CABINET MEETING – 10th February, 2010

EXECUTIVE SUMMARY SHEET – PART I

Title of Report:
Capital Programme 2010/2011 including Prudential Indicators and Treasury Management Strategy and Policy

Author(s):
Chief Executive and Director of Financial Resources

Purpose of Report:
To update Cabinet of the level of capital resources and commitments for the forthcoming financial year and seek a recommendation to Council to the overall Capital Programme 2010/2011, the Prudential Indicators, and the Treasury Management Strategy and Policy for 2010/2011.

Description of Decision:
Cabinet is requested to:

- recommend to Council approval of:
    - the proposed Capital Programme for 2010/2011;
    - the prudential indicators and revisions to the operational limit for 2009/2010;
    - the Annual Minimum Revenue Provision Statement for 2010/2011 and adjustments to 2009/2010;
    - the Annual Treasury Management Strategy including specifically the Annual Borrowing and Investment Strategies;
    - the adoption of the revised CIPFA Treasury Management Code of Practice 2009;
    - the Treasury Management Policy Statement.

Is the decision consistent with the Budget/Policy Framework? No this report is integral in reviewing and amending the Budget and Policy Framework
If not, is Council approval required to change the Budget/Policy Framework? Yes.

Suggested reason(s) for Decision:
To comply with statutory requirements.

Alternative options to be considered and recommended to be rejected:
No alternatives are submitted for Cabinet consideration.

Is this a "Key Decision" as defined in the Constitution? Yes **Is it included in the Forward Plan?** Yes	**Scrutiny Review Committee:** Management Audit and Governance

Cabinet – 10th February, 2010

Capital Programme 2010/2011 including Prudential Indicators and Treasury Management Strategy and Policy

Report of the Chief Executive and Director of Financial Resources

1. Purpose of Report:

1.1 To update Cabinet of the level of capital resources and commitments for the forthcoming financial year and seek a recommendation to Council to the overall Capital Programme 2010/2011, the Prudential Indicators, and the Treasury Management Strategy and Policy for 2010/2011.

2. Description of Decision:

2.1 Cabinet is requested to:

- recommend to Council approval of:
  - the proposed Capital Programme for 2010/2011;
  - the prudential indicators and revisions to the operational limit for 2009/2010;
  - the Annual Minimum Revenue Provision statement for 2010/2011 and adjustments to 2009/2010;
  - the Annual Treasury Management Strategy including specifically the Annual Borrowing and Investment Strategies;
  - the adoption of the revised CIPFA Treasury Management Code of Practice 2009;
  - the Treasury Management Policy Statement.

3. Capital Programme 2010/2011

3.1 As reported to Cabinet in January 2010, and in accordance with the Council's Capital Strategy, resources for the main programme areas of Children's Services, Adult Services, Highways, and Housing have been allocated on the basis of their Supported Capital Expenditure (SCE (R)) approvals and other service specific resources.

3.2 Any further SCE (R) or grant approvals which are received will be reported to Cabinet as part of the regular capital programme reviews during the year together with any proposals for additional schemes as appropriate.

3.3 Due to the continuing impact of the economic downturn and the fact that the housing market is still depressed, economic recovery is expected to be slow. As a result, very few capital receipts have been, or are anticipated to be received in 2009/2010 and it will be necessary to continue to use temporary funding from the Strategic Investment Reserve to fund high priority capital programme plans and commitments.

In assessing the overall resources position, an assessment has been made of the capital programme and a range of potential sources of funding including:

- Debt Charge Savings;
- Contingency Savings, including provision for the future strategic waste solution;
- VAT Refunds;
- Government Grants etc.

Taking account of the above, therefore, the Revenue Budget can provide funding of £15.068 million to support 'one off' revenue budget commitments and proposals and to assist in funding the Capital Programme.

In the light of the above, it is proposed that:

- £6.876 million of this sum is used to support one off revenue budget commitments and proposals;
- £8.192 million is used to support the capital programme for 2010/2011.

3.4 Since the January 2010 Cabinet meeting, consultation with the appropriate Cabinet Portfolio Holders has been undertaken on the proposals to utilise the resources available for new starts. In considering proposals for new starts regard has been given to relevant factors to be taken into account in determining priorities set out in the Council's Capital Strategy and the outcome of budget consultation.

3.5 The recommended Capital Programme is included in full as Appendix A to this report. A summary of proposed new starts for the Environmental Protective and Cultural Services (Other Services) Block is set out at Appendix B. Proposed new starts for Children's Services, Adult Services, Housing, and Highways are detailed within Appendix C.

3.6 In accordance with the Council's Constitution, prior to commencement of projects, details of all new schemes with an estimated cost in excess of £250,000 will be reported for approval to Cabinet utilising the capital investment appraisal documentation which outlines the detail of the scheme, the outputs and outcomes expected together with funding sources and the consequential revenue implications.

