**Report to:** Cabinet **Date of Meeting:** 16 February 2017

Council 2 March 2017

**Subject:** Treasury Management Policy and Strategy 2017/2018

**Report of:** Head of Corporate Resources **Wards Affected:** All

**Is this a Key Decision?** No **Is it included in the Forward Plan?** No

**Exempt/Confidential** No

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**Purpose/Summary**

To advise Cabinet of the proposed procedures and strategy to be adopted in undertaking the Treasury Management Function in 2017/2018.

**Recommendation(s)**

Cabinet to recommend to Council that: -

a) The Treasury Management Policy Document for 2017/2018 (Annex A) be agreed;

b) The Treasury Management Strategy Document for 2017/2018 (Annex B) be agreed; and

c) The basis to be used in the calculation of the Minimum Revenue Provision for Debt Repayment in 2016/2017 (Annex C) be agreed.

**How does the decision contribute to the Council's Corporate Objectives?**

| | Corporate Objective | Positive Impact | Neutral Impact | Negative Impact |
|---|---|---|---|---|
| 1 | Creating a Learning Community | | √ | |
| 2 | Jobs and Prosperity | | √ | |
| 3 | Environmental Sustainability | | √ | |
| 4 | Health and Well-Being | | √ | |
| 5 | Children and Young People | | √ | |
| 6 | Creating Safe Communities | | √ | |
| 7 | Creating Inclusive Communities | | √ | |
| 8 | Improving the Quality of Council Services and Strengthening Local Democracy | | √ | |

**Reasons for the Recommendation:**

To enable the Council to effectively manage its treasury activities.

**What will it cost and how will it be financed?**

**(A) Revenue Costs**

All issues are identified within the report

**(B) Capital Costs**

None.

**Implications:**

The following implications of this proposal have been considered and where there are specific implications, these are set out below:

| **Legal** | Local Authorities are required to have regard to the Code of Practice on Treasury Management under the provisions of the Local Government Act 2003 |
|---|---|
| | |
| Equality<br>1. No Equality Implication<br>2. Equality Implications identified and mitigated<br>3. Equality Implication identified and risk remains | <br>√<br><br> |

**Impact on Service Delivery:**
None.

**What consultations have taken place on the proposals and when?**

The Head of Corporate Resources is the author of the report (FD4494/17)

The Head of Corporate Legal Services has been consulted and has no comments on the report (LD3777/17).

**Are there any other options available for consideration?**
None.

**Implementation Date for the Decision**
With effect from 1st April 2017.

**Contact Officer:** Stephan Van Arendsen
**Tel:** 0151 934 4081
**Email:** Stephan.VanArendsen@sefton.gov.uk

**Background Papers:**

None

## Background

1.1 The Council has previously adopted CIPFA's revised 2001 Code of Practice on Treasury Management in the Public Services which recommends the production of annual Treasury Management Policy and Strategy Documents, and the revision to the Code in 2009 following the Icelandic bank collapse. The Council has also adopted the revisions contained within the 2011 Code.

1.2. In addition, the Council has also adopted, and incorporated into both documents:

a) The requirements of the 2003 Prudential Code for Capital Finance in Local Authorities; and,

b) An Investment Strategy produced in line with guidance from the then Office of the Deputy Prime Minister, concerning the investment of surplus funds. This sets out the manner in which the Council will manage its investments, giving priority to the security and liquidity of those investments.

## 2. Treasury Management Policy and Strategy Documents

2.1. The Code requires the Council to produce:

a) A Treasury Management Policy Document – which outlines the broad policies, objectives and approach to risk management of its treasury management activities;

b) A Treasury Management Strategy Document – This sets out specific treasury activities which will be undertaken in compliance with the Policy in 2017/2018; and

c) Suitable treasury management practices, setting out the manner in which the organisation will seek to achieve these policies and objectives, prescribing how it will manage and control those activities.

The content of the policy statement and the treasury management practices will follow the recommendations contained in sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key principles. None have occurred in recent years.

2.2. The proposed Policy and Strategy Documents are attached at **Annex A and B** respectively.

2.3. In view of the complex nature of Treasury Management, regular treasury update reports will be presented to the Audit and Governance Committee.

## 3. Financial Procedure Rules – Banking Arrangements

3.1. The Treasury Management Policy Document at **Annex A** delegates certain responsibilities to the Head of Corporate Resources, including all executive decisions on borrowing, investment or financing, in line with the Constitution of the Council.

## 4. Minimum Revenue Provision (MRP) for Debt Repayment Policy Document

4.1. Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146, as amended] require local authorities to make a prudent amount of minimum revenue provision (MRP).

4.2. The MRP regulations were revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414]. These regulations were complimented by the publication of guidance by the DCLG on determining the “prudent” level of MRP, to which authorities are required to have regard. The latest guidance was published in February 2012 (3rd Edition). The 2008 regulations and associated guidance allowed local authorities more flexibility in calculating their MRP annual charge.

4.3. Authorities are required to prepare an annual statement of their MRP policy for submission to their full council. The aim is to give elected Members the opportunity to scrutinise the proposed application of the MRP guidance.

4.4. Authorities are required to approve their MRP policy for 2016/17 before 31 March 2017.

4.5. The proposed MRP Policy for 2016/17 is set out in **Annex C**.

**ANNEX A**

# SEFTON COUNCIL

## TREASURY MANAGEMENT

## POLICY

## 2017/2018

**CORPORATE RESOURCES**

## 1. Treasury Management Policy

1.1. The Council defines Treasury Management as:

The management of the Authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2. The Council’s Statement of Treasury Management Policy is:

a) Effective Treasury Management is acknowledged as providing support towards the achievement of the Council’s business and service objectives. It is therefore committed to the principles of achieving best value in Treasury Management, and to employing suitable performance measurement techniques, within the context of effective risk management;
b) The successful identification, monitoring and control of risk is regarded as being the prime criteria by which the effectiveness of the Council’s Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the organisation.

