the summary table above.

### d. (i) Nottinghamshire County Council Main Precept

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | |
| Council Tax Requirement | **£44,038,753** | £41,933,500 | |
| Council Tax at Band D | **£1,328.85** | £1,288.43 | The increase, £40.42, is a 2.99% increase on the 2017/18 full precept, £1,351.97. |

### **d.** (ii) Nottinghamshire County Council Social Care Precept

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | |
| Council Tax Requirement | **£3,001,867** | £2,067,986 | |
| Council Tax at Band D | **£90.58** | £63.54 | The Social Care precept increase of £27.04, is a 2.00% increase on the 2017/18 full precept, £1,351.97. |

## e. Nottinghamshire Police and Crime Commissioner

The Nottinghamshire Police and Crime Commissioner has declared the following for 2018/19:

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | The Council Tax Base has increased. See table at (a) above. |
| Council Tax Requirement | **£6,475,322** | £5,969,624 | The Police and Crime Commissioner is raising an additional £506k from the Ashfield Area to fund Police services. |
| Council Tax at Band D | **£195.39** | £183.42 | An increase of 6.53%. This increase has been formally notified to the Council. |

## f. Nottinghamshire Fire and Rescue Authority

The Nottinghamshire Fire and Rescue Authority has declared the following for 2018/19:

| | **2018/19** | 2017/18 for comparison | Notes |
|---|---|---|---|
| Council Tax Base | **33,140.5** | 32,546.2 | The Council Tax Base has increased. See table at (a) above. |
| Council Tax Requirement | **£2,568,720** | £2,450,403 | The Fire and Rescue Authority is raising an additional £118k from the Ashfield area to fund their services. |
| Council Tax at Band D | **£77.51** | £75.29 | An increase of 2.95%. This increase has been formally notified to the Council. |

## g. Summary of Council Tax Demands by Band

### For Residents of the Annesley and Felley Parish Area:

| Council Tax Band | A | B | C | **D** | E | F | G | H |
|---|---|---|---|---|---|---|---|---|
| Annesley and Felley Parish Precept | £67.51 | £78.76 | £90.01 | **£101.26** | £123.76 | £146.26 | £168.77 | £202.52 |
| Ashfield DC Council Tax | £123.64 | £144.25 | £164.85 | **£185.46** | £226.67 | £267.89 | £309.10 | £370.92 |
| Nottinghamshire County Council Precept | £946.29 | £1,104.00 | £1,261.72 | **£1,419.43** | £1,734.86 | £2,050.29 | £2,365.72 | £2,838.86 |
| Nottinghamshire Police and Crime Commissioner Precept | £130.26 | £151.97 | £173.68 | **£195.39** | £238.81 | £282.23 | £325.65 | £390.78 |
| Nottingham Fire and Rescue Authority Precept | £51.67 | £60.29 | £68.90 | **£77.51** | £94.73 | £111.96 | £129.18 | £155.02 |
| **TOTAL COUNCIL TAX** | £1,319.37 | £1,539.27 | £1,759.16 | **£1,979.05** | £2,418.83 | £2,858.63 | £3,298.42 | £3,958.10 |

This total Council Tax is a 4.58% increase on 2017/18 Band D of £1,892.40.

**For Residents of the Selston Parish Area:**

| Council Tax Band | A | B | C | **D** | E | F | G | H |
|---|---|---|---|---|---|---|---|---|
| Selston Parish Precept | £42.01 | £49.02 | £56.02 | **£63.02** | £77.02 | £91.03 | £105.03 | £126.04 |
| Ashfield DC Council Tax | £123.64 | £144.25 | £164.85 | **£185.46** | £226.67 | £267.89 | £309.10 | £370.92 |
| Nottinghamshire County Council Precept | £946.29 | £1,104.00 | £1,261.72 | **£1,419.43** | £1,734.86 | £2,050.29 | £2,365.72 | £2,838.86 |
| Nottinghamshire Police and Crime Commissioner Precept | £130.26 | £151.97 | £173.68 | **£195.39** | £238.81 | £282.23 | £325.65 | £390.78 |
| Nottingham Fire and Rescue Authority Precept | £51.67 | £60.29 | £68.90 | **£77.51** | £94.73 | £111.96 | £129.18 | £155.02 |
| **TOTAL COUNCIL TAX** | £1,293.87 | £1,509.53 | £1,725.17 | **£1,940.81** | £2,372.09 | £2,803.40 | £3,234.68 | £3,881.62 |

This total Council Tax is a 4.67% increase on 2017/18 Band D of £1,854.16.

**For Residents of all Other Parts of the Ashfield District Area:**

| Council Tax Band | A | B | C | **D** | E | F | G | H |
|---|---|---|---|---|---|---|---|---|
| Ashfield DC Council Tax | £123.64 | £144.25 | £164.85 | **£185.46** | £226.67 | £267.89 | £309.10 | £370.92 |
| Nottinghamshire County Council Precept | £946.29 | £1,104.00 | £1,261.72 | **£1,419.43** | £1,734.86 | £2,050.29 | £2,365.72 | £2,838.86 |
| Nottinghamshire Police and Crime Commissioner Precept | £130.26 | £151.97 | £173.68 | **£195.39** | £238.81 | £282.23 | £325.65 | £390.78 |
| Nottingham Fire and Rescue Authority Precept | £51.67 | £60.29 | £68.90 | **£77.51** | £94.73 | £111.96 | £129.18 | £155.02 |
| **TOTAL COUNCIL TAX** | £1,251.86 | £1,460.51 | £1,669.15 | **£1,877.79** | £2,295.07 | £2,712.37 | £3,129.65 | £3,755.58 |

This total Council Tax is a 4.84% increase on 2017/18 Band D of £1,791.14.

## Implications

**Corporate Plan:**

**Legal:**

The Council must set a legal budget by 11 March 2018.

**Finance:**

| Budget Area | Implication |
|---|---|
| General Fund – Revenue Budget | Setting the Council Tax is the final stage of budget preparation for 2018/19. The impact of this proposal is to increase the Council Tax collected by £166k, which when added to the impact of an increased Council Tax Base (£107k), gives a budgeted Council Tax amount of £6.146m. |
| General Fund – Capital Programme | None relevant to this report. |
| Housing Revenue Account – Revenue Budget | None relevant to this report. |
| Housing Revenue Account – Capital Programme | None relevant to this report. |

**Risk:**

| Risk | Mitigation |
|---|---|
| The Council Tax amount must be set by 11 March 2018. | Arrangements are in place for the Council to approve the setting of the Council Tax and the Budget. |
| Not to set a balanced budget | The Council Tax figures in this report are as laid out in the MTFS. |

**Human Resources:**

None directly relevant to this report.

**Equalities:**

None directly relevant to this report.

**Other Implications:**

None

**Reason(s) for Urgency**

The decision is not subject to call-in as the matter will be considered for approval by Council at the Extraordinary meeting being held after Cabinet.

**Background Papers**

Details of the Provisional Local Government Financial Settlement from the Government web site.

The Council Tax Base for 2018/19 was set in an Officer Decision Record (11 January 2018), which is available in the Council's web site.

**Report Author and Contact Officer**

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Ashfield
DISTRICT COUNCIL

| Report To: | CABINET | Date: | 5 MARCH 2018 |
|---|---|---|---|
| Heading: | COUNCIL'S TREASURY MANAGEMENT STRATEGY | | |
| Portfolio Holder: | CORPORATE RESOURCES AND FINANCE | | |
| Ward/s: | ALL | | |
| Key Decision: | YES | | |
| Subject to Call-In: | NO | | |

**Purpose of Report**

The Council's Treasury Management Strategy underpins the Council's approach to its treasury management activities. This report will highlight the risks involved with treasury management and the actions that will be undertaken to minimise these risks.

To seek approval for the Council's Treasury Management Activities Prudential Indicators:-

- Estimate of financing costs to net revenue stream for the period split between the Housing Revenue Account;
- Estimate of the incremental impact of capital investment decisions on the Council Tax and Rent Levels;
- Net borrowing and Capital Financing Requirement split between the General Fund and the Housing Revenue Account;
- Estimate of Capital expenditure for the period split between the General Fund and Housing Revenue Account.
- The Authorised Boundary and Operational Boundary limits.
- Changes to Minimum Revenue Provision Policy.
- Note Statutory Changes relating to Minimum Revenue Provision and Local Government Investments.

**Recommendation(s)**

Members are requested to approve and recommend to Council to approve both the Treasury Management Strategy Statement in Section 5 and the Prudential Indicators in Section 6.

**Reasons for Recommendation(s)**

The Treasury Management Strategy Statement recommendations will allow for effective Treasury Management operations within the Authority and the Prudential Indicator ratios offer a benchmark by which any future capital expenditure decisions should be made.

**Alternative Options Considered**
None.

**Detailed Information**

## 1. Treasury Management Defined

This Council defines its treasury management activities as:

(a) The management of the Council's borrowing, 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.

(b) 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 Council.

(c) 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 performance measurement techniques, within the context of effective risk management

## 2. Scope of the Treasury Management Strategy Statement

2.1 This Strategy Statement sets out the Council's approach to financing (borrowing) and investment for the financial year but also sets the context for the following two years.

2.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice for Treasury Management in the Public Services (the "TM Code"). This requires local authorities to determine the Treasury Management Strategy Statement (TMSS) on an annual basis.

2.3 This Strategy statement also incorporates the formal investment strategy that is necessary to comply with guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG).

2.4 The Strategy sets out the context to Treasury Management in terms of the Council's financial resources as measured in its balance sheet and external factors e.g. interest rates.

## 3. Approach to risk

3.1 As mentioned in paragraph 1(b) above 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. The main risks to the Council's Treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (adequacy of cash resources)
- Market or Interest Rate Risk (exposure or fluctuations in interest rate levels)
- Inflation Risk (Exposure to Inflation)
- Refinancing Risk (impact of debt maturing in future years)
- Legal and Regulatory Risk (compliance with statutory powers and regulatory requirements)
- Fraud, Error and Corruption and Contingency Management (maintenance of sound systems and procedures)

## 4. Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability
- The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

## 5. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) FOR 2018/19

### 5.1 Introduction

**The TMSS covers two main areas:**

- **Capital issues**

  - **the Capital Plans and the Prudential Indicators (5.2)**
  - **the Minimum Revenue Provision (MRP) strategy (5.3)**

- **Treasury Management issues**

  - the current treasury position (5.4)
  - prospects for interest rates (5.5)
  - borrowing strategy (5.6)
  - policy on borrowing in advance of need (5.7)
  - debt rescheduling (5.8)
  - Annual Investment Strategy (AIS) including policies on creditworthiness and external service providers(AIS) (5.9)

**The elements within these areas cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, The MHCLG MRP Guidance, the CIPFA Treasury Management Code, and the MHCLG Investment Guidance.**

### 5.2 The Capital Prudential Indicators 2018/19 to 2020/21

At the meeting on 23 March 2017, Cabinet considered a set of Prudential Indicators and referred them for approval by Council on 20 April 2017. Since that meeting, there have been revisions to the proposed Capital Programme. The latest version of the Capital Programme was agreed by Cabinet 19th February 2018 and then to be considered by Council 1st March 2018. The Prudential Indicators now reflect the latest Capital Programme; the revised figures are included in Section 6.

a. Capital Expenditure

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist members with their overview and confirmation of those capital expenditure plans.

b. Capital Financing Requirement (CFR)(the Council's borrowing need)

The CFR represents the total historic capital expenditure which has <u>not</u> yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure not immediately financed, for example by capital grants, will increase the CFR.

c. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs, net of investment income) against the net revenue stream of the Council. Estimates of financing costs include current commitments, and the effects of the proposals within the current cycle.

d. Incremental impact of 2018/19 – 2020/21 capital investment decisions on council tax

This indicator identifies the revenue costs associated with the capital programme.

### 5.3 Minimum Revenue Provision (MRP) Policy Statement

Capital expenditure is expenditure on assets with a life expectancy of more than one year, for example, buildings, vehicles, machinery etc. Each year, the Council is required to pay off part of its accumulated capital expenditure by way of a revenue charge, i.e. a "minimum revenue provision" (MRP).

MHCLG regulations require the Council to approve an MRP Statement in advance of each financial year. The Council must determine an amount of MRP that it considers to be "prudent", the broad aim being to ensure that borrowing is repaid over a period that reflects the useful lives of the assets acquired. The Council is obliged to have regard to the MHCLG guidance, but it is not prescriptive. The guidance does not, however, define "prudent", instead making recommendations on the interpretation of the term. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent MRP, having had regard to the guidance and its own circumstances.

The following MRP Policy Statement is proposed for 2018/19:

a. The Council will assess MRP in accordance with the recommendations within the guidance issued under section 21(1A) of the Local Government Act 2003

b. Option 1, the regulatory method, will be used for calculating MRP in respect of all capital expenditure incurred up to and including 31 March 2008.

c. Option 3, the Asset Life Method, will be used for calculating MRP in respect of capital expenditure incurred on and after 1 April 2008 where appropriate. An equal instalment approach will be adopted.

d. Where appropriate and prudent the Council will consider using Option 4, the Depreciation Method, this follows the standard accounting depreciation procedures. The Council is currently reviewing its future approach to Investment Properties. As this method is no longer suitable for Investment Properties.

e. The Chief Financial Officer (CFO) will determine estimated asset lives.

f. In view of the economic climate and significant budgetary pressures, the Council will not provide for an additional voluntary contribution to MRP in 2018/19.

g. MRP is charged in the following accounting year after expenditure is incurred. Based on the above policy, the total MRP charge for 2018/19 has been calculated as £1.809m, as detailed below. The exact amount of MRP will be subject to the out-turn of 2017/18 Statement of Accounts.

| | £000's |
|---|---:|
| Option 1 – Regulatory Method | 1,092 |
| Option 3 – Asset Life Method | 913 |
| Option 4 – Depreciation Method | 0 |
| **Total MRP** | **1,809** |

### 5.4 The Council's current Treasury portfolio position

The Council must ensure that its total debt, does not, except in the short term, exceed the total of the CFR in the preceding year (the opening CFR), plus the estimates of any additional CFR for the coming year and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's estimated treasury portfolio position at 31 March 2018, together with forward projections, is summarised below. The table shows the expected actual external debt against the underlying capital borrowing need (the CFR).

| | **31/03/2018 Estimate £m** | **31/03/2019 Estimate £m** | **31/03/2020 Estimate £m** | **31/03/2021 Estimate £m** |
|---|---:|---:|---:|---:|
| **Capital Financing Requirement** | 117.682 | 117.157 | 116.435 | 114.823 |
| **Less:** Profile of Current External Borrowing | 74.748 | 74.748 | 74.748 | 74.748 |
| **Under over borrowing position (Headroom)** | 42.934 | 42.409 | 41.687 | 40.075 |

## 5.5 Prospects for Interest Rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

| | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.00% | 1.00% | 1.25% | 1.25% | 1.25% | 1.50% | 1.50% | 1.50% |
| 5yr PWLB rate | 1.90% | 2.00% | 2.10% | 2.10% | 2.20% | 2.30% | 2.30% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% |
| 10yr PWLB rate | 2.50% | 2.50% | 2.60% | 2.70% | 2.70% | 2.80% | 2.80% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% |
| 25yr PWLB rate | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | 3.50% | 3.50% | 3.60% | 3.60% |
| 50yr PWLB rate | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% |

The Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. At its February 2018 meeting, there was no change in Bank Rate but the forward guidance changed significantly to warn of "earlier, and greater than anticipated" rate of increases in Bank compared to their previous forward guidance. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in May and November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. There was a sharp rise in bond yields after the US Presidential election in November 2016 and yields have risen further more recently as a result of an agreement to a big increase in the government deficit aimed at stimulating economic growth and the Fed. taking the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature. We have also seen a sharp selloff in equities and bonds in February 2018 that has given further impetus to a rise in bond yields.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts

for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without a fully agreed and stable coalition government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

**Investment and borrowing rates**

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2017-18 and increased sharply after the result of the general election in June 2017, after the September MPC meeting, (when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases), and again in January and February 2018. Increases have ben sharper in periods up to 10 years than in longer maturities.. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed

to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

**a) Eurozone Economy**

Economic growth in the Eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in December inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

**b) USA Economy**

Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 started erratically with quarter 1 coming in at an annualised rate of only 1.2%, quarter 2 at 3.1%, quarter 3 3.2% and Q4 2.6%. This gave an overall figure for annual growth in 2017 of 2.6%, an acceleration from 1.5% in 2016. Unemployment in the US has also fallen to the lowest level for seventeen years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with five increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

**d) China and Japan**

China - Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan - GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

## 5.6 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Corporate Finance Manager (Chief Finance Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

Any decisions will be reported to the Cabinet as part of the half-year or full year out-turn treasury management reports.

**Treasury management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance*.* The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. Consider local indicator covering both fixed and variable debt.

## 5.7 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment of the extra sums borrowed, since this is illegal. Any decision to borrow in advance of need will be within the forward-approved CFR estimates, and will be considered carefully to ensure value for money can be demonstrated, and that the Council can ensure the security of such funds.

## 5.8 Debt Rescheduling

As short-term borrowing rates will be considerably cheaper than longer-term fixed interest rates, there may be potential for some residual opportunities to generate savings by switching from long-term to short-term debt, however, these savings will need to be considered in the light of the premiums incurred, their short nature, and the likely cost of refinancing them once they mature, compared to the current rates on longer term debt in the existing debt portfolio. Any such rescheduling is likely to cause a flattening of the Council's maturity profile, as in recent years there has been a skew towards longer dated PWLB.

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cashflow savings, at minimum risk
- Helping to fulfil the treasury strategy
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

All rescheduling will be reported to Cabinet within the half-year or full year out-turn treasury management reports.

### 5.9 Annual Investment Strategy 2018/19

The intention of the strategy is to provide security of investment and the minimisation of risk. The aim is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

5.9.1 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

**highest priority -** security of the invested capital;

**followed by -** liquidity of the invested capital (this enables the Council to react to changing circumstances);

**finally -** an optimum yield which is proportionate with security and liquidity.

5.9.2 Investments made by the Council's Officers are restricted to the following organisations:-

(a) Banks or Building Societies who currently meet the Link Asset Services suggested investment duration

(b) Nationalised Industries and Statutory Corporations

(c) Other Government Institutions

(d) Other Local Authorities

(f) Money Market Funds

(g) Bills of Exchange which have been accepted by authorised institutions

(h) United Kingdom Gilt-edged Securities

(i) Negotiable instruments such as Certificates of Deposit, Treasury Bills and Corporate Bonds

(j) Approved counterparties from countries with a minimum sovereign credit rating of AAA from all three rating agencies, with the exception of UK.

Total investments with any one institution shall not exceed £5 million.

Total investments of over 365 days shall not exceed £5 million in total.

5.9.3 Appointment of External Fund Managers

External Fund managers may be appointed to administer the investment of the Council's surplus funds and reserves. Any appointments will be made by the appropriate portfolio holder, having received an analysis of the capabilities and performance of the Fund Manager by the Chief Financial Officer. Fund Managers will be bound by the restrictions contained within the Treasury Management Policy Statement. The performance of the Fund Managers will be contained in the annual report on the treasury management operation.

5.9.4 Appointment of External Service Providers

The Council uses Link Asset Services as its external treasury management advisers, however it recognises that responsibility for treasury management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon external service providers.

The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 6. Prudential Indicators

The overriding requirement of the prudential code is that borrowings or credit should be both prudent and affordable and remain within sustainable limits.

To demonstrate this, the Council is required to determine a number of limits before the start of the financial year to control the extent of exposure to credit. The Chief Financial Officer then has a duty to monitor borrowing and credit against these indicators and report on the authority's compliance or otherwise at the end of the year in question. The indicators may be revised during the year if necessary but the amendments must be approved by Cabinet.

Members are therefore requested to consider the Prudential Indicators detailed in this report.

### 6.1 Prudential Indicators of Affordability

The Council is therefore required to consider all of its available resources in the medium term (usually defined as three years) together with total plans for expenditure. Any known significant variations beyond this timeframe also need to be taken into account.

The Prudential indicators for affordability are as follows:

a) Estimate of ratio of financing costs to net revenue stream for the next three years split between the Housing Revenue Account and the General Fund

For the next three years, the Council is required to calculate an estimated ratio of its financing costs to net revenue stream for both the General Fund and the Housing Revenue Account. This takes into account predicted future levels of Government funding.

It is suggested that the following indicator be set for the next three years:

| | **2018/2019 %** | **2019/2020 %** | **2020/2021 %** |
|---|---|---|---|
| Housing Revenue Account | 14.50 | 14.60 | 14.26 |
| Non HRA (General Fund) | 11.19 | 14.86 | 16.63 |

b) <u>Estimate of the incremental impact of capital investment decisions on the Council Tax and Rent Levels</u>

Authorities are required to estimate for the next three years the impact on the Council Tax (General Fund) and Rent levels (HRA) of the capital programme including running costs and financing costs. These indicators have been prepared using the revised Capital Programme, which went to Cabinet 19th February 2018.