3.7 For schemes / projects below £250,000, full capital investment appraisal documentation will be prepared and consultation will take place with the relevant Cabinet Portfolio Holder in advance of delegated decisions being taken to implement these schemes / projects.

4. Prudential Framework for Local Authority Capital Expenditure

4.1 One of the principal features of the Local Government Act 2003 was to provide the primary legislative framework to introduce a prudential regime for the control of Local Authority capital expenditure. The regime relies upon both secondary legislation in the form of regulations, and a prudential code issued and maintained by the Chartered Institute of Public Finance and Accountancy (CIPFA).

4.2 Under the prudential framework local authorities are free to borrow without specific government consent if they can afford to service the debt without extra government support. The basic principle is that authorities will be free to invest as long as their capital spending plans are affordable, sustainable and prudent. This allows the Council to manage and control its capital programme and how it is financed. The key elements of control and management of capital finance are through:

- capital expenditure plans – the Council's capital programme;
- external debt - how the Council proposes to fund its capital programme;
- treasury management – the management of the Council's investments, cash flows, banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks.

All authorities must follow the prudential code published by CIPFA. This involves setting various prudential limits and indicators that must be approved by the Council before the start of the relevant financial year as part of their budget setting process. The prudential indicators have been prepared and all matters specified in the code have been taken into account. Regular monitoring will take place during the year and reports made to Cabinet on the indicators as part of the quarterly capital review reports where appropriate.

5. The Prudential Code and Prudential Indicators

5.1 The Local Government Act 2003 gives statutory backing to the CIPFA Prudential Code for Capital Finance. The regulations specify that it is this Code to which authorities must have regard when setting and reviewing their affordable borrowing limits. The Prudential Code was reported to Council in March 2004.

CIPFA has issued a revised Prudential Code in 2009 with a number of indicators being removed from the Prudential Code and becoming part of the CIPFA Treasury Management in the Public Services Code of Practice.

The following indicators, previously included in the Prudential Code, now form part of the CIPFA Treasury Management in the Public Services Code of Practice but have been included alongside Prudential Code indicators in Appendix D for ease of reference:

Indicator	**Appendix D Reference**
Upper limit on fixed interest rate exposure.	P10
Upper limit on variable interest rate exposure.	P11
Upper limit for the maturity structure of borrowing.	P12
Lower limit for the maturity structure of borrowing.	P12
Prudential limit for principal sums invested for periods longer than 364 days.	P13

All of the above indicators together with background information to these indicators and what they are seeking to assess, are detailed in Appendix D in full compliance with the revised code.

5.2 It should be noted that accounting regulations relating to the introduction of International Financial Reporting Standards (IFRS) are being introduced from 1st April 2010 that are likely to affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's Balance Sheet. This will result in an increase to the Council's capital financing requirement, authorised limit for external debt, and its operational boundary for external debt. These adjustments are technical in nature and a prudent amount has been added to all limits for 2010/2011 onwards to reflect these adjustments. This is in accordance with government and accounting guidance which has not yet been finalised and is therefore subject to further changes as necessary. It is considered likely that the Council's operational boundary for 2009/2010 of £227.212 million will be exceeded as a result of these changes and Cabinet is asked to recommend to Council a revision to the Council's operational boundary for external debt for 2009/2010 of £292.481 million.

6. The Annual Minimum Revenue Provision Statement

6.1 Regulations came into force on 31st March 2008 revoking secondary legislation relating to the requirement to make a Minimum Revenue Provision (MRP) to repay borrowing over time, and replacing the legislation with a new regulation containing a duty for local authorities, each year, to determine for the current financial year, an amount of MRP that it considers prudent. The Department for Communities and Local Government (DCLG) has provided statutory guidance on the methodology to use, which local authorities 'must have regard to'.

The guidance recommends that authorities must submit to full Council an annual statement of its policy on making a MRP in respect of the following financial year and highlight which of the various options set out in their guidance will be followed.

6.2 Provision for the repayment of debt is considered to be prudent where the period of repayment is either reasonably commensurate with that over which the capital expenditure to which it relates provides benefits, or in the case of borrowing supported by government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

6.3 The four options for calculating MRP which were set out in the guidance can be summarised as follows:

- Option 1 – Regulatory Method: applying the statutory formula set out in the 2003 Regulations before it was revoked in 2008.
- Option 2 – Capital Financing Requirement (CFR) Method: multiplying the CFR at the end of the preceding financial year by 4%.
- Option 3 – Asset Life Method: amortising expenditure over an estimated useful life for the relevant assets created. An assessment must be made of the asset life at the outset of the capital scheme and MRP is charged to revenue in either equal annual instalments or by an annuity method over the estimated life of the asset. The MRP charge will commence in the financial year following the one in which the asset comes into service.
- Option 4 – Depreciation Method: making charges to revenue in accordance with the standard rules for depreciation accounting for the particular asset being created or enhanced.