1.3 A dedicated team of three officers carries out the day-to-day treasury management activities. Two of the current officers are qualified accountants, and one is a qualified accounting technician. The Service Manager – Treasury & Capital has obtained the CIPFA/Association of Corporate Treasurers sponsored qualification CertITM-PF, which is aimed at giving a solid grounding in treasury management and which is tailored to the public sector.

1.4 Members should receive training in the Treasury Management function, in order to assist in the understanding of this relatively complex area. This will be addressed via the provision of regular reporting to Cabinet, Corporate Services Cabinet Member Meeting and the Audit and Governance Committee, and the provision of specific training on Treasury Management from the authority’s Treasury Management Advisers.

## 2. Policy on the use of external service providers

2.1 The Council currently employs Sector as its treasury consultants. Sector was engaged for the first time with effect from 01/04/2014, following a tendering exercise for the contract. The Council recognises that responsibility for treasury management decisions rests with the Council at all times. It also recognises that there is value in such arrangements in order to acquire access to specialist skills, knowledge, and advice. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly documented, and subjected to regular review.

2.2 The current contract is due to expire on 31/03/2017. A tendering exercise is currently underway to appoint the Council’s treasury consultants for a further three years.

3. **Treasury Management Strategy**

3.1. The Annual Strategy Document sets out in detail how the Treasury Management Activities are to be undertaken in a particular financial year to comply with the Council's Policy. The strategy for 2017/2018 is attached at **Annex B**.

4. **Delegated Powers**

4.1. The Head of Corporate Resources, under the Council's Constitution, is given the following authority:

a) All money in the hands of the Council shall be aggregated for the purposes of Treasury Management and shall be under the control of the Head of Corporate Resources, the Officer designated for the purposes of Section 151 of the Local Government Act, 1972;
b) All executive decisions on borrowing, investment or financing shall be delegated to the Head of Corporate Resources (or in his/her absence the Deputy Section 151 Officer) who shall be required to act in accordance with the Council's Treasury Policy, Treasury Management Practices and CIPFA's Standard of Professional Practice on Treasury Management.

5. **Reporting Requirements/Responsibilities**

5.1. Council

Council will approve, prior to each financial year, the Treasury Management Policy and Strategy Documents. Also, an annual outturn report on Treasury Management activity will be presented to Council following consideration by the Audit & Governance Committee.

5.2. Cabinet

Cabinet will:

a) Consider, prior to each financial year, Treasury Management Policy and Strategy Documents and refer them to Council for approval;
b) Monitor these documents and approve any in-year amendments necessary to facilitate continued effective Treasury Management activity; and
c) Receive an annual outturn report on Treasury Management activity prior to the 30th June following each financial year.

5.3 Audit and Governance Committee

Audit and Governance Committee will:

a) Implement and monitor performance on at least a quarterly basis that is necessary to facilitate continued effective Treasury Management activity;

b) Receive an annual outturn report on Treasury Management activity prior to the 30th June following each financial year; and
c) Will be responsible for ensuring effective scrutiny of treasury management and policies.

5.4 Head of Corporate Resources

The Head of Corporate Resources will:

a) Draft and submit to Cabinet and Council prior to each financial year, Treasury Management Policy and Strategy Documents;
b) Implement and monitor these documents resubmitting any necessary in-year revisions/amendments (at least on a quarterly basis) to Cabinet for approval;
c) Draft and submit an annual outturn report on Treasury Management activity to Cabinet and Council by the 30th June following each financial year-end (and subsequently to Council);
d) Draft and submit an annual outturn report (and quarterly performance reports) on Treasury Management activity to the Audit & Governance Committee by the 30th June following each financial year-end;
e) Maintain suitable Treasury Management Practices (TMP), setting out the manner in which the Council will seek to achieve its objectives. The TMP's will also prescribe how the treasury activities will be managed and controlled;
f) Be responsible for the execution and administration of treasury management decisions; and
g) Act in accordance with the Council's policy statement and treasury management practices, and also in accordance with CIPFA's Standard of Professional Practice on Treasury Management.

## 6. Borrowing and investments

6.1 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

6.2 The Council's primary objective in relation to investments remains the security and liquidity of capital. The yield earned on investments remains important but is a secondary consideration.

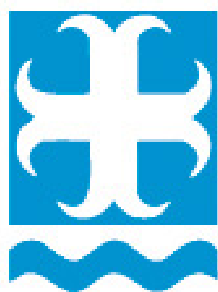
**ANNEX B1**

# SEFTON COUNCIL

## TREASURY MANAGEMENT

## STRATEGY

## 2017/2018



**CORPORATE RESOURCES**

**SEFTON COUNCIL**

**Treasury Management Strategy**

## 1. Introduction

1.1. The Treasury Management Strategy Document sets out in detail how the Treasury Management Activities are to be undertaken in a particular financial year to comply with the Council's Treasury Management Policy.

1.2 The Strategy has been produced to incorporate the requirements of the CIPFA Code of Practice on Treasury Management; the 2011 revised Prudential Code for Capital Finance, and the revised Treasury Management in the Public Services code of Practice and Cross-Sectoral Guidance Notes (2011).

## 2. Treasury Management Strategy 2017/2018

2.1. The Strategy for 2017/2018 covers:

a) Treasury Limits in force which will limit the borrowing activity of the Council (2.2);
b) Prudential Indicators 2017/2018 to 2019/2020 (2.3);
c) Credit Risk (2.4);
d) Interest Rates (2.5);
e) Exchange Rates (2.6);
f) Capital Borrowing (2.7);
g) Debt Rescheduling opportunities (2.8);
h) Borrowing in advance of need (2.9);
i) The Use of Financial Instruments for the Management of Risks (2.10);
j) Investment Strategy (2.11);
k) Member and Officer Training (2.12).

2.2. Treasury Limits for 2017/2018

The Treasury Limits set by Council in respect of its borrowing activities are:

| | |
|---|---|
| The overall or Affordable Borrowing Limit (Authorised limit as per Prudential Indicators 2017/2018). | Maximum £198.5m |

It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. The Affordable Borrowing Limit takes into account the Council's current debt, an assessment of external borrowing to fund the Capital Programme in 2017/2018, the need to fund capital expenditure previously met from internal funding, and cash flow requirements.

| The amount of overall borrowing, which maybe outstanding by way of short-term borrowing. | Maximum £15m |
|---|---|

The Short–Term Borrowing limit takes into account an assessment of any potential short-term financing the Council may need (e.g. bank overdraft, short-term funding in anticipation of grant receipts). Short-Term Borrowing is defined as being for less than 12 months.

| The proportion of external borrowing which is subject to variable rate interest. | Maximum 20% |
|---|---|

The limit on variable rate borrowing gives the Council flexibility to finance expenditure at favourable market rates, but ensures Council exposure to variable interest commitments is within prudent levels.

2.3. Prudential Indicators

The following prudential indicators are considered relevant by CIPFA for setting an integrated Treasury Management Strategy.

2.3.1 Interest Rate Exposure Indicators

Fixed rate borrowing and investment has the benefit of reducing the uncertainty surrounding future interest rate changes. However, in looking to improve performance best practice recommends retaining a degree of flexibility through the use of variable rates on at least part of the Treasury Management Activity.

To ensure that the risk associated with improved performance which may be achieved by using variable loans and investments is minimised, it is necessary to establish indicators to control the position. The control is based on setting an upper limit for both fixed and variable interest rate exposures expressed as a percentage of the Council's net outstanding principal sum. The following indicators are to be used:

| **Upper Limit for Interest Rate Exposures** | **2017/18 %** | **2018/19 %** | **2019/20 %** |
|---|---|---|---|
| Upper limit for fixed interest rate exposure expressed as a percentage of net outstanding principal sum | 340 | 340 | 340 |

| Upper limit for variable interest rate exposure expressed as a percentage of net outstanding principal sum | -20 | -20 | -20 |
|---|---|---|---|

2.3.2 Non Specified Investment Indicator

The Investment Strategy (Para 2.11) allows non-specified investments (see paragraph 2.11.3 for definition) to be made using funds managed by the Council. The indicator is designed to control the level of such non-specified investments when compared to the overall investments of the Council.

| **Upper Limit on Non-Specified Investments** | **2017/18 %** | **2018/19 %** | **2019/20 %** |
|---|---|---|---|
| Upper limit on the value of non-specified investments as a percentage of total investments (including long term investments, and investments without credit ratings or rated below A-) | 40 | 40 | 40 |

2.3.3. Debt Maturity Indicators

These indicators are designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of high interest rates. The control is based on the production of a debt maturity profile, which measures the amount of borrowing that is fixed rate that will mature in each period as a percentage of total projected borrowing that is fixed rate. Any borrowing decision and related maturity dates will be taken by the Council mindful of maturity profile limits set out below to ensure large concentrations of debt do not fall due for repayment in any one future financial year. The profile reflects borrowing advice provided by Sector, the Council's Treasury Management Advisors.

| **Maturity Structure of Fixed Rate Borrowing During 2017/2018** | **Upper Limit %** | **Lower Limit %** |
|---|---|---|
| Under 12 month | 35% | 0% |
| 12 months and within 24 months | 40% | 0% |
| 24 months and within 5 years | 40% | 0% |
| 5 years and within 10 years | 40% | 0% |
| 10 years and above | 90% | 25% |

2.3.4 Principal sums invested for periods linger than 364 days

An upper limit on the value of non-specified investments over 1 year, but less than 5 years is set at 40% of Total Investments. This limit will be kept under review to take advantage of any opportunities in the current money market. Members will be advised of any change.

2.4 Credit risk

All investments involve a degree of risk. In order to mitigate these risks the Council will consider the credit ratings supplied by a variety of recognised money market organisations, as part of the process to determine the list of banks where the level of risk is acceptable, with security, then liquidity, being the key aims. As part of this process advice from Sector will be considered, both in terms of maximum duration and level of investment.

The Council also considers alternative assessments of credit strength, and information on corporate developments and of market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA- for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.
- Background research in the financial press
- Discussion with our treasury consultants
- Internal discussion with the Head of Corporate Resources

The Council will only invest in institutions that have a Risk Matrix scoring of long term A- (or equivalent).

The Council maintains a full record of each investment decision taken, each of which is authorised by an appropriate level of signatory.

2.5. Interest Rates

2.5.1 Sector provide regular forecasts of interest rates to assist decisions in respect of:

a) Capital Borrowings (2.7);
b) Debt Rescheduling opportunities (2.8);
c) Temporary borrowing for cash flow; and
d) Investments strategy (2.11).

2.5.2 **Annex B2** gives details of Sector's central view regarding interest rate forecasts. Sector's forecast is for official interest rates to remain at 0.25% until the end of March 2019 rising to 0.50% by the end of June 2019, then rising to 0.75% by the end of December 2019 and continuing at this rate to the end of financial year.

2.5.3 The advice from Sector takes into account financial activity both in the UK and world economies and the impact of major national and international events. It is essential that borrowing and investment decisions are taken mindful of independent forecasts as to interest rate movements. The Council will continue to take account of the advice of treasury management advisors.

2.6 Exchange Rate Risk Management

The Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income and expenditure levels.

2.4. Capital Borrowing

2.7.1 The Authority currently holds £126.828m of loans, a decrease of £13.163m on the previous year as set out below:

| **Debt Portfolio** | 31/03/2016 |
|---|---|
| Average Interest Rate | 4.52% |
| Debt Outstanding – Fixed Rate | £m |
| PWLB | 110.177 |
| Other Borrowing | 12.275 |
| Other Long Term Liabilities | 4.376 |
| Total Debt | 126.828 |

The category of other borrowing (£12.275m) represents finance lease liabilities.

Other long term liabilities (£4.376m) represent transferred debt from the Merseyside Residuary Body.

2.7.2 The Council will raise its required finance, following advice from treasury management advisors, from the Public Works Loan Board (PWLB), or other local authorities, and any other body that is considered suitable, such as the Municipal Bond Agency.

The Council's forecast borrowing requirement for 2017/2018 is as follows:

| Borrowing Requirement | Estimate £m |
|---|---|
| New Borrowing | 60.717 |
| Replacement Borrowing | 0 |
| **Total Borrowing** | **60.717** |

The new borrowing represents the unsupported borrowing as required by the Capital Programme in 2017/18 (£5.7m), additional borrowing required as a result of a payment in advance to Merseyside Pension Fund in 2017/18 (£15m) and headroom of £40m to allow for new borrowing requirements. As noted in 2.7.4 (below) the Council is internally borrowed, and may take additional borrowing if required in order to reverse this position.

2.7.3 The Sector forecast for interest rates is set out at **Annex B2**. This would suggest that the following strategy is followed:

- The cheapest borrowing will be internal borrowing, which involves reducing cash balances and foregoing interest earned at historically low rates. Consideration will always be given to long term borrowing rates and the possibility of rates rising, which could mean borrowing at future higher rates which could erode the advantages of internal borrowing
- Temporary borrowing from money markets or other local authorities.

2.7.4 The authority borrows from the PWLB in order to fund part of the Capital Programme, the maximum that the Council can borrow being the Capital Financing Requirement (CFR). PWLB borrowing as at 31st January 2017, plus lease liabilities and other long term liabilities, is £116.828m, as against a CFR of £200.107m for 2017/18. This position is classed as being internally borrowed which does have the advantage of reducing exposure to interest rate and credit risk. To be internally borrowed is a conscious decision to use cash balances to fund capital expenditure, rather than borrow from the PWLB. This position can be reversed at any time by borrowing from the PWLB, or any other appropriate organisation such as the Municipal Bond Agency.

2.7.5 2017/18 is expected to experience a continuation of a low base rate. Hence, internal borrowing is a sensible option where interest rates on deposits are much lower than the current PWLB borrowing rates, but this will be reviewed should interest rates change significantly.

2.7.6 However, as noted in 2.7.3, savings have to be weighed against the potential for incurring long term extra costs by delaying unavoidable new borrowing until later years when PWLB rates are forecast to be higher. This issue will be left under review and discussions with treasury management advisors will be ongoing to ascertain the optimum time for undertaking future borrowing.

2.7.7 The UK Municipal Bond Agency issues bonds to finance local authority projects at a lower rate than the PWLB. The Authority may wish to make use of this alternative source of borrowing if and when appropriate.

2.7.8 Against this background, caution will be adopted in undertaking borrowing in 2017/2018. The Head of Corporate Resources will monitor the interest rate market and following advice from Sector, adopt a pragmatic approach to changing circumstances during the year.

2.7.9 External v Internal Borrowing

The Council currently has a difference between gross debt and net debt (gross debt net of cash balances) of £85m. The general aim of the strategy would be to reduce the difference between the two in order to reduce the credit risk of holding investments.

2.7.10 As noted in 2.7.4 above the Council is internally borrowed. If this continues this will reduce the difference between gross and net debt. Early repayment of debt is, however, not a realistic option since the introduction by the PWLB of significantly lower rates on 1 November 2007 compounded by a considerable further widening of the difference between new borrowing and repayment which has meant that large premiums would be incurred.

## 2.8. Debt Rescheduling Opportunities

2.8.1 As noted in 2.7.10 above, restructuring with the PWLB is now much less attractive than before due to the potentially large premiums that would be incurred.

2.8.2 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring. However, the situation will be monitored and the Council will consider the option of debt restructuring during 2017/2018, should the financial circumstances change.

## 2.9 Borrowing in advance of need

2.9.2 The Council will not borrow more than, or in advance of, its needs purely to profit from the investment income made on the extra sums borrowed. Any decision to borrow in advance of need will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

2.9.3 In determining whether to borrow in advance of need the Council will;

- Ensure that there is a direct link between the Capital Programme and maturity profile of the existing debt portfolio which supports the need to borrow in advance of need;
- Ensure that the revenue implications of such borrowing have been considered in respect of future plans and budgets; and
- Consider the merits of other forms of funding.

2.9.4 The total amount borrowed will not exceed the authorised borrowing limit of £168.500m. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

2.10 The Use of Financial Instruments for the Management of Risks

2.10.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires councils to clearly detail their policy on the use of derivatives in the annual strategy.

2.10.2 The Council's policy on such items is that it will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

2.10.4 The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use. At the present time, no such arrangements are in place.

2.11. Investment Strategy

2.11.1 The Council manages the investment of its surplus funds internally, and operates in accordance with the Guidance on Local Government Investments issued by CLG, and the 2011 CIPFA Treasury Management in Public Services and Cross Sectoral Guidance Notes. Surplus funds are invested on a daily basis ensuring security, followed by liquidity.

2.11.2 The Council's investment priorities are, in order of priority:

- The security of capital
- The liquidity of capital

The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.11.3 Under the system of guidance investments are classified as Specified or Non Specified.

Specified Investments are those which satisfy the following conditions:
a) The investment and all related transactions are in sterling;
b) The investment is short-term i.e. less than 12 months;
c) The investment does not involve the acquisition of share capital;
Either:
i) The investment is made with the UK Government or local authority; OR
ii) The investment is made with a body or scheme, which has been awarded a high credit rating by a credit rating agency (A- or above).

Non Specified Investments are those that do not meet the above definition.

2.11.4 The Council's investment portfolio as at 24th January 2017 is set out below:

| Investments Portfolio | £m |
|---|---|
| Specified Investments | 54.920 |
| Non-Specified Investments | 0.000 |
| Total | 54.920 |

2.11.5 The Council banks with National Westminster, which is part of the Royal Bank of Scotland Group. It is currently a part government-owned institution. At the present time, it does not meet the minimum credit criteria of A- (or equivalent) long term. The Bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements when no other options are available.