It is estimated that the incremental impact for the next three years will be as follows:

| | **2018/2019 £** | **2019/2020 £** | **2020/2021 £** |
|---|---|---|---|
| General Fund (Band D) | 1.72 | 2.04 | 1.11 |
| HRA (52 weeks) | 0 | 0 | 0 |

There is not expected be any new borrowing for the HRA between 2018/19 – 2020/21 as the Authority has reached the borrowing cap. The ratio for the General Fund is calculated by estimating the interest payable on the average capital borrowing requirement and dividing this by the estimated number of Band D equivalents.

c) <u>Net borrowing and the Capital Financing Requirement split between the General Fund and the Housing Revenue Account</u>

In order to ensure that in the medium term borrowing is only undertaken for capital purposes, local authorities are required to ensure that external borrowing does not exceed, except in the short term, the total of their capital financing requirement over the planning period. In broad terms the capital financing requirement reflects an authority's need to borrow for capital purposes and is a measure of the assets contained on the balance sheet which have as yet not been fully financed, i.e. there is still some indebtedness outstanding.

It is necessary to estimate the capital financing requirement at the end of the forthcoming year and the subsequent two years for both the Housing Revenue Account and General Fund activities:

| | **31st March 2019** | **31st March 2020** | **31st March 2021** |
|---|---|---|---|
| | **£m** | **£m** | **£m** |
| Housing Revenue Account | 80 | 80 | 80 |
| General Fund | 37 | 36 | 35 |

<u>d) Capital Expenditure</u>

<u>Estimates of capital expenditure for the next three years split between the General Fund and the Housing Revenue Account</u>

The estimated net capital expenditure requiring funding, as detailed in the Capital Programme Report is:

| | **2018/2019** | **2019/2020** | **2020/2021** |
|---|---|---|---|
| | **£m** | **£m** | **£m** |
| Housing Revenue Account | 9.3 | 8.5 | 8.5 |
| General Fund | 4.3 | 2.6 | 1.8 |

External Debt

e) Authorised Limit

For the next three years, the authority is required to set an authorised limit for its total external debt, gross of investments. This is calculated by taking into account current external debt, new borrowing for loans that mature or for capital purposes and the need to borrow on a short term basis to cover for temporary shortfalls in revenue income and expenditure.

It is estimated that the following will be a suitable authorised limit for the next three years:

| | **2018/2019** | **2019/2020** | **2020/2021** |
|---|---|---|---|
| | **£m** | **£m** | **£m** |
| Borrowing | 130 | 130 | 130 |
| Other Financial Instruments | 0 | 0 | 0 |

f) Operational Boundary

As well as an authorised limit, the local authority must also set an operational boundary for its external debt for the next three years. The operational boundary is based on the most likely or prudent but not worst case scenario in relation to cash flow.

It is estimated that the following will be a suitable operational boundary for the next three years:

| | **2018/2019** | **2019/2020** | **2020/2021** |
|---|---|---|---|
| | **£m** | **£m** | **£m** |
| Borrowing | 120 | 120 | 120 |
| Other Financial Instruments | 0 | 0 | 0 |

### 6.2 Prudential Indicators for Prudence including Capital Expenditure, External Debt and Treasury Management

The prudential indicators for prudence have to be set taking into account those relating to affordability as outlined above and are as follows:

Treasury Management

a) Interest rate exposure

Local authorities are required to set limits for the next three years for the upper limits on exposure to the effects of changes in interest rates. The indicators relate to both fixed and variable rate interest, and are net of any investments.

Depending on the level of interest rates and their expected movement in the year, the Council may take up all of its new borrowings in the form of either fixed or variable rate debt. The figures below give the following maximum levels, when compared to the operational boundary, of exposure to fixed and variable interest rates, which are prudent limits for the forthcoming years:

| **Principal Outstanding** | **2016/2017** | **2017/2018** | **2018/2019** |
|---|---|---|---|
| | £m | £m | £m |
| Fixed Rates | 130 | 130 | 130 |
| Variable Rates (No more than 40% of the operational boundary). | 52 | 52 | 52 |

b) Maturity Structure of borrowing

For the next three years, the authority is required to set both upper and lower limits for the maturity structure of its borrowing. This indicator relates only to fixed rate debt and is therefore a measure of the longer term exposure to interest rate risk.

Given the current structure of the Council's debt portfolio it is proposed the following limits for all three years be made for the maturity of the debt:

| | **Lower £m** | **Upper £m** |
|---|---|---|
| Less than 12 months | 0 | 20 |
| 12 months to 24 months | 0 | 20 |
| 24 months to 5 years | 0 | 25 |
| 5 years to 10 years | 0 | 50 |
| 10 year and over | 10 | 100 |

c) Principal sums invested for more than 365 days

Where a local authority invests, or plans to invest for periods of more than 365 days it must set an upper limit for each year for the maturity of such investments. The purpose of setting this limit is to contain any exposure to losses that might arise in the event of having to seek early repayment of the investment and / or adverse movements in shorter term interest rates.

It is suggested that the use of longer term investments be limited to a maximum of £5m maturity in each of the next three years to tie in with the Council's already approved policy of not investing more than £5m with any one bank or building society at the same time.

## 7. Statutory Guidance Updates February 2018

The Government update its Statutory guidance on both Minimum Revenue Provision (MRP) and Local Government Investment. Copies of each of these guidance is included at the end of the report. Details on how the new guidance will affect the Authority are provided below:

### 7.1 Statutory Guidance on MRP

The new guidance states that MRP Option 4 is no longer a suitable approach for calculating the MRP to be charged in respect of investment properties. The Option 4 method that was previously used meant that MRP was charged on the difference between the completion cost and its fair value. If the fair value was greater than the completion cost there was not any requirement to charge any MRP other than the MRP on the cost of purchase.

The change required in the guidance will mean that MRP will be charged on the full asset cost. The Authority does not expect this change to be effective until the 2019/20 financial year. It is seeking clarification from KPMG its external auditors regarding this.

### 7.2 Statutory Guidance on Local Government Investments

The disclosures in the statutory guidance will be included in full in the next version of the Strategy in 2018/19. The Strategy requires a risk assessment stating the Authority's approach to assessing risk of loss, for non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. The Strategy should detail how reliant the service delivery objectives are on its investing activities.

The strategy also should disclose the action taken to ensure elected members and statutory officers involved in investment decisions have appropriate capacity, skill and information to enable them to take informed decisions.

**Glossary of Terms**

Call Deposits — Call Deposit Meaning: In deposit terminology, the term Call Deposit refers to a specific type of interest bearing investment account that allows a person to withdraw their money from the account without a penalty.

Fed. — The Federal Reserve System is the central banking system of the United States.

GDP — Gross Domestic Product
This is the monetary value of all the finished goods and services produced by a country within its borders in a specific time period, usually a year.

G7 — This is an international organisation established to facilitate economic cooperation among the seven wealthiest developed nations – Canada, France, Germany, Great Britain, Italy, Japan and USA

CPI — Consumer Price Index

LIBID — The London Interbank Bid Rate, that is, the interest rate at which banks bid to take short-term deposits from other banks

RPI — Retail Price Index
Both CPI and RPI measure inflation by measuring changes in the price levels of a sample of representative goods and services purchased by households. They use different items and different formulae for the calculations which means that CPI is often lower than RPI.

y/y — Year on year is a method of evaluating two or more measured events to compare the results of one time period with those of a comparable time period on an annualised basis.

MPC — Monetary Policy Committee
This is a committee of the Bank of England which decides the official interest rate in the UK (the Bank of England Base Rate) and also directs other monetary policy such as quantitative easing and forward guidance.

PWLB — Public Works Loan Board
The PWLB is a statutory body operating within the UK Debt Management Office to lend money from the National Loan Fund to local authorities and to collect the repayments.

QE — Quantitative Easing is an unconventional form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This process aims to directly increase private sector spending in the economy and return inflation to target.

The decision is not subject to call in as the matter will be considered for approval by Council at the Extraordinary meeting being held after Cabinet.

**Implications**

**Corporate Plan:**

**Legal:**

Approval of the Council's Treasure Management Strategy ensures compliance with legislation and guidance.

**Finance:**

| Budget Area | Implication |
|---|---|
| General Fund – Revenue Budget | No General Fund Revenue Implications. |
| General Fund – Capital Programme | No General Fund Capital Implications. |
| Housing Revenue Account – Revenue Budget | No HRA Revenue Implications. |
| Housing Revenue Account – Capital Programme | No HRA Capital Implications. |

**Risk:**

| Risk | Mitigation |
|---|---|
| The Minimum Revenue Provision (MRP) policy is no longer suitable. | Careful monthly monitoring of Capital Expenditure should ensure an appropriate and prudent MRP provision is made annually. |
| The Annual Investment Strategy is no longer appropriate for the Authority. | Information received from our Treasury Management Advisors should allow the Authority to take necessary action to mitigate against any risks. |

**Human Resources:**
There are no HR implications.

**Equalities:**
None.

**Other Implications:**
*(if applicable)*

**Reason(s) for Urgency**
*(if applicable)*

**Reason(s) for Exemption**
*(if applicable)*

**Background Papers**
*(if applicable)*

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## STATUTORY GUIDANCE ON MINIMUM REVENUE PROVISION

Guidance issued by the Secretary of State under section 21(1A) of the *Local Government Act 2003*

### POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 21(1A) of the *Local Government Act 2003.* Under that section local authorities are required to “have regard” to this guidance.

### DEFINITION OF TERMS

2. The **2003 Act** means the *Local Government Act 2003.*

3. The **2007 Act** means the *Local Government and Public Involvement in Health Act 2007.*

4. The **2003 Regulations** means the L*ocal Authorities (Capital Finance and Accounting) (England) Regulations 2003* [as amended].

5. **Local authority** has the meaning given in section 23 of the 2003 Act.

6. **MRP** means Minimum Revenue Provision.

7. The **Prudential Code** means the statutory code of practice, issued by CIPFA, referred to in Regulation 2 of the 2003 Regulations.

8. **CFR** means the Capital Financing Requirement, as defined in the Prudential Code.

9. **Non-housing CFR** has the meaning given in Regulation 28(11) of the 2003 Regulations, before this was amended. This is the total CFR for a local authority less the Housing Revenue Account CFR, where a local authority has a Housing Revenue Account.

10. **Credit Arrangement** has the meaning given in Section 7 of the 2003 Act.

11. **Supported Capital Expenditure** means the total amount of capital expenditure which a local authority had been notified by one or more Government departments was to be taken into account in the calculation of the revenue grant due to the local authority in respect of it its use of borrowing and credit. It excludes any expenditure that is supported by capital grant.

12. **Housing assets** means any land, dwellings or other property to which Section 74(1) of the Local Government Housing Act 1989 (duty to keep a Housing Revenue Account) applies.

13. **UL** means the estimated useful life of an asset as determined by proper accounting practices.

14. **Lease** means a lease transaction as defined under proper accounting practices.

## APPLICATION

### Effective date

15. This Guidance applies for accounting periods starting on or after 1 April 2019, with the exception of paragraphs 27-29 of this Guidance "Changing Methods for Calculating MRP", which apply from accounting periods starting on or after 1 April 2018. However, early adoption is encouraged. It supersedes all previous versions of this Guidance.

### Local authorities

16. This guidance applies to all local authorities in England and their relevant bodies. It does not apply to parish councils or charter trustees.

## INTRODUCTION

17. Under Regulation 27 of the 2003 Regulations, local authorities are required to charge MRP to their revenue account in each financial year. Before 2008, the 2003 Regulations contained details of the method that local authorities were required to use when calculating MRP. This has been replaced by the current Regulation 28 of the 2003 Regulations, which gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to this guidance.

## ANNUAL MRP STATEMENT

18. Before the start of each financial year a local authority should prepare a statement of its policy on making MRP in respect of that financial year and submit it to full Council for approval. For local authorities without a full Council the statement should be presented for approval at the closest equivalent level. The statement should describe how it is proposed to discharge the duty to make prudent MRP during that year.

19. Local authorities can vary the methodologies that they use to make prudent provision during the year. If they do so they should present a revised MRP statement to the next full Council or equivalent. Where a change in MRP

methodology would impact on the value for money assessment of non-financial investments, the updated statement should summarise this impact.

**MEANING OF PRUDENT PROVISION**

20. Regulation 28 of the 2003 Regulations requires a local authority to calculate in each financial year an amount of MRP that it considers to be prudent.

21. An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their CFR. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits.

22. In the case of historical borrowing originally supported by grant income rolled into Revenue Support Grant the meaning of prudent provision is to put funds aside over a period commensurate with the period implicit in the determination of that original grant.

23. The Secretary of State considers that the methods of making prudent provision include the options set out in paragraphs 31 to 37. However, this does not rule out or otherwise preclude a local authority from using an alternative method should it decide that is more appropriate. Any method used is subject to the conditions in paragraphs 38 to 42 as far as these are relevant.

**OVERPAYMENTS OF MRP**

24. Local authorities may choose to pay more MRP than they consider prudent in any given year. If they do so they should separately disclose the in-year and cumulative amount of MRP overpaid in the Statement presented to full council

**MEANING OF CHARGE TO A REVENUE ACCOUNT**

25. A charge to a revenue account for MRP cannot be a negative charge.

26. A charge to a revenue account for MRP can only be £nil if:
    - A local authority's CFR was nil or negative on the last day of the preceding financial year; or
    - A local authority chooses to offset a previous year's overpayment (as set out in paragraph 24) against the current year's prudent provision. If a local authority chooses to offset a previous year's overpayment, they should disclose this fact and any remaining cumulative overpayment of MRP in the Statement presented to full council.

## CHANGING METHODS FOR CALCULATING MRP

27. A local authority may change the method(s) that it uses for calculating part or all of its MRP at any time.

28. Where a local authority changes the method(s) that it uses to calculate MRP, it should explain in its Statement, why the change will better allow it to make prudent provision.

29. The calculation of MRP under the new method(s) should be based on the residual CFR at the point the change in method is made (i.e. it should not be applied retrospectively). Changing the method used to calculate MRP can never give rise to an overpayment in respect of previous years, and should not result in a local authority making a reduced charge or a charge of £nil for the accounting period in which the change is made, or in any subsequent period, on the grounds that it needs to recover overpayments of MRP relating to previous years.

## TRANSFERRING DEBT

30. Where debt is transferred between authorities, the authorities concerned should agree on the arrangements for the continued making of MRP and adjust their unfunded CFRs accordingly. Normally the authority releasing the debt should cease to make MRP in respect of it and the authority taking it over should begin to make MRP in the same way that it would do for any other increase in CFR.

## OPTIONS FOR MAKING PRUDENT PROVISION

31. This Guidance presents four ready-made options for calculating prudent provision. Local authorities can use a mix of these options for debt taken out at different times should they consider it appropriate to do so.

### Option 1: Regulatory method

32. MRP is equal to the amount determined in accordance with the former Regulations 28 and 29 of the 2003 Regulations as if they had not been revoked by the 2008 amendment to those regulations. For the purposes of that calculation, the adjustment A should normally continue to have the value attributed to it by the local authority in the financial year 2004-05. However, it would be reasonable for local authorities to correct any perceived errors in adjustment A, if the correction would be in their favour.

33. The former Regulations 28 and 29 of the 2003 Regulations are included at **Annex A**.

Option 2: CFR method

34. MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.

Option 3: Asset Life Method

35. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the useful life of the asset. There are two main methods by which this can be achieved, as described below.

**(a) Equal instalment method**

MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

Where:

**A** is the amount of capital expenditure in respect of the asset financed by borrowing or credit arrangements.

**B** is the total provision made before the current financial year in respect of that expenditure.

**C** is the inclusive number of financial years from the current year to that in which the estimated useful life of the asset expires.

**(b) Annuity method**

MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation method

36. MRP is deemed to be equal to the provision required in accordance with deprecation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment charged to the income and expenditure accounts.

37. For this purpose standard depreciation accounting procedures should be followed, except in the following respects:

- MRP should continue to be made annually until the cumulative amount of provision made is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority will cease to make MRP.
- On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. This does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.

Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

**CONDITIONS FOR USING THE OPTIONS**

38. **Use of options.** Options 1 and 2 may only be used in relation to capital expenditure incurred before 1 April 2008, which form part of its supported capital expenditure.

39. For expenditure incurred on or after 1 April 2008, which does not form part of the authority's supported capital expenditure, prudent approaches include options 3 and 4.

40. **Commencement of provision.** Subject to paragraph 41 below, MRP should normally commence in the financial year following the one in which the expenditure was incurred.

41. **MRP Commencement.** When borrowing to provide an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. Therefore, it may postpone beginning to make MRP until the financial year following the one in which the asset becomes operational. 'Operational' here means when an asset transfers from Assets under Construction to an Assets in Use category under normal accounting rules.

**42. Estimated useful life of assets.** Where a local authority uses options 3 or 4 or where it uses another methodology that has the UL of assets as a component to the calculation, it should normally not exceed a maximum UL of 50 years. Local authorities can exceed this maximum in two scenarios:
    - where a local authority has an opinion from an appropriately qualified professional advisor that an asset will deliver service functionality for more than 50 years it can use the life suggested by its professional advisor; and
    - for a lease or PFI asset, where the length of the lease/PFI contract exceeds 50 years. In this case the length of the lease/PFI contract should be used.

**LEASES AND PFI**

43. In the case of finance leases (or, when applicable, leases where a right-of-use asset is on balance sheet) and on balance sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability.  Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off- balance sheet, the MRP requirement would be regarded as having been met by the inclusion in the charge for the year in which the restatement occurs, of an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

**HOUSING ASSETS**

44. The duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets (as defined in paragraph 12 above).

**INVESTMENT PROPERTIES**

45. The duty to make MRP extends to investment properties where their acquisition has been partially or fully funded by an increase in borrowing or credit arrangements.  As depreciation is not charged on investment properties, Option 4: the Depreciation method is not a suitable approach for calculating the MRP to be charged in respect of investment properties.

**CAPITALISED EXPENDITURE**

46. Where on or after 1 April 2008 an authority incurs expenditure which is:
    - Financed by borrowing and credit arrangements; and
    - Treated as capital expenditure by virtue of either a direction under section 16(2)(b) of the 2003 Act or Regulation 25(1) of the 2003 Regulations,

    The authority should calculate MRP in accordance with Option 3.

47. For the purpose of the formula in paragraph 35 above, in the initial year of making MRP the variable "C" should be given the maximum values as set out in the following table:

| **Expenditure type** | **Maximum value of "C" in initial year** |
|---|---|
| Expenditure capitalised by virtue of a **direction under s.16(2)(b)** | "C" equals 20 years |
| **Regulation 25(1)(a)**<br>Expenditure on computer programmes | "C" equals the shorter of the UL of the hardware or the length of the software license. |
| **Regulation 25(1)(b)**<br>Loans and grants towards capital | "C" equals the UL of the assets for in relation to which the third party |

| | |
|---|---|
| expenditure by third parties. | expenditure is incurred. |
| **Regulation 25(1)(c)**<br>Repayment of grants and loans for capital expenditure | "C" equals 25 years or the period of the loan if longer. |
| **Regulation 25(1)(d)**<br>Acquisition of share capital | "C" equals 20 years. |
| **Regulation 25(1)(e)**<br>Expenditure on works to assets not owned by the authority | "C" equals the UL of the assets. |
| **Regulation 25(1)(ea)**<br>Expenditure on assets for use by others. | "C" equals the UL of the assets. |
| **Regulation 25(1)(f)**<br>Payment of levy on large scale voluntary transfers (LSVT) of dwellings | "C" equals 25 years. |

## ANNEX A – REGULATIONS 28 AND 29 OF THE 2003 REGULATIONS BEFORE THESE WERE AMENDED

### Calculation of minimum revenue provision

**28.**—(1) Subject to paragraphs (2) and (3) and regulation 29, the minimum revenue provision for the current financial year shall be calculated by the local authority in accordance with the following formula—

$$\frac{4[CFR - (A - HC)]}{100}$$

where—

- CFR is the capital financing requirement at the end of the preceding financial year;
- A is an adjustment (which may be a positive, nil or negative amount) to be calculated in accordance with the following formula—

$$[CFRM - (HA + NHA)] + \frac{(HA - HB)}{2}$$

where—

  - CFRM is the capital financing requirement on 31st March 2004;
  - HA is the housing amount on 31st March 2004;
  - HB is the opening HRA capital financing requirement for the financial year beginning on 1st April 2004, except that if that opening HRA capital financing requirement is a negative amount, HB is nil; and

- NHA is the non-housing amount on 31st March 2004; and
- HC is the opening HRA capital financing requirement for the current financial year, except that if that opening HRA capital financing requirement is a negative amount, HC is nil.

(2) An additional amount of minimum revenue provision for the current financial year (“the additional amount”) shall be calculated by the local authority where—

(a)a credit approval, within the meaning of regulation 136 of the Local Authorities (Capital Finance) Regulations 1997 (use of certain credit approvals)(1), was issued to the local authority before 1st April 2004; and

(b)the amortisation period specified in the credit approval expires during or after the current financial year,

and the additional amount shall be the total amount determined by the local authority under regulation 136(2) of those Regulations for the current financial year, as if those Regulations were still in force for the purposes of this regulation.

(3) Where, in relation to the current financial year, the total of—

(a)the amount calculated in accordance with the formula for the minimum revenue provision in paragraph (1); and

(b)the additional amount, if any, calculated under paragraph (2),

is a negative amount, the minimum revenue provision for the current financial year shall be treated as nil.

(4) For the purposes of this regulation—

“arms length management organisation” means a body set up by a local authority as a housing management company to exercise management functions as agent of the local authority under an arrangement approved by the Secretary of State under section 27 of the Housing Act 1985 (management agreements)(2);

“capital financing requirement” has the same meaning as in the “Prudential Code for Capital Finance in Local Authorities” published by CIPFA, as amended or reissued from time to time(3);

“certified value” means the market value certified by the district valuer or by a suitably qualified valuer employed by the local authority;

“current financial year” means any financial year for which the local authority is determining the amount of its minimum revenue provision;

“district valuer”, in relation to any land in the district of a local authority, means an officer of the Commissioners of Inland Revenue appointed by them for the purpose of exercising, in relation to that district, the functions of the district valuer under the Housing Act 1985;

“housing amount” and “non-housing amount” have the same meaning as those terms had on 31st March 2004 in Part XII of the Local Authorities (Capital Finance) Regulations 1997 (minimum revenue provision);

“Housing Revenue Account”, also referred to as “HRA”, has the same meaning as in section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account)(4);

“major repairs reserve” has the same meaning as in regulation 7(5) of the Accounts and Audit Regulations 2003 (statement of accounts)(5);

“opening HRA capital financing requirement” means—

(a) for the financial year beginning on 1st April 2004, the amount calculated in accordance with paragraph (5);

(b) for the financial year beginning on 1st April 2005 and any subsequent financial year, the amount calculated In accordance with paragraph (6); and

“preceding financial year” means the financial year immediately preceding the current financial year.

(5) The amount referred to in sub-paragraph (a) of the definition of “opening HRA capital financing requirement” in paragraph (4) is the amount calculated in accordance with the following formula—

$$OHCC + IA - ID$$

where—

OHCC is the opening HRA credit ceiling for the financial year beginning on 1st April 2003, which has the same meaning as the “opening HRA credit ceiling” in paragraph 7.1 of the Item 8 Credit and Item 8 Debit (General) Determination 2003-2004 (“the Determination”)(6);

IA means the total of—

(a)

the items to be aggregated as specified in paragraph 7.2 of the Determination but substituting “2003-2004” for “2002-2003” in each place where it occurs in that paragraph; and

(b)

the amounts of all supplementary credit approvals issued in respect of financial years beginning before 1st April 2004 under section 54 of the Local Government and Housing Act 1989 (supplementary credit approvals)(7) for the purposes of expenditure in relation to arms length management organisations; and

ID means the items to be deducted as specified in paragraph 7.3 of the Determination but substituting “2003-2004” for “2002-2003” in each place where it occurs in that paragraph.

(6) The amount referred to in sub-paragraph (b) of the definition of “opening HRA capital financing requirement” in paragraph (4) is the amount calculated in accordance with the following formula—

$$OCFR + TIA - TID$$

where—

- OCFR means the opening HRA capital financing requirement for the preceding financial year;
- TIA means the total items to be aggregated, being the total of the following—

(a) the capital expenditure of the local authority financed by borrowing or credit arrangements which was incurred during the preceding financial year on any interest in housing land; and

(b) the certified value of any interest in housing land which commenced or recommenced to be accounted for in the Housing Revenue Account in the preceding financial year for a reason other than acquisition by the local authority;

- TID means the total items to be deducted, being the total of the following—

(a) such part of any capital receipt from the disposal of an interest in housing land which was used during the preceding financial year to repay the principal of any amount borrowed by the local authority or to meet any liability in respect of credit arrangements;

(b) 75 per cent. of the certified value of any interest in a dwelling, and 50 per cent. of the certified value of any interest in other housing land, that ceased to be accounted for in the Housing Revenue Account in the preceding financial year other than by virtue of disposal by the local authority;

(c) the amount of the provision for the repayment of the principal of any amount borrowed by the local authority or the meeting of any liability in respect of credit arrangements which the local authority determined during the preceding financial year to make from the Housing Revenue Account; and

(d) the amount of the provision for the repayment of the principal of any amount borrowed by the local authority or the meeting of any liability in respect of credit arrangements which the local authority determined during the preceding financial year to make from the major repairs reserve.

**Commutation adjustment**

**29.**—(1) Subject to paragraph (2), where a commuted payment was made to or for the benefit of a local authority in the financial year beginning on 1st April 1992, the local authority may reduce the amount of its minimum revenue provision for the current financial year, calculated in accordance with regulation 28, by an amount calculated in accordance with the following formula—

$$G \quad (I - M)$$

where—

- G is the total amount of contributions, grants and subsidies which would have been payable to the local authority by the Secretary of State for the current financial year but for commutation;
- I is the total of—

(a) the amount by which interest, payable by the local authority in the current financial year on loans, is reduced; and

(b) the amount by which interest, payable to the local authority in the current financial year on deposits and investments, is increased, by virtue of commutation; and

- M is the amount of minimum revenue provision for the current financial year which would have been calculated by the local authority in accordance with regulation 28 but for commutation, less the amount of minimum revenue provision for the current financial year actually calculated in accordance with regulation 28.

(2) Where the amount calculated in accordance with the formula in paragraph (1) is a negative amount, that amount shall be treated as nil.

(3) For the purposes of paragraph (1)—

“commutation” means the making of a commuted payment to, or for the benefit of, a local authority in the financial year beginning on 1st April 1992;

“commuted payment” has the same meaning as that term had on 31st March 2004 in section 157 of the Local Government and Housing Act 1989 (commutation of, and interest on, periodic payments of grants etc.)(8); and

“current financial year” has the same meaning as in regulation 28(4).

## ANNEX B – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON MINIMUM REVENUE PROVISION

Introduction

1. **The main section** of this document contains Statutory Guidance on Minimum Revenue Provision ("the Guidance") issued by the Secretary of State. **Annex A** provides the former Regulations 28 and 29 of the (Capital Finance and Accounting) (England) Regulations 2003. These have now been amended and have no force in statute. However, the calculations in these Regulations are still used for recommended option 1, the CFR method, so the former Regulations have been included as an Annex to this Guidance. **Annex B** provides an informal commentary ("the commentary") on that statutory guidance. **Annex C** provides the transitional arrangements.

2. Local authorities are normally required each year to set aside some of their revenues as provision for debt. More precisely, the provision is in respect of capital expenditure financed by borrowing or credit arrangements but, both in these guidance notes and in the statutory guidance, it has generally proved more convenient to use the term "debt" as shorthand for that technically more accurate form of expression.

Application Date

3. The Guidance and the commentary apply from 1 April 2019. The exception is paragraphs 27-29 of the Guidance and the commentary on those paragraphs, which apply from 1 April 2018. All previous editions of the MRP Guidance and any commentary published with that Guidance are superseded.

4. When considering transitional arrangements local authorities should refer to the Q&A published alongside the consultation, which is reproduced at **Annex C**.

MRP Calculation – Amendment Regulation

5. Amendment regulation 4(1) of the 2008 Regulations revised the former regulation 28. In the new regulation 28, the detailed rules are replaced with a simple duty for an authority each year to make an amount of MRP which it considers to be "prudent". The regulation does not itself define "prudent provision". However, the MRP guidance makes recommendations to authorities on the interpretation of that term. The operative date of the change is 31 March 2008, which means that it applies to the financial year 2007-08 and to subsequent years.

Power to Issue Guidance

6. The issue of statutory MRP guidance was made possible by section 238(2) of the *Local Government and Public Involvement in Health Act 2007*, which amends section 21 of the *Local Government Act 2003*. Section 21 already allowed

*regulations* to be made on accounting practices and is the power under which the existing MRP regulations were made. The amendment inserts a new section 21(1A) into the 2003 Act, enabling the Secretary of State also to issue *guidance* on accounting practices and thus on MRP.

7. Authorities are obliged by new section 21(1B) to "have regard" to such guidance – which is exactly the same duty as applies to other pieces of statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the MHCLG Guidance on Local Government Investments.

8. The statutory MRP guidance itself is the front section of the present document. Annex B of this document is an informal commentary, explaining the policy intention in more detail and including other information to help practitioners; it has no statutory force.

9. Specific requirements of the statutory guidance are considered in more detail below.

<u>Annual MRP Statement [paragraphs 18-19 of the guidance]</u>

10. Authorities are asked to prepare an annual statement of their policy on making MRP for submission to their full council (for authorities without a full council, approval of the statement should be at the closest equivalent level). 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. If it is ever proposed to vary the terms of the original statement during the year, a revised statement should be put to the council at that time. It is for each council to consider with its officers the preferred format of the statement and MHCLG will not being issuing any advice on the matter.

11. To underpin this recommendation, it was necessary to amend the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000 [SI 2000/2853].* Regulation 4(1)(b) specifies functions which are not to be the sole responsibility of an authority's executive and includes the authority's borrowing, investments, capital expenditure and now also the making of MRP.

<u>Meaning of prudent provision [paragraphs 20 – 23 of the guidance]</u>

12. The main part of the guidance is concerned with recommendations on the interpretation of the term "prudent provision" as used in the amended Regulation 28. The guidance includes specific examples of options for making "prudent provision".

13. It explains that provision for the debt which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service. However, some local authorities have increased their debt to acquire assets that do not generate direct service benefits, for example assets held for investment purposes or as part of regeneration schemes. In addition, there may be a significant mismatch between the period over which an asset provides a direct service benefit and the lifetime of the debt that has been taken out to acquire assets taken out.

14. Whilst recognising that local authorities have options other than building up prudent provision to repay debt, the Government has identified that there is a mismatch between the weighted average lifetime of local authority debt and the length of time it would take to fully provide for that debt based on current levels of MRP charged. Whilst this is not a risk if ease of access to PWLB remains unchanged, assuming that this will remain the case over the length of longer dated local authority debt instruments is not a prudent approach. For this reason, the Government has changed the definition of "prudent provision" to highlight that there is a balance between matching MRP to the service potential of assets and to the weighted average lifetime of local authority debt.

Meaning of a charge to a revenue account [paragraphs 25-26]

15. The Government has identified that there are some local authorities who have adopted very aggressive strategies with regard to making provision for repayment of debt. In some cases these have resulted in charges of £nil or negative charges being made. Feedback from external auditors indicates a lack of understanding about whether such practices are lawful.

16. The Government is of the view that this is not the most prudent approach that local authorities could adopt, and those that do so are deferring cost so that it falls on future rather than current council tax payers. Therefore, this update clarifies that except in cases where a local authority has a negative or nil CFR or is offsetting a previous overpayment of MRP, MRP should not be £nil or a negative charge.

Negative CFR

17. Where the CFR (as calculated for the normal purposes of the Prudential Code and not the adjusted CFR mentioned above) is nil or negative on the last day of a financial year, this indicates that the authority's provision for debt is equal to or greater than the debt incurred. There is accordingly no need to make MRP in the following financial year under any of the specified options, or in any other way.

Change in methods for calculating MRP [paragraphs 27 – 29]

18. The most common justification for local authorities who have decided to significantly reduce their MRP charge or take a payment holiday is that a changing the methodology that they use to calculate MRP has resulted in identification of a historical overpayment. The mechanism tends to be a reassessment of the assumptions underpinning Option 3: The Asset Life Method.

19. Given that conceptually, this recommended option requires local authorities to charge MRP as a proxy for depreciation, and depreciation is an accounting estimate, the Government believes that local authorities should follow proper accounting practices when changing an accounting estimate. In depreciation accounting, when an entity reassesses the life of an asset, it does not recalculate the depreciation it has charged from acquisition of the asset. Instead, depreciation must be recalculated over the revised asset life using the current net book value of the asset as the new starting point.

20. Adopting this approach will require local authorities to spread the benefit of charging a lower annual MRP to council tax payers over time, rather than taking all of the benefits up front at the expense of longer term financial sustainability.

OPTIONS FOR PRUDENT PROVISION

21. Four ready-made options are included in the guidance (and there are two alternatives under Option 3). The options are those likely to be most relevant for the majority of authorities but other approaches are not meant to be ruled out, provided that they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timetables and revenue-earning profiles. Authorities may wish to consult their legal advisers and external auditors about their approach to MRP if it involves a significant departure from the guidance or relates to any large, complex or novel schemes. However, the decision on what is prudent is for the authority and it is not for MHCLG to say in particular cases whether any proposed arrangement is consistent with the statutory duty.

Option 1: Regulatory Method [paragraphs 32 - 33]

22. For debt which is supported by the Government through the RSG system, authorities may continue to use the formulae in the current regulations, since the RSG is calculated on that basis. Although the existing regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities will be able to calculate MRP as if it were still in force. The earlier regulations relevant to MRP are included in this Guidance at **Annex A**.

23. Normally, under this option, the former regulations should be followed exactly as if they had not been revoked. That includes taking advantage, if desired, of the **commutation adjustment** in the former regulation 29.

24. When introducing the new MRP regime in 2004, as part of the Prudential system framework, the Government's policy aim was that the move from the former MRP scheme should not itself increase any authority's MRP liability. Safeguards to achieve that result were built in from the outset (or added later as anomalies came to light).

25. The main device for achieving the neutrality between old and new MRP systems was "Adjustment A" in the original regulation 28. This was an amount to be calculated at the start of the new system in 2004 and not subsequently varied. For the purposes of Option 1, Adjustment A should therefore continue to be given the value attributed to it in the financial year 2004-05, even if that value reflected erroneous calculations under the former capital finance system which reduce MRP liability under the present system. If, however, Adjustment A reflects an error which increases the current MRP liability, the authority would be justified in recalculating it and hence reducing MRP to its proper level.

26. Similarly, if an authority considers that, in its particular circumstances, strict compliance with any other aspect of the former regulations would produce an anomalous and disadvantageous result, it may consider modifying the rules to achieve the intended neutrality. Again, such a step should be discussed in advance with external auditors.

<u>Option 2: CFR Method [paragraph 34]</u>

27. This is a technically much simpler alternative to Option 1 which may be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement [CFR], which is easily derived from the balance sheet, it avoids the complexities of the formulae in the old regulation 28 (though for most authorities it will probably result in a higher level of provision than Option 1). It does however still rely on definitions in regulation 28(11), which are as follows:

*"Non-housing CFR" means that part of the capital financing requirement which is not housing CFR. "Housing CFR" means that part, if any, of the capital financing requirement which is in respect of borrowing or credit arrangements used to finance capital expenditure on housing assets. "Housing assets" means any land, houses or other property to which subsection (1) of section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account) for the time being applies.*

<u>Option 3: Asset Life Method [paragraph 35]</u>

28. For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, there are two options included in the guidance.

29. Option 3 is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach. Within option 3, two methods are identified.

30. The first of these, the **equal instalment method**, allows the use of the simple formula in paragraph 35(a) of the guidance. This will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure ("A" in the formula) remains constant. The cumulative total of the MRP made to date ("B" in the formula) will increase each year.

31. The outstanding period of the **estimated life** of the asset ("C" in the formula) reduces by 1 each year. For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year, C will be equal to 24, and so on. The original estimate of the life is determined at the outset and should not be varied thereafter, even if in reality the condition of the asset has changed significantly (paragraph 11).

32. The formula allows an authority to make **voluntary extra provision** in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.

33. The alternative is the **annuity method**, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time. Guidance on the calculation method is given by CIPFA in its publication *Practitioners Guide to Capital Finance in Local Government (2012 Edition).*

34. **Freehold land** (paragraph 12) cannot properly have a life attributed to it, so for the purposes of Option 3 it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

35. Provision for debt under Option 3 will normally commence in the financial year following the one in which the expenditure is incurred [paragraph 40]. But paragraph 41 of the guidance highlights an important exception to this rule. In the case of the provision of a new asset, MRP would not have to be charged until the asset came into service and would begin in the financial year following the one in

which the asset became operational. This “**MRP holiday**” would be perhaps 2 or 3 years in the case of major projects, or possibly longer for some complex infrastructure schemes, and could make them more affordable. There would be a similar effect in the case of Option 4 under normal depreciation rules.

Option 4: Depreciation Method [paragraphs 36 to 37]

36. Alternatively, for new borrowing under the Prudential system for which no Government support is being given, Option 4 may be used. This means making MRP in accordance with the standard rules for depreciation accounting.

37. Authorities will normally need to follow the standard procedures for calculating depreciation provision. But this Guidance identifies some necessary exceptions:

(a) MRP continues until the total provision made is equal to the original amount of the debt and may then cease.

(b) The capital receipt from the disposal of the asset may not be used for revenue spending, since that would run counter to the Government’s “golden rule”. Capital receipts may be used only as specified in regulation 23 of the 2003 regulations.

(c) If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

CONDITIONS FOR USING THE OPTIONS

Use of Options [paragraphs 38 – 39]

38. The intention is that Options 1 and 2 should normally be available only for **Government-supported borrowing**. Options 3 and 4 are meant to be used for all **self-financed borrowing**.

Commencement of MRP [paragraphs 40-41]

39. The Guidance recognises that MRP should not be provided for Assets under Construction. Long term projects, for example infrastructure or regeneration, may be transferred from **Assets under Construction** to **Assets in Use** over a number of years. Local authorities should consider commencing to provide MRP on debt, apportioned by when each stage of the project transfers to **Assets in Use**.

Estimated useful life of assets [paragraph 42]

40. The Government is concerned that some local authorities are making capital investments that can only be justified as being value for money, by providing for MRP over a much longer period that any debt instruments taken out to finance acquisition. Under current PWLB terms of trade, local authorities can always refinance their debt. However, it is impossible to guarantee that PWLB terms of

trade for new loans will remain unchanged over the lifetime of existing loans. If PWLB terms of trade changed for new loans, local authorities that had otherwise expected to be able to freely refinance existing debt may instead be required to choose between significantly increasing their annual charge to 'top-up' their MRP or develop other plans to manage increased liquidity risk on repayment of debt.

41. Whilst the normal maximum asset life has been set at 50 years, the Guidance recognises that there may be circumstances where this maximum can be prudently exceeded. By service functionality, the Guidance means assets that are directly used to deliver the functions of the authority. It does not include investment assets.

Leases and PFI [paragraph43]

42. At the time of drafting this Guidance, it is anticipated that proper practices for leases will move to being based on *International Financial Reporting Standard (IFRS) 16: Leases,* with effect from 1 April 2019, the effective date of this Guidance. However, at the time of drafting the extant proper practices are based on *International Accounting Standard (IAS) 17: Leases* and this Guidance maintains the provisions in relation to finance leases under that standard. Guidance in relation to finance leases under IAS 17 as adopted by proper practices should be used, until proper practices replace that standard with provisions based on IFRS 16.

43. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is low value. Implementation of this standard is expected to bring more lease contracts, and the related assets and liabilities onto the balance sheet.

44. When these lease contracts along with the related assets and liabilities come onto the balance sheet, a local authority will increase its long term liabilities. This will increase the quantum of debt that MRP needs to cover. Generally accepted accounting practice requires these changes to be accounted for retrospectively, with the result that an element of the rental or service charge payable in previous years (and previously charged to revenue accounts) will be taken to the balance sheet to reduce the liability. On its own, this change in the accounting arrangements would result in a one-off increase to the capital financing requirement and an equal increase in revenue account balances.

45. This is not seen as a prudent course of action and the guidance aims to ensure authorities are in the same position as if the change had not occurred. It does this by recommending the inclusion in the annual MRP charge of an amount equal to the amount that has been taken to the balance sheet to reduce the

liability, including the retrospective element in the first year. (This approach will produce an MRP charge comparable to that under Option 3, in that it will run over the life of the lease or PFI scheme and will have a profile similar to what the annuity method gives). MHCLG recognises the complexity of the accounting in this area and acknowledges that the recommendations in paragraph 43 of the formal guidance and in this commentary may not be entirely appropriate in all cases. It will be open to authorities to consider a different approach to the calculation, subject to compliance with the overriding statutory requirement to make a prudent level of MRP.

Housing assets

46. As was the case under regulation 28 of the 2003 Regulations prior to its amendment by the 2008 Regulations, the duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets [as defined in paragraph 12]. Options 1 and 2 above already automatically achieve this; and when using options 3 or 4 (or any other method) the authority should not take account of capital expenditure on housing assets.

47. The rationale for this is that assets held in the Housing Revenue Account are self-financing. Instead, local authorities with Housing Revenue Accounts are required to make a charge to their Major Repairs Reserve, to maintain the functionality of housing assets.

Investment Properties [paragraph 45]

48. Where a local authority classifies an asset as an investment property, it is declaring that it is holding that asset for commercial reasons. Therefore, it should fully provide for debt taken on to acquire that asset over the lifetime of that debt. In addition as investment properties are not subject to depreciation, Option 4 – the depreciation method, is not appropriate for calculating prudent provision.

49. The Guidance recognises that some local authorities may have made different assumptions when they acquired investment properties. For this reason the maximum life that should be used for calculating MRP on such assets has been set at 50 years, which is the maximum loan period for PWLB debt.

Capitalised expenditure [paragraphs 46 – 47]

50. Authorities may borrow to meet expenditure which is treated as capital expenditure by virtue of either a capitalisation direction (section 16(2)(b) of the 2003 Act ) or regulation 25(1) of the 2003 Regulations. The guidance recommends that MRP in such cases is determined under Option 3. However, since the expenditure does not relate (directly at least) to an asset for which a life can be estimated, guidance is given on how to determine the value of the variable "C" in the formula in paragraph 9 of the guidance.

51. The table in paragraph 24 of the guidance gives the value of “C” for each of the categories listed in regulation 25(1). The basic principle is that, where the capitalised expenditure can be indirectly linked to an asset, the estimated life of that asset should be used.

52. In other cases, 25 years is proposed as a reasonable default. But for the acquisition of **share capital** (regulation 25(1)(d)), the slightly shorter period of 20 years is specified, because the aim of that regulation is to discourage the use of those particular forms of investment.

53. Similarly, 20 years is specified in the case of expenditure **capitalised by direction**, since the Government again does not wish to encourage reliance upon that practice.

54. It should be noted that the value of “C” given in each case applies only in the *initial* year of making MRP. Subsequently, the value will decrease by 1 in each successive year.

## Annex C - Transitional arrangements

1. The Government wants to ensure that local authorities make prudent provision for the repayment of debt. The Government believes that it is for local authorities to assess what is prudent according to their circumstances. The proposals aim to continue to give local authorities flexibility to define prudent provision and to change the methodology that they use to assess this if needed.

2. There is no requirement for local authorities to make decisions based on prospective Guidance. It is for individual local authorities to make their own judgement as to whether they apply the current Guidance or the prospective Guidance to decisions that they take prior to 1 April 2019, in consultation with their external auditors where they feel that is appropriate. Government has no intention of seeking to second guess or comment on local decisions taken in accordance with local Standing Orders.

3. The Government does not expect any local authority to recalculate MRP charged in the 2017-18 financial year or any prior year due to the proposed changes in methodology. Where a local authority has changed the methodology that it uses to calculate prudent provision and generated what the current Guidance calls an 'overpayment' it can continue to incorporate that overpayment into future calculations of prudent provision.

4. As set out in **paragraph 15** of the statutory guidance, a local authority that changes the methodology it uses to calculate MRP in 2018-19 does not generate an overpayment by doing so.

5. Where a local authority has selected a long asset life for borrowing or has decided not to charge MRP on non-Housing Revenue Account debt, we would expect the calculation of future year's MRP to be made under the new guidance, as set out in the Government response following completion of the consultation. We have suggested maximum useful economic lives in the draft for consultation, but if any local authority believes that there are reasons why these maximums are inappropriate for borrowing to support particular activities, we would encourage them provide the evidence to us. If a local authority feels that it needs to adjust the useful economic lives that it is basing its MRP charge on, then that adjustment should only be applied to calculations made in 2019-20 and subsequent years.

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## STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

## (3rd Edition)

**Issued under section 15(1)(a) of the *Local Government Act 2003* and effective for financial years commencing on or after 1 April 2018**

### POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 15(1)(a) of the *Local Government Act 2003.* Under that section local authorities are required to "have regard" to "such guidance as the Secretary of State may issue".

### DEFINITION OF TERMS

2. In this guidance the ***2003 Act*** means the *Local Government Act 2003.*

3. **Local authority** has the meaning given in section 23 of the *2003 Act.* To the extent that this guidance applies to parish councils and charter trustees (see paragraph 11) a reference to a local authority includes those councils and trustees.

4. The definition of an **investment** covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

5. For the avoidance of doubt, the definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party. The term does not include *pension funds* or *trust fund investments,* which are subject to separate regulatory regimes and therefore are not covered by this guidance.

6. A **credit rating agency** is one of the following three companies:
   - Standard and Poor's;
   - Moody's Investors Service Ltd; and
   - Fitch Ratings Ltd.

7. For the purposes of this guidance a **loan** is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who promises to return it according to the terms of the agreement, normally with interest. This definition does not include a loan to another local authority, which is classified as a specified investment.

8. The **Treasury Management Code** means the statutory code of practice issued by CIPFA: *“Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition”.*

9. The **Prudential Code** means the statutory code of practice, issued by CIPFA: *“The Prudential Code for Capital Finance in Local Authorities, 2017 Edition”.*

10. The **Capital Strategy** is the strategy required by the updates to the Prudential Code and Treasury Management Code.

**APPLICATION**

**Effective date**

11. This guidance applies for financial years commencing on or after 1 April 2018. It supersedes all previous editions of the Statutory Guidance on Local Authority Investments.

12. Strategies presented to Council or equivalent before 1 April 2018 but relating to 2018-19 and future financial years do not need to include all of the additional disclosures required by this edition of the guidance should it not prove practical or cost effective to do so. If a local authority chooses not to include the new disclosures in its 2018-19 Strategy, it must include the disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

**Local authorities**

13. This guidance applies to all local authorities in England.

14. This guidance applies to parish councils and charter trustees, providing their total investments exceed or are expected to exceed £100,000 at any time during the financial year. Where a parish council or charter trustee expects its total investments to be between £10,000 and £100,000, it is encouraged to adopt the principles in this guidance.

**KEY PRINCIPLES**

**Transparency and democratic accountability**

15. For each financial year, a local authority should prepare at least one Investment Strategy (“the Strategy”). The Strategy should contain the disclosures and reporting requirements specified in this guidance.

16. The Strategy should be approved by the full council. For authorities without a full Council, the Strategy should be approved at the closest equivalent level. The

Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

17. Where a local authority proposes to make a material change to its Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

18. The Strategy should be publicly available on a local authority's website. Where a parish council or charter trustee does not maintain its own website, they should post a public notice detailing how local residents can obtain a copy of the Strategy, free of charge.

19. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Strategy can be published in those documents instead of in the Strategy.

**Contribution**

20. Investments made by local authorities can be classified into one of two main categories:
    - Investments held for treasury management purposes; and
    - Other investments.

21. Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance.

22. Local authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority. It is for each local authority to define the types of contribution that investments can make and a single investment can make more than one type of contribution.

**Use of indicators**

23. The Strategy should include quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return

received. Where investment decisions are funded by borrowing the indicators used should reflect the additional debt servicing costs taken on.

24. Local authorities should consider the most appropriate indicators to use, given their risk appetite and capital and investment strategies. Whilst this guidance does not prescribe specific indicators or thresholds, the indicators used should be consistent from year to year and should be presented in a way that allows elected members and the general public to understand a local authorities' total risk exposure from treasury management and other types of investment.

25. Where a local authority has entered into a long term investment or has taken out long term debt to finance an investment the indicators used should allow Councillors and the general public to assess the risks and opportunities of the investment over both its payback period and over the repayment period of any debt taken out.

**Security, Liquidity and Yield**

26. A prudent investment policy will have two underlying objectives:
    - **Security** – protecting the capital sum invested from loss; and
    - **Liquidity** – ensuring the funds invested are available for expenditure when needed.

27. The generation of **yield** is distinct from these prudential objectives. However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these priorities.

28. When entering into treasury management investments, local authorities should consider security, liquidity and yield in that order of importance.

29. When entering into other types of investments local authorities should consider the balance between security, liquidity and yield based on their risk appetite and the contribution(s) of that investment activity.

**Security**

<u>Financial Investments</u>

30. Financial investments can fall into one of three categories:
    - **Specified investments**;
    - **Loans**; and
    - Other **Non-specified investments**.

<u>Specified Investments</u>

31. An investment is a specified investment if all of the following apply:
    - The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling.
    - The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a non-conditional option.
    - The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].*
    - The investment is made with a body or in an investment scheme described as high quality (see paragraph 33 or with one of the following bodies:
        i. The United Kingdom Government;
        ii. A local authority in England or Wales (as defined in section 23 of *the 2003 Act*) or a similar body in Scotland or Northern Ireland; or
        iii. A parish council or community council.

32. For the purposes of paragraph 32 the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 42 is relevant.

Loans

33. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

34. Local authorities can make such loans whilst continuing to have regard to this guidance if they can demonstrate in their Strategy that:
    - Total financial exposure to these type of loans is proportionate;
    - They have used an allowed “expected credit loss” model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 *Financial Instruments* as adopted by proper practices to measure the credit risk of their loan portfolio;
    - They have appropriate credit control arrangements to recover overdue repayments in place; and
    - The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

Non-specified investments

35. A non-specified investment is any financial investment that is not a loan and does not meet the criteria to be treated as a specified investment.

36. For non-specified investments (i.e. those not meeting the criteria in paragraph 31), the Strategy should:
    - Set out procedures for determining which categories of investments may be prudently used (and where these procedures involve the use of credit ratings, paragraph 32 is relevant).
    - Identify which categories of investments have been defined as suitable for use.
    - State the upper limits for the maximum amounts both individually and cumulatively that may be held in each identified category and for the overall amount held in non-specified investments and confirm that investments made have remained within those limits.

Non-financial investments

37. As defined in paragraph 4 of this guidance non-financial investments are non-financial assets that the organisation holds primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in *International Accounting Standard 40: Investment Property* as adapted by proper practices.

38. Where the fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

39. Where the fair value of non-financial investments is no longer sufficient to provide security against loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

40. Where a local authority recognises a loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Risk Assessment

41. The Strategy should state the local authority's approach to assessing risk of loss before entering into and whilst holding an investment, making clear in particular:

- How it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements.
- Whether and, if so how, a local authority uses external advisors be they treasury management advisors, property investment advisors or any other relevant persons.
- How the local authority monitors and maintains the quality of advice provided by external advisors.
- To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies.
- Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.
- What other sources of information are used to assess and monitor risk.

**Liquidity**

42. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed and state what those maximum periods are and how the local authority will stay within its stated investment limits.

43. For non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at a portfolio level if appropriate.

**Proportionality**

44. Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and/or place making role of that local authority is dependent on achieving the expected net profit. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net profit.

**45.** The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

**Borrowing in advance of need**

46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:
    - Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and
    - The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

**Capacity, skills and culture**

48. The Strategy should disclose the steps taken to ensure that those elected members and statutory officers involved in the investments decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment, to assess individual assessments in the context of the strategic objectives and risk profile of the local authority and to enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

49. The Strategy should disclose the steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

50. Where appropriate the Strategy should comment on the corporate governance arrangements that have been put in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

## ANNEX A – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Power under which this Guidance is issued [paragraph 1]

1. The **Local Government Act 2003**, section 15(1), requires a local authority "…to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify…".

2. The guidance on investments in the main part of this document is issued under section 15(1) of the 2003 Act and authorities are therefore required to have regard to it. This part (**Annex A**) contains an informal commentary ("the commentary") on the Statutory Guidance.

3. Two codes of practice issued by the *Chartered Institute of Public Finance and Accountancy* (CIPFA) contain investment guidance which complements the MHCLG guidance. These publications are:
   - *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*
   - *The Prudential Code for Capital Finance in Local Authorities*

4. Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the *Local Authorities* (*Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] as amended.*

Objectives in updating the Guidance

5. The 2nd edition of this Guidance, which was issued in 2010, reflected concerns raised by the CLG and Treasury Select committees as part of their enquiries into the financial crash of 2007-8. The key areas of focus were:
   - The practice of investing for yield, especially in Icelandic Banks;
   - The need for transparent investment strategies; and
   - The use of Treasury Management advisors.

6. The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

7. In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

    - Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
    - There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and
    - Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

<u>Effective Date [paragraphs 11-12]</u>

8. This Guidance applies from 1 April 2018. It supersedes all previous editions of the Guidance.

9. The Guidance requires local authorities to produce a number of additional disclosures. Many local authorities already produce these as part of internal reporting and risk management procedures. However, if these disclosures are not currently produced, then local authorities do not need to prepare them in full for Strategies presented to full Council or equivalent before 1 April 2018. Those local authorities who do not include the required disclosures in their 2018-19 strategies, should present them for approval the first time the relevant Strategy is updated or superseded.

<u>Local Authorities [paragraphs 12-13]</u>

10. This Guidance applies to all local authorities, who hold or during the next financial year intend to hold financial or non-financial investments, solely or in part to generate revenue income.

11. It applies to parish councils whose investments exceed the thresholds set out in paragraph 14. The decision to lower the financial threshold for parish councils has been taken in recognition that some parishes have begun to engage in commercial ventures. As parish councils tend to be fairly small and to obtain a greater percentage of their funding directly from council tax payers than other types of local authority, it is right that they demonstrate that they have carefully considered the expertise that they need to manage the risks arising from their strategy.

<u>Transparency and democratic accountability [paragraphs 15-19]</u>

12. The Government believes that local authorities need to be better at explaining "why" not just "what" they are doing with their investment activity. That means that the sector needs to demonstrate more transparency and openness and to

make it easier for informed observers to understand how good governance and democratic accountability have been exercised.

13. The additional disclosures required by the Guidance should be included in a single document presented to full Council or the equivalent. Although the Guidance refers to an Investment Strategy, providing that all of the disclosures are easy for interested parties to find and are in or linked from a single document, a separate Strategy does not need to be prepared. The Strategy should be updated at least annually.

14. Subject to the provisions in paragraph 35 and 36 of the commentary, local authorities can exclude specific non-financial investments from the required disclosures on grounds of commercial confidentiality. The Government expects that non-disclosure on grounds of commercial confidentiality will be an exceptional circumstance. A local authority should only determine that it would breach commercial confidentiality to include an investment in the disclosures on receipt of appropriate professional advice, using the same criteria as would be used to exclude the public from a Council meeting. Local authorities should reassess whether the commercial confidentiality test is met every time a new Strategy is presented to full Council or the equivalent.

15. Under Regulation 17 of the *The Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012* as amended overview and scrutiny committee members have right of access to any confidential information relating to any decision by any committee or any member of the executive of their council. Nothing in this Guidance has the power to override this regulation.

16. Assets that generate revenue income solely through fees and charges for discretionary services levied under Section 93 of the *Local Government Act 2003* should not be classified as non-financial investments for this purpose.

17. If disclosures are already produced in another document that is publicly available then a local authority can provide a link to the disclosures from the Strategy rather than reproducing them. The exception is disclosures contained in the Statutory Accounts, which do not meet the requirements of this Strategy. This is because local authority statutory accounts can be complex and difficult for users who are not familiar with local government accounting to understand and statutory accounts are prepared to a higher level of materiality than local authorities should use for internal risk management.

Contribution [paragraphs 20-22]

18. Local authorities may have several different objectives, when deciding to acquire an asset. If an asset is not solely held for yield, then a local authority may have a different risk appetite or be willing to accept a lower return than it otherwise would.

19. Each local authority should determine how it categorises different types of contribution, and each investment can have more than one type of contribution. A non-exhaustive list of types of contribution include:
    - Yield/profit
    - Regeneration
    - Economic benefit/business rates growth
    - Responding to local market failure
    - Treasury management

20. Where a local authority classifies an investment as contributing to regeneration or local economic benefit, it should be able to demonstrate that the investment forms part of a project in its Local Plan.

Use of indicators [paragraphs 23-25]

21. Local authorities should present a range of indicators to allow members and other interested parties to understand the total exposure from borrowing and investment decisions. The indicators should cover both the local authority's current position and the expected position assuming all planned investments for the following year are completed. The indicators do not need to take account of Treasury Management investments unless these are expected to be held for more than 12 months.

22. The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. We recommend that, the indicators in the table below are used. Where local authorities have a different risk appetite or different expectation of returns depending on the contribution(s) each type of investment makes, they should consider presenting the indicators, classified by type of contribution or risk appetite.

| | |
|---|---|
| Debt to net service expenditure (NSE) ratio | *Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.* |
| Commercial income to NSE ratio | *Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.* |
| Investment cover ratio | *The total net income from property investments, compared to the interest expense.* |
| Loan to value ratio | *The amount of debt compared to the total asset value.* |
| Target income returns | *Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties.* |
| Benchmarking of returns | *As a measure against other investments and against other council's property portfolios.* |
| Gross and net income | *The income received from the investment portfolio at a gross level and net level (less costs) over time.* |
| Operating costs | *The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.* |
| Vacancy levels and Tenant exposures for non-financial investments | *Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.* |

23. Where appropriate, local authorities should consider including targets or limits set by members alongside the outturn. Where there has been a significant change in year on year performance against any of the indicators presented local authorities should include an explanation in the Strategy.

24. Local authorities can choose to present additional indicators in the Strategy should they believe that it would enhance understandability and transparency to do so.

Security, liquidity and yield [paragraphs 26-29]

25. For treasury management and other financial investments local authorities should continue to prioritise **SECURITY, LIQUIDITY** and **YIELD** in that order of importance.

26. Whilst consideration of **security** and **liquidity** is important for loans and non-financial investments, the relative balance between objectives may be different depending on the nature and objectives in making a specific investment.

Security and liquidity

Loans [paragraphs 33 – 34, 40]

27. Loans to joint ventures, local SMEs or third sector bodies, and wholly owned companies fall within the scope of the Guidance. When considering security and liquidity of loans local authorities should set limits for their total exposure and apply the expected loss model in line with the requirements of *IFRS 9 Financial Instruments*.

Non-financial investments [paragraphs 37-40, 43]

28. Where a local authority has a non-financial investment, it will have an asset that can be realised to recoup the sums invested. Therefore, the Guidance requires local authorities to consider security by reference to the value of the asset relative to purchase price and to set out the plans to recoup the investment if realising the asset would not recoup the sums invested. In the period immediately after purchase, it is normal for the directly attributable costs of purchasing an non-financial investment to be greater than the realisable value of the asset. In this scenario, all the Strategy needs to disclose is how long the local authority expects it to take for the increase in asset values to provide security for the sums invested and the assumptions underpinning that expectation.

29. Non-financial investments are by their nature illiquid. However, this does not mean that the local authority does not need to plan for realising a part of its non-financial investment portfolio, for example to repay debt. The liquidity of the non-financial investment portfolio should be considered over the repayment period of any debt taken out to acquire assets, which could be very long term. Given current trends such as the scale and pace of technology driven change, there is no guarantee that non-financial investments will continue to deliver value over their lifetime. To manage this risk, local authorities need to have plans to realise the capital tied up in non-financial investments if required. In addition, the Strategy should consider the trade-offs between accepting capital loss and refinancing debt incurring additional debt servicing costs by doing so, if appropriate.

Proportionality [paragraphs 44-45]

30. Local authorities need to consider the long term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure.

31. In addition, whilst under statute, local authority debt is secured on the revenues of that authority, in practice, there is no realistic prospect of the revenues of any local authority being sufficient to pay back debt equating to many multiples of the sum of NNDR and Council Tax Income, without a pervasive and long term impact on service delivery. It is unclear whether local authorities who have adopted a debt financed commercial investment strategy have realistic plans to manage failure. Whilst the Government recognises the importance of local authorities taking on debt to enhance service provision, irrespective of the source of finance, it does not believe that it should do the same for commercial investments.

32. For this reason, the Guidance introduces a new requirement that in every local authority, full council or its nearest equivalent, sets limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure.

33. If a local authority has exceeded these limits through investments taken out prior to the introduction of this Guidance, it does not need to dispose of investments currently held. However, authorities who have exceeded their self-assessed limits should not enter into any further investments, irrespective of how these are financed, other than short term investments required for efficient treasury management.

Borrowing in advance of need [paragraphs 46-47]

34. The Prudential Code, issued by CIPFA has always contained a statement that local authorities should not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The purpose of repeating that statement in this Guidance is to make it clear that it extends to borrowing taken on to finance the acquisition of non-financial as well as financial investments.

35. Local authorities can still finance the acquisition of financial on non financial investments from capital receipts generated from the sale of surplus assets. However, they should not repurpose receipts allocated to the acquisition of assets that contribute to service delivery to fund the purchase of investments, solely to avoid the requirements against borrowing in advance of need.

36. If exceptionally a local authority, chooses not to have regard to the provision on borrowing to fund investment activity the Guidance requires them to explain, in their Strategy, the rationale for this decision.

37. The purpose of this disclosure is to allow external auditors, tax payers and other interested parties to understand why the local authority has chosen to disregard

the Guidance, and to hold the authority to account should they believe there is not sufficient reason for doing so.

Capacity, Skills and Culture [paragraphs 48-50]

38. In the Public Accounts Committee report of 18 November 2016[1], members raised concerns that, locally elected members may not always have the background and expertise to understand the risks associated with the decisions that they are being asked to make. For this reason the Guidance extends the requirements on capacity and skills to members and any statutory officers involved in or responsible for signing off on investment decisions.

39. Members do not necessarily need formal training in understanding investment risks to satisfy the requirements of the Guidance. Depending on their level of expertise a presentation setting out the risks and opportunities of an investment strategy/specific investment in terms a layman would understand, may be sufficient to meet the new requirements.

40. The Government is aware that many local authorities have brought in outside expertise to identify and negotiate investment opportunities. Whilst this can be an effective method of risk management, it is important that those negotiating deals understand that they are not operating in a purely commercial environment and that the prime purpose of a local authority is to deliver statutory services to local residents. Therefore, the Strategy should comment on how they have been made aware of this.

[1] https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2015/financial-sustainability-local-authorities-16-17/