6.4 For 2010/2011, having considered all of the options available to the Council, it is proposed that the Council use Option 1 (the Regulatory Method) for government supported borrowing. This is a continuation of the method currently used by the Council (under the existing regulations 28 and 29 of the Capital Finance Regulations and the Local Government Act 2003) where MRP is calculated with regard to the 'credit ceiling' of the authority. This takes into account all loan advances and repayments through the Council's consolidated advances and borrowing pool with MRP being calculated at 4% of the opening 'credit ceiling' balance.

Option 1 is preferred as this option takes the formulae used by the government in calculating revenue support grant as its basis and better reflects the actual funding provided by government.

6.5 Neither of the two options recommended for future borrowing, for which no government support is being given and is therefore self-financed (options 3 and 4), reflect current Council policy to accelerate debt repayments on unsupported borrowing through an increased voluntary MRP. The depreciation method for calculating MRP is also subject to volatility when asset lives are reassessed as part of the revaluation process.

6.6 The Council currently follows the criteria set out below for all unsupported borrowing and provides an increased voluntary MRP:

- In the case of invest to save schemes MRP is based on the payback period for any borrowing taken out up to a maximum of 7 years (this requirement is relaxed where unsupported borrowing is taken out on behalf of trading services, which are subject to market pressures);
- In cases where a full option appraisal shows borrowing to offer better value for money than leasing, MRP is based on the payment period that would have arisen had a lease been taken out instead of a loan;
- In the case of any form of grants for capital purposes that have been given in earlier years and any new grants given for which borrowing is taken out, MRP is based on the actual principal repayment schedule relating to the grant provided. This option is used for existing loans provided to Wearside College, mortgages provided in earlier years to householders under Right to Buy regulations, and loans to industry to support economic regeneration.

6.7 Given budget pressures it is proposed that opportunities for utilising the above framework be restricted to strategic priorities and invest to save schemes, where a provision has been made within the budget and also where option appraisal of funding through borrowing instead of leasing is appropriate.

For the purposes of the proposed regulations Option 3 is recommended for self-financed borrowing as this method is subject to less potential variation than Option 4.

It is recommended to continue existing practice so that any unsupported borrowing schemes will be subject to an additional voluntary MRP repayment as shown in the criteria detailed in 6.6 above. For any unsupported borrowing taken out in support of strategic priorities or for trading services which are subject to market pressures it is recommended that discretion be afforded in relation to relaxing the additional voluntary MRP requirement and that MRP is calculated using Option 3 where this is deemed to be appropriate. This will mean that trading services would not be put at an unfair disadvantage in comparison to any potential competitors.

In addition revised accountancy guidelines to comply with IFRS are to be introduced for 2010/2011. The new standards will potentially have the effect of reclassifying operational leases, finance leases and PFI contracts. These proposed changes may affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's balance sheet adjusting previous years' MRP repayments. It is recommended that the MRP policy for both 2009/2010 and 2010/2011 be adjusted in accordance with section 6.8 c) below and monitored to ensure that there will be no impact on council taxpayers from revisions to accounting standards.

6.8 In summary, it is recommended that the Council approves the following Annual Minimum Revenue Provision Statement for both 2009/2010 and 2010/2011:

a) For all government supported borrowing the Council will adopt Option 1 as set out in the government's guidance which is a continuation of the basis upon which the Council currently calculates MRP.

b) For all unsupported borrowing the Council will adopt Option 3 and make MRP repayments using the equal instalment method with the estimated useful life of an asset being assessed by the Director of Financial Resources in consultation with appropriate officers.

c) For MRP payments in relation to finance leases and PFI contracts previously held off-balance sheet but now included on-balance sheet to comply with IFRS requirements, the amount of MRP to be made will be set to ensure that the finance charge and MRP for finance leases and on-balance sheet PFI schemes is equal to the rental or service charge payable in the income and expenditure account for the year, which writes down the balance sheet liability of those assets. The Council will therefore follow DCLG guidance which states:

'IFRS 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 the 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. This is not seen as a prudent course of action, and guidance aims to ensure that 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.'

Following the above DCLG guidance will ensure that, if the impending move to IFRS in local government has the effect of bringing more PFI schemes and leases on balance sheet, there will be no effect on the charge to the revenue account and no impact on council taxpayers arising from changes made to accounting standards that must be followed by the Council.

d) The Council will make additional voluntary MRP payments to that indicated by the adoption of Option 3, with reference to the Council's existing framework as detailed in 6.6 above, in order to make an increased voluntary MRP where this is considered to be both prudent and affordable. This requirement may be relaxed by the Director of Financial Resources where appropriate, in particular for any unsupported borrowing taken out on behalf of trading services, which are subject to market pressures.