2.11.6 The Council Strategy will be:

a) To make Specified Investments in line with the above conditions;
b) To make Non Specified Investments which satisfy all of the above with the exception of 2.11.3 b) which is extended to a period of less than 2 years for fixed term deposits, and is open ended for negotiable instruments such as CDs;

It is suggested that the following investment vehicles should be made available to the authority:

| Investment | Reason | Risk |
|---|---|---|
| Term deposits made with banks with a high credit quality (see Annex B3). Deposits also acceptable on an overnight call basis. Can also deposit with Local Authorities. | Certainty of rate of return and repayment of capital | Liquid, with potential for deterioration in credit risk. Most Local Authorities are not credit rated. |
| Certificates of Deposit with Banks and Building Societies | Certainty of rate and liquid | If not held until maturity, can be sold for a capital loss on the secondary market |

| Supra-national bonds | Greater levels of security of investment. A fairly liquid investment, though not as liquid as Gilts | High credit rating as placed with EIB and World Bank (AAA rated). Bond price may vary if sold early |
|---|---|---|
| Investments with Registered Providers | Certainty of rate of return and repayment of capital | Most Registered Providers are not credit rated. |
| Investments with organisations that do not meet the Council's specified investment criteria (subject to an external credit review and specific advice from TM advisor). Such investments include property funds. | Greater diversification and allows a small portion of the portfolio to be invested at higher rates of return | Investments may not be with credit rated organisations |
| AAA rated Money Market Fund (MMF) | Same day liquidity and high credit worthiness due to considerable diversification | High credit rating via the International Money Market Fund Association or IMMFA (AAA rated) |
| Other Money Market and Collective Investment Schemes | Strong portfolio diversification | Variable Net Asset Value VNAV funds – potential for receiving less than paid in. Plus long lead time for return of investment. |
| Corporate Bonds | Can be sold on the secondary market | Can be sold for a capital loss |
| Gilts | Liquid and very secure. Interest paid every six months | High credit rating as Government backed (AAA rated). Bond price may vary if sold early |
| Treasury Bills | Liquid and very secure. Duration of < 1year | No interest paid – they are zero-coupon rated, but are typically bought at a discount. |
| Debt Management Agency Account Deposit Facility (DMADF) | Secure investment | High credit rating as Government backed (AAA rated). Interest earned low. Investment cannot be repaid early |

The maximum that can be invested in any of the above vehicles is £25m, except for term deposits, MMF's and UK Government investments for which no limit is set. The maximum maturity period in any is 2 years for non-tradable deposits, and 5 years for deposits that are tradable on the secondary market. However, advice from Sector will be taken into account in determining whether shorter maximum investment period is more appropriate during the year.

It is NOT proposed that the Council will be making any Non Specified Investments in 2017/2018 that do not comply with the above, however,

should the situation change, the Head of Corporate Resources will report to Cabinet requesting appropriate approval to amend the Strategy before any such investments are made.

2.11.7 The Bank of England Base Rate has remained significantly low at 0.25%. Sector's projection of interest rates is for a rise to 0.50% by the end of June 2019 increasing to 0.75% by December 2019 (**Annex B2**). Given the volatility of the market, the forecasts can only be used as a general guide to the future position. Consequently for 2017/18, the Authority has taken a prudent view and budgeted for an investment return based upon Sector's base rate projection during 2017/18.

2.11.8 In order to pursue the strategy of maximising returns from surplus funds at an acceptable level of security and liquidity, the following Brokers will be utilised for investments of over one month:

ii) Sterling International Brokers Limited;
iii) Tradition UK Limited;
iv) Tullet Prebon Limited.

2.11.9 As noted in previous year's reports, Cabinet agreed that the limit of investments that can be made to any approved UK or international banking institution was raised from £15m to £25m. This reflected the fact that our counterparty list became drastically reduced following the downgrading of many banks by the credit rating agencies following the credit crunch. However, now that stability has entered the banking sector, on an operational basis we are using an institutional or group limit of 10% of total investments in order to increase security of capital by spreading risk.

It should be noted that the previous policy of increasing the investment in groups to 1.5 times that of an individual institution has been removed. An operational maximum limit of £22.5m previously applied to banking groups has also now been removed.

2.11.10 The current list of countries at **Annex B4** has been produced for information; this takes account of the most up-to-date credit ratings available in respect of the countries named, and utilising Sector's creditworthiness advice. It should be noted that a maximum of £25m can be invested with any one country outside of the UK. The investment counterparties within each country will be monitored daily with the assistance of treasury management advisors to ensure they continue to meet the requirements for high credit quality as outlined at **Annex B3**. In the event of a change in credit rating or outlook, the Council, with advice from treasury management advisors, will evaluate its significance and determine whether to include (subject to Cabinet approval) or remove a country from the approval list.

2.11.11 If any of the Council's investments appear at risk of loss due to default (i.e. this is a credit related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make an assessment of whether a revenue provision of an appropriate amount is required.

2.11.12 Performance monitoring

a) Compliance with investment strategy (i.e. level of risk is not exceeded).

b) The performance of the Council’s investment strategy will be assessed by monitoring the average interest rate earned against the average 7 day LIBID on a monthly basis.

This will be reported to the Audit and Governance Committee on a quarterly basis, with outturn reports also presented to Cabinet and Council.

2.12 Member and Officer training

2.12.1 CIPFA’s Code of Practice requires the Head of Corporate Resources to ensure that all Members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

2.12.2 In order to address this, the Service Manager – Treasury & Sector has obtained the CIPFA/Association of Corporate Treasurers sponsored qualification CertITM-PF, which is aimed at giving a solid grounding in treasury management and which is tailored to the public sector. Training will be provided for Members of the Audit & Governance Committee on 22nd March 2017 and it is intended for such training to occur at least annually.

**ANNEX B2**

# INTEREST RATE FORECAST

## Sector's Interest Rate Forecast as at 23rd January 2017

| Capita Asset Services Interest Rate View | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 |
| Bank Rate View | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% | - |
| 3 Month LIBID | 0.30% | 0.30% | 0.30% | 0.30% | 0.30% | 0.30% | 0.30% | 0.40% | 0.50% | 0.60% | 0.70% | 0.80% | 0.90% | 0.90% |
| 6 Month LIBID | 0.40% | 0.40% | 0.40% | 0.40% | 0.40% | 0.40% | 0.40% | 0.50% | 0.60% | 0.70% | 0.80% | 0.90% | 1.00% | 1.00% |
| 12 Month LIBID | 0.70% | 0.70% | 0.70% | 0.70% | 0.70% | 0.80% | 0.80% | 0.90% | 1.00% | 1.10% | 1.20% | 1.30% | 1.40% | 1.40% |
| 5yr PWLB Rate | 1.60% | 1.60% | 1.60% | 1.60% | 1.70% | 1.70% | 1.70% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% | - |
| 10yr PWLB Rate | 2.30% | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | - |
| 25yr PWLB Rate | 2.90% | 2.90% | 2.90% | 3.00% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | - |
| 50yr PWLB Rate | 2.70% | 2.70% | 2.70% | 2.80% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | - |
| **Bank Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% | - |
| Capital Economics | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% |
| **5yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 1.60% | 1.60% | 1.60% | 1.60% | 1.70% | 1.70% | 1.70% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% | - |
| Capital Economics | 1.40% | 1.60% | 1.80% | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% | 2.50% | 2.70% | 2.80% | 2.90% | 3.00% | 3.20% |
| **10yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 2.30% | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | - |
| Capital Economics | 2.20% | 2.30% | 2.40% | 2.55% | 2.60% | 2.70% | 2.70% | 2.80% | 2.90% | 3.10% | 3.20% | 3.30% | 3.40% | 3.60% |
| **25yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 2.90% | 2.90% | 2.90% | 3.00% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | - |
| Capital Economics | 2.75% | 2.90% | 3.05% | 3.15% | 3.25% | 3.25% | 3.35% | 3.45% | 3.55% | 3.65% | 3.75% | 3.95% | 4.05% | 4.15% |
| **50yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 2.70% | 2.70% | 2.70% | 2.80% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | - |
| Capital Economics | 2.70% | 2.80% | 2.90% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.40% | 3.60% | 3.70% | 3.80% | 3.90% | 4.10% |

**ANNEX B3**

## FITCH RATING EXPLANATION

### Short term rating

This places greater emphasis on the liquidity necessary to meet financial commitments.

***F1*** – highest credit quality (+ denotes exceptionally strong)
***F2*** – good credit quality
***F3*** – fair credit quality

### Long term rating

| | |
|---|---|
| ***AAA*** | highest credit quality – lowest expectation of credit risk and exceptionally strong capacity to pay financial commitments |
| ***AA*** | very high credit quality – very low credit risk and very strong capacity to pay financial commitments |
| ***A*** | high credit quality – low credit risk and considered to have strong capacity to pay financial commitments, but may be vulnerable |

### Viability rating

This assesses how a bank would be viewed if it were entirely independent and could not rely on external support.

| | |
|---|---|
| **aaa** | - highest fundamental credit quality |
| **aa** | - very high fundamental credit quality |
| **a** | - high fundamental credit quality |
| **bbb** | - good fundamental credit quality |
| **bb** | - speculative fundamental credit quality |
| **b** | - highly speculative fundamental credit quality |
| **ccc** | - substantial fundamental risk |
| **cc** | - very high levels of fundamental credit risk |
| **c** | - exceptionally high levels of fundamental credit risk |
| **f** | - failed |

### Support rating

Judgement of a potential supporter’s (either sovereign state of parent) propensity to support the bank and its ability to support it.

**1** – extremely high probability of external support
**2** – extremely high probability of external support
**3** – moderate probability
**4** – limited probability
**5** – cannot rely on support

**Changes to the Credit Rating Methodology in 2015:**

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory sector levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria; the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

**ANNEX B4**

## SEFTON COUNCIL – APPROVED COUNTRIES FOR INVESTMENTS

*This list is based on those countries which have sovereign ratings of AA- or higher (based on the lowest from the ratings awarded by Fitch, Moody's or S&P as at 27/01/2017) and also have banks operating in sterling markets which have credit ratings of green or above in Sector's credit worthiness service.*

### AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland
- USA

### AA+

- Finland

### AA

- Abu Dhabi (UAE)
- France
- Qatar
- United Kingdom

### AA-

- Belgium

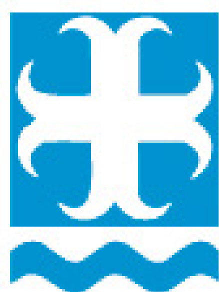
**ANNEX C**

# SEFTON COUNCIL

## MINIMUM REVENUE PROVISION

## POLICY STATEMENT

## 2016/17



## CORPORATE RESOURCES

**SEFTON COUNCIL**

# MINIMUM REVENUE PROVISION POLICY

## 1. Background

Local Authorities have a statutory requirement to set aside each year part of their revenues as a provision for the repayment of debt, called the Minimum Revenue Provision (MRP). The provision is in respect of capital expenditure incurred in previous years and financed by borrowing.

Previously the Council was required to follow a prescriptive MRP calculation as set out in former regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 2003/3146, as amended]. This system was revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414].

As part of those regulations the DCLG issued guidance recommending local authorities to prepare an annual statement of its strategic policy on making MRP, to be approved by the full council. The guidance provides for each authority to determine its own MRP within the given framework and also requires that the amount of MRP charged is a prudent amount.

The broad aim of a prudent amount is to ensure that the debt is repaid over a period that is either reasonably commensurate with the period over which the capital expenditure provides benefit, or, in the case of borrowing supported by formula grant, reasonably commensurate with the period implicit in the determination of that grant.

## 2. Strategic Options

The Council is free to determine its own method for calculating a prudent provision, but the guidance includes four options for calculating MRP. The Council can choose from or use a combination of the available options. The options are as follows:

### Option 1 – Regulatory Method

This provides for local authorities to continue to calculate MRP in line with the minimum existing statutory charge of 4% of outstanding debt related to supported borrowing only, less an adjustment that ensures consistency with previous capital regulatory regimes no longer in force. This option is available for all capital expenditure incurred prior to 1 April 2008.

### Option 2 – Capital Financing Requirement Method

This is very similar to the regulatory method but it does not take account of the adjustment that ensures authorities do not pay more MRP than under the previous capital regulatory regimes. For most authorities this method may not be appropriate as it would result in a higher level of provision than option 1.

**Option 3 – Asset Life Method**

This method is appropriate for calculating MRP in relation to debt incurred as unsupported borrowing (also known as prudential borrowing), and must be used for revenue expenditure capitalised by direction or regulation (such as that for equal pay). Under this option there are two methods available:

(i) **Equal instalment method.** This generates a series of equal annual amounts over the life of each asset that is financed by borrowing, with the life determined upon acquisition. This means that the charge to revenue closely matches the period of economic benefit of the asset.

(ii) **Annuity method**. This method links the MRP to the flow of benefits from an asset where the benefit is expected to increase in later years.

Under this option authorities should consider the type of assets that they finance through prudential borrowing, as the type of asset may have a significant impact on the level of MRP and the method used to calculate the MRP.

**Finance Leases and PFI**

The guidance indicates that for finance leases and on balance sheet PFI contracts, the MRP requirement is met by making a charge equal to the element of the finance lease rental that goes to write down the balance sheet liability under proper accounting practices. This is in effect a modified version of the annuity method of Option 3.

**Option 4 – Depreciation Method**

This method is appropriate for calculating MRP in relation to debt incurred as unsupported (prudential) borrowing. Under this method, MRP is equal to the amount of depreciation charged on assets funded from unsupported borrowing. This method may cause volatility in the annual charge for MRP because assets are revalued on a periodic basis, giving rise to significant changes in the amount of depreciation charged. Given this potential adverse impact on future budgets this option is not considered viable.

**Use of Capital Receipts**

In addition to the four options listed above, the Local Authorities (Capital Finance and Accounting) Regulations 2003 [SI 2003/3146] allow local authorities to use capital receipts to meet “any liability in respect of credit arrangements, other than any liability which, in accordance with proper practices, must be charged to a revenue account”.

For both finance leases and PFI contracts, proper accounting practices require that the element of the annual rental relating to the repayment of the liability is used to write down that liability on the balance sheet and is not charged to revenue. It therefore follows that local authorities are permitted to apply capital receipts to fund the principal element of the annual rental of a finance lease or on balance sheet PFI contract.

## 3. MRP Policy Adopted for 2015/16

In order to determine its MRP for 2015/16 the Council applied the following strategy:

| Supported borrowing | Basis of MRP Calculation |
|---|---|
| Capital expenditure incurred before 1 April 2008 | Annuity Basis over 50 years. |
| Capital expenditure incurred after 31 March 2008. | 2% straight line charge to ensure that balances are fully provided for within 50 years. |

| Unsupported (prudential) borrowing | Basis of MRP Calculation |
|---|---|
| Capital expenditure incurred after 31 March 2008. | Calculated using (Option 3) the estimated life method on an equal instalment basis. |

| PFI and Leasing Arrangements | Basis of MRP Calculation |
|---|---|
| On balance sheet PFI contracts | MRP charge to be equal to the principal element of the annual rental |
| On balance sheet leasing arrangements (finance leases) | MRP charge to be equal to the principal element of the annual rental |

In practice a number of standard asset lives have been applied to calculate the MRP charge for unsupported (prudential) borrowing incurred after 31 March 2008. The asset lives used are in most cases the same lives applied to calculate the depreciation in the Council's published accounts. These are summarised below:

| | |
|---|---|
| Intangibles (Software) | 3 Years |
| Vehicles, Plant & Equipment | 5 Years |
| Revenue Expenditure Funded for Capital Under Statute – Capitalised Redundancy Costs | 20 Years |
| Revenue Expenditure Funded for Capital Under Statute - Other | 25 Years |
| Community Assets (Parks, Gardens etc.) | 25 Years |
| Land and Buildings | 25 Years |
| Infrastructure | 40 Years |

Changes to the policy in 2015/16 released a saving of £20m and of this £8m was used to support the 2016/17 budget, with £12m being used to support the 2017/18 to 2019/20 MTFP. These changes to the policy will release up to £10m which will again be used to contribute to the achievement of the £64m savings target over the MTFP period.

## 4. Review of the estimated lives used in the MRP calculation

A review of the estimated asset lives used in the calculation of the MRP charge for unsupported (prudential) borrowing since 31 March 2008 has been undertaken. The review compared the asset lives used to calculate depreciation on land and buildings for capital schemes were expenditure exceeded £250,000. This represented a sample of more than 90% of capital expenditure on land and buildings between 1 April 2008 and 31 March 2015. The review revealed some significant differences in the asset lives recorded on the asset register compared to the 25 year average life assumed in the MRP calculation. This indicated that the MRP charge had resulted in an overprovision between 2009/10 and 2015/16. The MRP charges for this period were recalculated using the following asset lives:

| Scheme | Type | Estimated Life |
|---|---|---|
| Crosby Lakeside Adventure Centre | New Build | 50 Years |
| Litherland School Pathfinder | New Build | 50 Years |
| Netherton Activity Centre | New Build | 50 Years |
| Maghull Leisure Facility | New Build | 50 Years |
| South Sefton Investment Centre | New Build | 50 Years |
| St Peters House (Purchase) | Acquisition | 40 Years |
| Floral Hall & Theatre | Major Refurbishment | 30 Years |
| Southport Cultural Centre (Atkinson) | Major Refurbishment | 30 Years |
| Southport Market | Major Refurbishment | 30 Years |
| St Peters House (Refurbish) | Major Refurbishment | 30 Years |

MRP charges for unsupported (prudential) borrowing between 2009/10 to 2015/16 totalled £17.643m. After adjusting for the asset lives shown in the table above the MRP charge reduced to £14.979m. This indicates that the MRP charge was overstated by £2.664m during this period.

It is proposed that the MRP charge for 2016/17 be adjusted (reduced) by £2.664m to recover the overprovision.

## 5. MRP Policy for 2016/17

Supported Borrowing

In 2015/16 the Council changed the methodology used to calculate the MRP charge for Capital expenditure incurred before 1 April 2008 funded by Supported Borrowing to an Annuity Basis. At the same time the policy for Capital expenditure incurred after 31 March 2008 funded by Supported Borrowing was changed to a Straight-Line Basis. During the closedown of the 2015/16 accounts the Council's Auditors commented on the inconsistency in the treatment of Post 31 March 2008 Supported Borrowing. It is therefore recommended that the Council change the methodology used to calculate the MRP charge on Capital expenditure incurred after 31 March 2008 funded by Supported Borrowing to an Annuity Basis over a 50 year period and

backdated to 1 April 2015 so that there is a single consistent approach to the calculation of the MRP charge on all supported borrowing.

Backdating this change will release a further overprovision of £0.182m (made in 2015/16) which will be offset against the 2016/17 MRP charge.

It should be noted that the change to an annuity basis does not result in any overall saving over the life of the assets as the total amount borrowed still needs to be repaid. However, there is a reduction in the MRP charge in the earlier years. Based on Post-2008 Supported Borrowing at 31 March 2016, the change to an annuity calculation will result in a lower MRP charge from 2016/17 to 2043/44 and a higher MRP charge from 2044/45 to 2064/65.

- The largest reduction in the annual charge occurs in 2015/16 when the MRP charge would be £0.182m lower than if calculated on a straight-line basis.

- The largest increase in the annual charge occurs in 2064/65 when the MRP charge would be £0.316m higher than if calculated on a straight-line basis.

Unsupported (Prudential) Borrowing

It is also recommended that the basis for the MRP charge on Unsupported (Prudential) Borrowing be changed from a straight-line basis to an Annuity basis from 1 April 2016. This change will bring the treatment of unsupported borrowing in-line with the treatment of supported borrowing.

It should be noted that the change to an annuity basis does not result in any overall saving over the life of the assets as the total amount borrowed still needs to be repaid. However, there is a reduction in the MRP charge in the earlier years. Based on Post-2008 Unsupported Borrowing at 31 March 2016 the change to an annuity calculation will result in a lower MRP charge from 2016/17 to 2031/32 and a higher MRP charge from 2032/33 to 2062/63.

- The largest reduction in the annual charge occurs in 2016/17 when the MRP charge would be £0.753m lower than if calculated on a straight-line basis.

- The largest increase in the annual charge occurs in 2054/55 when the MRP charge would be £0.384m higher than if calculated on a straight-line basis.

MRP Policy 2016/17

The recommended MRP policy for 2016/17 is summarised below:

| Supported borrowing | Basis of MRP Calculation |
|---|---|
| Capital expenditure incurred before 1 April 2008 | Annuity Basis over 50 years (commencing 1 April 2015) |
| Capital expenditure incurred after 31 March 2008. | Annuity Basis over 50 years (commencing 1 April 2015) |

| Unsupported (prudential) borrowing | Basis of MRP Calculation |
|---|---|
| Capital expenditure incurred after 31 March 2008. | Calculated using (Option 3) the estimated life method on an Annuity Basis (commencing 1 April 2016) |

| PFI and Leasing Arrangements | Basis of MRP Calculation |
|---|---|
| On balance sheet PFI contracts | MRP charge to be equal to the principal element of the annual rental |
| On balance sheet leasing arrangements (finance leases) | MRP charge to be equal to the principal element of the annual rental |

Standard asset lives to be applied to calculate the MRP charge for unsupported (prudential) borrowing incurred after 31 March 2008:

<table>
<tr><td>Intangibles (Software)</td><td>3 Years</td></tr>
<tr><td>Vehicles, Plant & Equipment</td><td>5 Years</td></tr>
<tr><td>Revenue Expenditure Funded for Capital Under Statute – Capitalised Redundancy Costs</td><td>20 Years</td></tr>
<tr><td>Revenue Expenditure Funded for Capital Under Statute - Other</td><td>25 Years</td></tr>
<tr><td>Community Assets (Parks, Gardens etc.)</td><td>25 Years</td></tr>
<tr><td>Land</td><td>50 Years</td></tr>
<tr><td>Buildings – Scheme Value under £250,000</td><td>25 Years</td></tr>
<tr><td>Buildings – New Build (Value over £249,999)</td><td rowspan="2">Building Life per Asset Register*</td></tr>
<tr><td>Buildings – Acquisitions (Value over £249,999)</td></tr>
<tr><td>Buildings – Refurbishment / Remodelling (Value over £249,999)</td><td>30 Years</td></tr>
<tr><td>Infrastructure</td><td>40 Years</td></tr>
</table>

* The building life used in the MRP calculation will be subject to a maximum of 50 years.

The Chief Finance Officer will retain discretion to use alternative lives for assets (capital schemes) that have particular characteristics that mean using the standard life would not be considered appropriate. It is anticipated that this will only apply in very limited circumstances.

Commencement of MRP Charges

Provision for debt under Option 3 (Asset Life Method) will normally commence in the financial year following the one in which the expenditure is incurred. However, paragraph 13 of the DCLG 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 delay would be perhaps 2 or 3 years in the case of major projects, or possibly longer for some complex infrastructure schemes.

Use of Capital Receipts to Reduce MRP Charges

Any proposal to use capital receipts to reduce future MRP charges will be presented to Cabinet for approval prior to the application of the capital receipts.

## 6. Impact of Recommendations on MRP Change in 2016/17

By adopting the recommendations set out above the underlying MRP charge for 2016/17 would be £4.061m (excluding PFI and leasing schemes), which would be reduced by a further £2.846m for the impact of the MRP review. The savings compared to the 2015/16 policy are shown below:

| **MRP Charge 2016/17** | Charge Based on Current (2015/16) Policy £000 | Charge Based on Proposed (2016/17) Policy £000 | Variation £000 |
|---|---|---|---|
| Supported Borrowing (Pre 01/04/08) | 807 | 807 | 0 |
| Supported Borrowing (Post 31/03/08) | 289 | 111 | -178 |
| Unsupported Borrowing | 3,896 | 3,143 | -753 |
| **Underlying MRP Charge** | **4,992** | **4,061** | **-931** |
| Unsupported Borrowing - Review of Asset Lives | -2,664 | -2,664 | 0 |
| Supported Borrowing (Post 31/03/08) - Backdating Annuity to 1 April 2015 | n/a | -182 | -182 |
| **Adjusted MRP Charge** | **2,328** | **1,215** | **-1,113** |

In both cases it is assumed that the unwinding of the previous overprovision of MRP charges on unsupported borrowing would be implemented.