7. Treasury Management

7.1 The Revised CIPFA Treasury Management Code of Practice 2009

In the light of the demise of the Icelandic banks in 2008, CIPFA has responded by amending the CIPFA Treasury Management in the Public Services Code of Practice (the Code) and Cross-Sectoral Guidance Notes, including a revised Treasury Management Policy Statement. It is a requirement of the Code that it should be formally adopted by the Council. The revised code is set out in Appendix E and the Council is asked to adopt the revised Code together with the revised Treasury Management Policy Statement (Appendix F).

The revised Code addresses a number of key areas including the following:

- All Councils must formally adopt the revised Code and four clauses set out in Appendix E;
- The Treasury Management Strategy Statement should affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities;
- The Council's attitude towards risk must be clearly identified within the Treasury Management Strategy Statement which will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out;
- Responsibility for risk management and control lies with the Council and cannot be delegated to any outside organisation.
- Credit ratings in respect of investment strategy should only be used as a starting point when considering risk. Use should also be made of market data and information, quality financial press, information on government support for banks and the credit ratings of that government support.
- Councils should operate a sound diversification policy in respect of its investments, with high credit quality counterparties and consideration should be given to setting country, sector and group limits.

- Borrowing in advance of need is only to be permissible when there is a clear business case for doing so i.e. in respect of the current capital programme or to finance future debt maturities.
- The main annual treasury management strategy and policy reports must be approved by full Council.
- There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- Each Council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- Treasury management performance and policy setting should be subjected to prior scrutiny before full Council approval.
- Members should be provided with access to relevant treasury management training.
- Those charged with governance are also personally responsible for ensuring they have the necessary skills and training in treasury management.
- Responsibility for treasury management activities must be clearly defined within the Council.
- Officers involved in treasury management must be explicitly required to follow Council approved treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices set out in Appendix E (2.1)).

The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy (TMS) will be approved annually by the full Council and full Council will receive, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30th September of the following year. There will also be quarterly reports to Cabinet and the Audit and Governance Committee. In addition, there will be monitoring reports and regular review by members in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council will adopt the following reporting arrangements in accordance with the requirements of the Code: -

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Policy Statement (revised)	Full Council	Adoption of the new code for 2010/2011 and then as required
Treasury Management Strategy / Annual Investment Strategy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid year report	Full Council	Mid year
Treasury Management Strategy / Annual Investment Strategy – updates or revisions at other times	Full Council	As appropriate
Annual Treasury Management Outturn Report	Full Council	Annually by 30/9 after the end of the financial year
Treasury Management Monitoring Reports	Director of Financial Resources	Monthly
Treasury Management Practices	Director of Financial Resources	Annually
Scrutiny of Treasury Management Strategy	Cabinet / Audit and Governance Committee	Annually before Full Council
Scrutiny of Treasury Management Performance	Cabinet / Audit and Governance Committee	Quarterly

7.2 **Treasury Limits for 2010/2011 to 2012/2013 (under the newly revised CIPFA Prudential Code)**

It is a statutory duty under Section 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". This is prudential indicator P5 at Appendix D and is otherwise known as the Authorised Limit for External Debt.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable' and affordable.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion, incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is set, on a rolling basis, for the forthcoming financial year and the two successive financial years thereafter.

All Treasury Management indicators are included in Appendix D as noted previously in section 5.1.

7.3 Revised Investment Guidance

It should also be noted that CLG is undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities that will come into effect from 1 April 2010. Members will be informed when the guidance has been finalised, indicating any further changes that have been made that require incorporation in the Treasury Management Strategy Statement. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code and included in the Treasury Management Strategy Statement in Appendix G. However, in order to provide for the possibility of changes being made it is proposed that delegated authority be granted to the Director of Financial Resources to effect any changes necessary.

7.4 **Treasury Management Strategy for 2010/11**

The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Council's policies for managing its borrowing and investments and for giving priority to the security and liquidity of investments. The proposed Treasury Management Strategy Statement is detailed in Appendix G

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act and subsequent guidance requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2010/2011 is set out in Appendix G and is based upon the Director of Financial resources' views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Council's treasury adviser, Sector Treasury Services.

8. Alternative Options

8.1 No alternatives are submitted for Cabinet consideration.

9. Background Papers

Various Notifications regarding Capital Resources for 2010/2011 from Government Departments
Sector City Watch (Monthly)
Local Government Act 2003
The Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition
Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009)
Treasury Management in the Public services Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition)