REPORT TO	DATE OF MEETING
Council	1st March 2017

SOUTH RIBBLE BOROUGH COUNCIL forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
2017/18 Budget and Medium Term Financial Strategy	Finance	Susan Guinness	5(1)(b)

SUMMARY AND LINK TO CORPORATE PRIORITIES

This report sets out the Medium Term Financial Strategy (MTFS) and the information taken into consideration in determining the Council's financial planning detailing specifically the budget and Council Tax setting for 2017/18. The Medium Term Financial Strategy also recognises the corporate risks assessment processes and the priorities set out in the Corporate Plan with the financial contents also being aligned to The Treasury Strategy. The MTFS recognises the continued significant change and uncertainty surrounding core government grant funding and other local authority funding regimes.

RECOMMENDATIONS

Revenue Estimates

1. Council approves the revised estimates for 2016/17, the original estimate for 2017/18 and indicative original estimates for 2018/19 through to 2019/20, summarised at **Appendix A** to this report.

2. Council approves the Medium Term Financial Strategy (MTFS) to 2019/20 at **Appendix D** and the proposed budget efficiencies set out within the document to further improve efficiency/increase income and reduce the forecast budget deficit. Specifically the following:-

   - **Introducing Charges for collecting Garden Waste with effect from 1st April 2018.**
   - **Introducing a Charging Policy for the replacement of wheeled bins with effect from 1st April 2017.**
   - **Retracting the contribution made to the Police and Crime Commissioner for Police Community Support Officer in the sum of £0.044m.**

3. Council endorse the assessment on the level of reserves for 2017/18 in **Appendix F**.

4. Council approves the adjustments to General and Earmarked Reserves.

5. Subject to any amendments proposed in considering recommendations 1 to 4 above, Council recommend a Borough Council Net Expenditure requirement for 2017/18 (including parish/town council precepts) that is adequate to support the delivery of the MTFS.

6. The Chief Executive be authorised to deal with staffing issues arising from the report within the agreed budget and in accordance with the council's human resources policies. This will be done in consultation with the Leader, and in his absence the Deputy Leader and the Cabinet member with responsibility for Finance, and as appropriate other relevant Cabinet Members.

Council Tax

7. Subject to consideration of recommendations 1 to 6 above, Council approves the Borough Council's Band D equivalent Council Tax for 2017/18 to remain at the same level as 2016/17 being £208.38.

8 Council note that approval in respect of the setting Council Tax Support scheme applicable to working age claimants with effect from 1st April 2017 at £3.50 per week, is contained within the Council Tax Setting 2017/18 report on this agenda.

Capital Programme and Budget

9. Council approve the investment in the Capital Programme as set out in **Appendix E** and its proposed funding.

Robustness of the Budget and MTFS Sustainability.

10. The Council note the Statutory Finance Officer's comments and advice under Section 25 of the Local Government Act 2003 as set out in this report in **Appendix G** and have regard to it when approving the budget proposals for 2017/18.

Treasury Strategy 2017/18 to 2019/20

11. That Council is asked to approve the following as in the Treasury Strategy in **Appendix J**:
    1. The Prudential Indicators for 2017/18 to 2019/20 in **Appendix J2**.
    2. The Treasury Management Strategy and Treasury Indicators for 2017/18 (including Table 9 in **Appendix J2**).
    3. The Annual Investment Strategy 2017/18 including Financial Institutions and Investment Criteria.
    4. The Annual Minimum Revenue Provision (MRP) Policy Statement 2017/18.

DETAILS AND REASONING

This report sets out the Council's budget and Medium Term Financial Strategy (MTFS) to 2019/20 which includes the following:-

A. Key Budget and MTFS Messages
B. Forecasted Out-turn Position 2016/17 - The anticipated out-turn financial performance against the current year's approved original budget (2016/17).
C. 2017/18 MTFS – Forecasted Budget Projections to 2019/20 and Balancing the Budget over the Medium Term to 2019/20.
D. Proposed New Investment into the Council's Budget to fund the Corporate Improvement Plan.
E. Budget Consultation.
F. Capital Programme and Prudential Code.
G. Reserves.
H. Robustness of the Budget and MTFS Sustainability.
I. Council Tax.
J. Treasury Strategy 2017/18

A. Key Budget and MTFS Messages

The Council faces a challenge in achieving a balanced budget over the medium term due to a significant loss of income as part of the Local Government Finance Settlement and subsequent to the Spending Reviews in 2010 and 2015.

. A summary of the MTFS budget deficit is set out in the table below:

2017/18 Medium Term Financial Strategy (MTFS)	2017/18 £000	2018/19 £000	2019/20 £000
Forecasted Budget (Surplus)/ Deficit	**888**	**3,002**	**3,386**
2017/18 MTFS Budget Efficiencies Achieved in 2017/18	(874)	(504)	(504)
2017/18 MTFS Budget Efficiencies Approval for 2018/19 – Charges for collection of Garden Waste	-	(450)	(540)
Proposed Corporate Improvement Plan Budget Provision and Expanding Capacity to deliver the MTFS	200	225	225
Estimated One-off set up costs of Garden Waste Collection Charges	86	-	-
Sub-total Forecasted Budget (Surplus)/ Deficit	**300**	**2,273**	**2,567**
Less One-off contributions from General Reserve	(300)	(261)	-
Total Forecasted Budget (Surplus)/ Deficit	**Balanced Budget**	**2,012**	**2,567**

Nonetheless this report sets out a Medium term Financial Strategy that seeks to meet that challenge and balance the budget to 2019/20.

The key messages of the 2017/18 Budget and MTFS are summarised below:

KEY 2017/18 BUDGET MESSAGE - Proposed Council Tax 2017/18

Following on from last year's freeze the Council is proposing to keep the Council Tax for 2017/18 at the same amount as 2016/17 for the seventh time in the last eight years.

KEY 2017/18 BUDGET MESSAGE - New Revenue and Capital Investment

NEW REVENUE INVESTMENT

£0.200m will be invested in the base budget on a recurring bases to support the delivery of the Corporate Improvement Plan by increasing capacity.

NEW CAPITAL INVESTMENT

The proposed Capital Programme to 2019/20 includes new investment into our assets in the sum of £0.330m to help safeguard a heritage asset in Worden Hall and to facilitate an increase in opportunities to generate income on a commercial basis within the Civic Centre's Banqueting Suite.

KEY 2017/18 BUDGET MESSAGE - 2017/18 MTFS Balanced Budget

The MTFS aims to deliver budget efficiency option to bridge the budget shortfall in its entirety by 2019/20.

KEY 2017/18 BUDGET MESSAGE - Focus on Income Generation

The MTFS objective is to take action and bridge the budget gap of £3.6m. To help safeguard front-line services 60% of budget efficiencies will be achieved by increasing income.

KEY 2017/18 BUDGET MESSAGE - Charging for collecting Garden Waste

The majority of Lancashire Councils have introduced a charge for the collection of Garden Waste which is an add-on non-statutory service that has been provided on a complimentary free of charge basis. South Ribble Council has been able to delay the introduction of the charge for another 12 months, however, an annual charge of £30.00 per year will be introduced from 1st April 2018.

KEY 2017/18 BUDGET MESSAGE – Reserves Strategy to Mitigate Financial Risk

The reserves strategy is to retain the General Reserve at a level that is no lower than £4.0m by the end of the three year period contained within the 2017/18 MTFS to 2019/20.

This aim will therefore be the first call on uncommitted in year budget variations and City Deal receipts over and above those needed to support approved borough schemes. This Reserves Strategy will be monitored on a monthly basis and reported to Governance Committee on a quarterly basis in the Budget Management Reports.

Changes to the Waste Collection Service

From April 2018 the Council will no longer receive waste cost share funding from LCC, currently £0.909m per year. Fundamental changes to the waste collection service will need to be undertaken and the Council proposes two key approaches to mitigate this substantial loss of income:

1. A charging policy for replacement wheeled bins to be introduced in April 2017
2. A subscription based garden waste collection service to be introduced in April 2018

For the purposes of forecasting potential receipts some assumptions have been made to the policies to be applied and also demand profiles, however, detailed reports on the proposed draft policies will be submitted for formal approval in due course. Many charging policies for the collection of Garden Waste have been introduced across Lancashire and demand rates have been proven to be substantially high. The additional income and savings that are forecast to be generated from these schemes are £0.030m in 2017/18, £0.510m in 2018/19 and £0.600m in 2019/20.

B. Forecasted Out-turn Position 2016/17

The budget for the current year was set at £13.231m (excluding parish precepts). As in previous years it incorporated substantial proposals to improve efficiency totalling £0.616m **(Appendix C)** to be achieved by reducing expenditure and generating additional income. It was anticipated at the time the budget was approved that no budgeted contribution would be required from the General Reserve to balance the budget. The projected out-turn for the current year is summarised in **Appendix B.** It is currently forecasted that the Council will achieve a net underspend against the 2016/17 budget in the sum of £0.245m. A summary of the key budget variations for 2016/17 is presented in **Appendix B** and are in line with those reported throughout the year to the Governance Committee. The main variations in expenditure are in respect of employee costs and with regard to income the receipt of additional Planning Fee income and recovery of Housing Benefit overpayments, offset by a reduction in the receipt of Public Realm funding and Building Control income.

During the budget setting process, which updates the budget forecasts for the forthcoming year and the 2017/18 Medium Term Financial Strategy (MTFS) through to 2019/20, the impact on the forecasted level of reserves has been assessed. The Authority's MTFS forecasts an increasing budget deficit position mainly caused by Central Government's continued changes to Local Government funding and the expiry of the waste cost sharing agreement with Lancashire County Council (LCC). Council funding will, over this Spending Review period, only consist of local sources of taxation after the total withdrawal of funding via Revenue Support Grant (RSG). To maintain appropriate funding levels the Council will be required to generate income by growing the relevant residential and business tax bases by developing growth in the Borough through the development of additional business premises and house building. This will also invariably place additional demands on services together with the changing needs profile of residents and the business community. Managing financial performance against the approved budget is key to ensuring the delivery of the Corporate Plan and improving the performance of the Council. Financial performance reporting is specifically considered by Cabinet Members and officers alongside the Corporate Plan data. The Governance and Scrutiny Committees provides member oversight and scrutiny of the Council's financial arrangements and performance with the Committee receiving regular financial monitoring reports during 2016/17.

C. 2017/18 Medium Term Financial Strategy to 2019/20

The Revenue Budget forecasts for 2017/18 and beyond are set out in **Appendix A**. The budget translates the priorities in the Corporate Plan into cash terms to deliver the Corporate Priorities that are as follows:-

Clean, Green and Safe
Strong South Ribble in the Heart of a Prosperous Lancashire
Strong and Healthy Communities
Efficient, Effective and Exceptional Council

The table below shows the forecasted Medium Term Financial Strategy budget shortfall with no increases applied to Council Tax. The updated budget gap to 2019/20 is anticipated to be £3.386m. The MTFS in **Appendix D** sets out options that can be adopted to bridge the budget deficit position and balance the budget over the medium to longer term, the overarching aim to achieve financial self-sufficiency. A summary of the MTFS budget deficit is set out in the table below:

2017/18 Medium Term Financial Strategy (MTFS)	2017/18 £000	2018/19 £000	2019/20 £000
Forecasted Budget (Surplus)/ Deficit	**888**	**3,002**	**3,386**
2017/18 MTFS Budget Efficiencies Achieved in 2017/18	(874)	(504)	(504)
2017/18 MTFS Budget Efficiencies Approval for 2018/19 – Charges for collection of Garden Waste	-	(450)	(540)
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Estimated One-off set up costs of Garden Waste Collection Charges	86	-	-
Sub-total Forecasted Budget (Surplus)/ Deficit	**300**	**2,273**	**2,567**
Less One-off contributions from General Reserve	(300)	(261)	-
Total Forecasted Budget (Surplus)/ Deficit	**Balanced Budget**	**2,012**	**2,567**

Cabinet approved the new Corporate Improvement Plan on 20th February 2017. The initial estimate suggests a budget provision of £0.200m is required to implement the recommendations. This provision may be revised, however, as the project is progressed and detailed restructure changes, and the resulting staffing implications, are known and been granted Council approval.

The Council is proposing to bridge this forecasted budget shortfall via a number of options. These are explained in detail with **Appendix D**.

The Council's budget and forecasted budget deficit over the MTFS period has been updated from the information provided within the Final Local Government Finance Settlement published on 15th December 2016. The reductions made to core funding by Central Government as part of the fundamental change being implemented as to how Local Government is funded, means that the Council needs to address a continued and increasing budget gap from 2017/18 onwards. The impact of the recent spending review on core funding is indeed significant as the transition is completed transforming core funding from direct grant funding received from Central Government to 100% sourced from local taxation only. The regime also contains a number of yet unknown elements, including the projectory of the new Tariff Adjustment and the trends within the business tax base post the national re-valuation exercise.

On an annual basis the Council has been faced with significant financial challenges and budgetary pressures in ensuring it is able to balance its budget both in the short and longer term. This is due to a number of external influencing factors:

- A continued pressured economic climate and the impact of Central Government Spending Reviews resulting in substantial reductions in core grant as the Government addresses the national public spending deficit.
- Increased uncertainty and risk with regard to Core Funding levels received from Central Government. The SR 2015 continued to implement fundamental changes in local government financing that removed all core funding to a system whereby the Council earns its own income through local taxation. A Tariff Adjustment charge from the Council to Central Government in the sum of £0.494m has also been introduced to replace the reductions in RSG post it reaching a zero level. There is currently no detailed information in respect of this new form of income reduction with regard to its expected profile or scale.
- Other income streams have also undergone revision and reduced as a result. NHB allocations have been significantly reduced and the business rates tax base has been fundamentally reviewed and re-valued downwards by the Valuation Office Agency (VOA).

It is also important to note that the budget forecasts contain a number of key budget assumptions. Estimates have been made taking into account the financial impact of future changes, for example, pay-awards and levels of fees and charges income. The key assumptions made in preparing the estimates are set out at **Appendix H** and also include the following:-

- New Homes Bonus grant and the outcome of the budget consultation to the City Deal Agreement.
- Business Rates Retention (BRR) and the resulting trends in respect of the rating list re-valuation including the impact on the City Deal Agreement.
- The Capital Programme and its revenue implications.
- Implementation costs of the Draft Corporate Improvement Plan.
- The need to maintain an adequate level of reserves.
- Impact of known budget decisions taken by partner organisations.
- Issues identified through the preparation of the draft risk register.

As in previous years, the need to deliver substantial year on year efficiencies is embedded into the Council's Medium Term Financial Strategy. For 2017/18 this ambitious programme continues and is set out in the report in **Appendix D**.

Balancing the Budget in 2017/18	Budget Plan 2017/18 £m	Recurring into Future Years £m
Forecast Budget Deficit/(Surplus) 2017/18	**0.888**	**3.386**
Stage One Review of Earmarked Reserves	(0.700)	(0.300)
Contribution from General Reserve	(0.300)	-
Increasing Business Rates Retention Income	(0.100)	(0.100)
Charging for Replacement Waste Collection Bins	(0.030)	(0.060)
Contribution Paid to The Police and Crime Commissioner for Police Community Support Officers	(0.044)	(0.044)
Budget Deficit/(Surplus) 2017/18 MTFS before Investment	**(0.286)**	**2.882**
Investment in the Corporate Improvement Plan and Expanding Capacity to deliver the MTFS	**0.200**	**0.225**
Estimated One-off set up costs of Garden Waste Collection Charges	**0.086**	**-**
Budget Deficit/(Surplus) 2017/18 MTFS	**Balanced Budget**	**3.107**

IMPACT OF FUNDING CHANGES ON THE MTFS

(1) Final Local Government Finance Settlement and RSG

The 2017/18 Final Local Government Finance Settlement was published on 20th February 2017 with no adjustment made to the previous provisional settlement issued in December 2016. It represents the fourth year in which the Business Rates Retention (BRR) scheme, introduced in 2013/14, is the principal form of external local government funding. As in previous years, the final settlement provides authorities with a combination of provisional grant allocations and their baseline figures within the BRR scheme. The 2017/18 announcement includes local authority allocations up to 2019/20.

The Settlement Funding Assessment amount consists of three funding streams:

(i) Business Rates Retention
(ii) Revenue Support Grant
(iii) Tariff/Top Up adjustment amounts (2019/20 only)

The table below illustrates how the Formula Grant has reduced since 2010/11 and the Comprehensive Spending Review in 2015.

Core funding received since CSR 2010 to 2015/16

	2010/11 £m	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m	2015/16 £m
Business Rates	6.579	4.115	4.555	New Business Rates Retention Scheme introduced		
Revenue Support Grant	0.955	1.272	0.092			
Formula Grant	-	-	-	4.117	4.106	3.499
Council Tax Support Grant	-	-	-	*0.767	-	-
Re-basing of 2010/12 Grant	**(1.106)					
Sub Total	**6.428**	**5.387**	**4.647**	**4.884**	**4.106**	**3.499**
Council Tax Freeze Compensation	-	0.189	0.189	0.268	0.343	0.343
Homelessness Prevention Grant	-	0.057	0.057	0.057	0.056	0.056
Total Formula Grant	**6.428**	**5.633**	**4.893**	**5.209**	**4.505**	**3.898**

** The Council Tax Support Grant is rolled into and included in the Formula Grant settlement in 2014/15. Therefore it cannot be separately identified and tracked in terms of value.*
*** 2010/11 formula grant re-based mainly due to transfer of Concessionary Travel to Lancashire County Council.*

Core funding to be received post the SR 2015 to 2019/20

The final settlement for 2017/18 contains a reduction in RSG of £0.661m in 2017/18 and then a final reduction of £0.350m in 2018/19 which means that RSG has been withdrawn in its entirety as a source of funding for the Council plus the tariff payment of £0.494m to Central Government in 2019/20. This equates to a total reduction in four years of £1.501m.

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
RSG received *from* Central Government	1.007	0.346	nil	nil
Baseline Funding Level	2.147	2.191	2.262	2.342
Tariff Adjustment paid *to* Central Government	-	-	-	(0.494)
Total Funding Level	**3.154**	**2.537**	**2.262**	**1.848**

(2) Business Rates Retention (BRR)

2013/14 was the first year with regard to the implementation of the Business Rates Retention funding regime. Local authorities are now allowed to retain a proportion of any additional income generated from growing the tax base for businesses in their area. Within these new arrangements it is important to note that although we continue to collect the business rates for this area, the Government still continues to determine the annual rate poundage and the Valuation Office Agency (VOA) will remain responsible for setting the rateable value for business premises. Although this scheme means that some of the financial benefit of net tax base growth is realised by the authority it also results in some of the risks of collection also transferring to local authorities. Also due to the inflationary arrangements built into the baseline funding level calculation within the scheme the tax base needs to be grown on an annual basis just to maintain existing funding levels. Growth over and above the incremental increase required as part of the Local Government Finance Settlement may result in additional income being generated, however, more than one of the variable factors may fluctuate during the year that can directly impact on the level of funding actually received. These are:-

(a) net movement in the business rate yield (determined by Central Government),
(b) losses on collection (impacted upon by the national economic environment), and
(c) reductions due to re-valuations and appeals (determined by the VOA).

The scheme allows for the opportunity for the Council to benefit financially from achieving growth in the tax base. The national scheme also allows groups of Councils to form a 'Pooling Agreement' whereby the group is treated as one authority for the purposes of calculating the Levy payments and Safety Net receipts. By being part of the Lancashire Pool in 2017/18, South Ribble will no longer be required to pay over to Central Government a 50% Levy Payments on new growth achieved. The benefits of entering into the Pool have contributed to the Council's balanced budget position. Taking into account the current degree of uncertainty caused by these external factors, an estimate of circa. £0.700m has been included in the forward estimates in the proposed MTFS over the longer term to reflect the impact of the Pooling Agreement. This assumes that the Pooling Agreement continues into future years and therefore should the Pooling Agreement either be dissolved or withdrawn by Central Government, this will in effect increase the forecasted budget deficit in future years.

(3) Council Tax Support Scheme

2013/14 also saw the introduction of the Council Tax Support Scheme which replaced Council Tax Benefit with a localised Council Tax Support charge in response to reductions in government grant subsidy. South Ribble Borough Council resolved in 2012 to recover the reduction in Central Government funding by reducing the level of entitlement to Council Tax Support for working age claimants. The Cabinet agreed it's Council Tax Support Scheme, to take effect from 2017/18, at the meeting on 26th October 2016. Once the council tax levels for the other precepting authorities have been determined for 2017/18 the Council will be required on 1st March 2017 to determine the reduction in Council Tax support applicable to working age claimants from 1st April 2017. This will be approved within the Council Tax Setting 2017/18 report on this Council agenda.

(4) New Homes Bonus (NHB) Grant

The Government introduced NHB in 2011/12 as an incentive for house building across the country. The Department for Communities and Local Government (DCLG) reduced the national RSG allocations to pay for the New Homes Bonus Scheme, the remaining RSG total balance now reducing to zero over the course of SR 2015. The remaining NHB pot is currently based on the average national Band D council tax for each new property built, with an additional top-up payable for affordable properties constructed. The funding is not ring-fenced and therefore can be used for wider service provision or specific amenities needed to support any new development.

The New Homes Bonus scheme was subject to a consultation paper in December 2015. The 2017/18 New Homes Bonus allocations and details of the consultation on the future of the scheme had been announced as part of the provisional finance settlement (previously these figures were only indicative) ahead of the final settlement. The number of years that the scheme will be based upon (currently 6 years' in 2016/17) will reduce to 5 years in 2017/18 and 4 years from 2018/19 onwards. The scheme will now also only reward growth in homes above 0.4% per annum.

This change also has an impact on City Deal (CD) and the implications are currently being assessed by the CD partners. This is set out in more detail in the City Deal Summary in **Appendix I**. The total NHB receipts for 2017/18 are £0.237m as according to the new NHB regime for a four year period, however £0.195m will be invested in the City Deal arrangements referred to within this report. The remaining balance of £0.042m will be retained by the Council.

It is important to note that, whilst the annual NHB allocations are made to councils as aggregated payments, the NHB allocations for each year are separate and discrete. This becomes important for financial planning as each discrete annual allocation is payable for a fixed number of years only and therefore this introduces an element of risk in relying on this to fund recurring expenditure. No assumptions have been made in the Medium Term Financial Strategy in relation to potential NHB receipts for NHB years 2018/19 onwards and the table below sets out all NHB receipts to be received to 2018/19 based on NHB years up to and including 2017/18, as per the Government allocations.

	2011/12 Year 1 £000	2012/13 Year 2 £000	2013/14 Year 3 £000	2014/15 Year 4 £000	2015/16 Year 5 £000	2016/17 Year 6 £000	2017/18 Year 7 £000	2018/19 Year 8 £000
NHB 2011/12	165	165	165	165	165	165		
NHB 2012/13		170	170	170	170	170	0*	
NHB 2013/14			177	177	177	177	177	0*
NHB 2013/14 adj			17					
NHB 2014/15				114	114	114	114	0**
NHB 2015/16					279	277	273	273
NHB 2016/17						75	75	75
NHB 2017/18							42	42
Total Receipts	**165**	**335**	**529**	**626**	**905**	**978**	**681**	**390**

**Reduction from 6 to 5 years under new scheme*
***Reduction from 6 to 4 years under new scheme*

The combined reduction in NHB income to the Council as a result of the reduction in years and the growth threshold, compared to the previous scheme are as follows:-

Reduced NHB Funding				
2017/18 £000	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
170	**291**	**386**	**349**	**118**

D. Proposed Improvement Plan Investment in the Budget

KEY 2017/18 BUDGET MESSAGE - New Revenue Investment

£0.200m will be invested in the base budget on a recurring bases to support the delivery of the Corporate Improvement Plan by increasing capacity.

At its meeting on 6th December 2016, Cabinet approved the action plan arising from the Scrutiny Review of Licensing and the development of the Council's Annual Governance Statement (AGS), and endorsed the development of a more detailed action plan incorporating key milestones and targets for monitoring both by the Employment Panel (who are responsible for overseeing the performance of the Interim Chief Executive) and by Scrutiny Committee, Governance Committee and Cabinet as appropriate. Detailed actions have now been developed and incorporated into an overarching Improvement Plan for the Council. The Corporate Improvement Plan identifies specific milestones to be achieved in relation to each of the actions, and identifies the relevant lead member and member of the Council's Senior Management Team who will lead in relation to the actions. An update on progress to date is shown by the Red/Amber/Green (RAG) rating included in the plan.

The Corporate Improvement Plan will be monitored monthly by the new Programme Board (consisting of the Council's Senior Management Team) with updates being reported to Cabinet, Scrutiny Committee and Governance Committee every quarter and to the Employment Panel as appropriate. Key risks are included in the Corporate Risk Register, and these will be monitored on a monthly basis by the Programme Board in between the quarterly reviews which will be undertaken alongside the quarterly reviews of the Corporate Plan. The Corporate Improvement Plan directly underpins the Council's Corporate Priorities set out in the Corporate Plan to be an efficient, effective and exceptional council. The actions aim to improve the Governance and overall performance of the Council. It is envisaged that investment is need to increase capacity to deliver the action effectively. Therefore a proposed initial recurring investment of £0.200m is included within this budget. The full Corporate Improvement Plan was approved by Cabinet on 20th February 2017. A further £0.025m has been added in 2018/19 and 2019/20 to provide administration support for the introduction of a charging policy for the collection of Garden Waste with effect from 01/04/18.

E. Budget Consultation

The Council's Corporate Plan has been refreshed and is proposed for approval by the Council to ensure it remains fit for purpose and includes all the key actions and measures to ensure the Council achieves its vision and priorities and implements the Corporate Improvement Plan. Feedback from our residents, councillors, employees, Cabinet and the Scrutiny Committee has been used in re-freshing the Corporate Plan. The budget proposals included within this report are designed to support those corporate priorities. An updated and revised Corporate Plan was approved by cabinet on 20th February 2017. The budget proposals do, however, recognise the financial constraints that have now been imposed on all local authorities. The budget proposals will be made available for local people and businesses to comment on and any feedback received will be taken into consideration before the budget is finalised at the Council meeting on 1st March 2017.

F. Capital Programme and Prudential Code

The Council's Capital Programme forms part of the Council's overall financial strategy to deliver some of its key objectives contained in the Corporate Plan. The Capital Programme has to be affordable and based upon prudence. The current local government financial position and the need to make revenue savings will impact on the Council's ability to finance further capital spending unless additional funding is secured from external sources. The Capital Programme has been constructed based upon the following strategic objectives.

- The resources available will be targeted at areas that deliver corporate priorities.
- Borrowing will be managed to ensure the future impact on revenue is minimised.
- As part of their capital expenditure strategy the Council will consider the purchase and/or development of assets to generate a sustainable revenue stream to counteract against the risk of future reductions in grant funding and year to year fluctuations.
- The Council will continue to invest in its own infrastructure reviewing the Asset Management Plan and Strategy to ensure levels of investment are appropriate.

As a consequence of adopting the strategy outlined above and incorporating the proposed new budget growth investments, the Council proposes to invest £11.545m over the MTFS period. The programme will be funded from a variety of sources, which is consistent with the Council's corporate priorities.

The following details of the Capital Programme are set out within the report at **Appendix E**:

- 2016/17 Capital Programme Out-turn including financing.
- Proposed 2017/18 Capital Programme to 2019/20 including proposed financing.
- Summary of proposed project amendments made.
- City Deal (cross reference to **Appendix I)**.
- Overview of new budget challenge process for the 2017/18 Capital programme setting round.

G. Reserves

The following details in respect of the General Reserve balance and Earmarked Reserves are set out within the report at **Appendix F**:

- Proposed 2017/18 Use of General Reserve
- Proposed 2017/18 Use of Earmarked Reserves
- Strategic Review of Reserves and the MTFS to 2019/20
- Capital Reserves

H. Robustness of the Budget and MTFS Sustainability

The Local Government Act 2003 requires the Chief Financial Officer (s151 Officer) to report upon the robustness of the estimates made for the purposes of the budget and council tax setting calculations. Spending plans ultimately impact on the level of council tax although, as explained below, the extent of any increase is also externally influenced by the provisions within the Localism Act (council tax referendum requirements).

The Medium Term Financial Strategy in **Appendix D** assesses the affordability of revenue and capital plans and the adequacy of reserves. As with all plans the further the estimate is in the future there is a higher risk with regard to its accuracy. This is now additionally problematic given the variable factors, uncertainty and increasing risk financial profile when dealing with the variable funding regimes and the unknown outcomes of the future settlements.

As with previous years' budget reports, the council's financial strategy continues to be aimed at addressing the longer term sustainability issues surrounding capital investment and the contributions that may be required to earmarked reserves. The Chief Finance Officer's Report is attached in **Appendix G**.

I. Council Tax

KEY 2017/18 BUDGET MESSAGE - Proposed Council Tax 2017/18

Following on from last year's freeze the Council is proposing to keep the Council Tax for 2017/18 at the same amount as 2016/17 for the seventh time in the last eight years.

The following table provides details of the Council Tax collected by the Borough Council, in its role as billing authority. The table also shows the component parts of the current year's council tax payable by the occupiers of a Band D property in the Borough together with the dates on which each of the precepting authorities are currently expected to agree their budgets and council tax for 2017/18.

Precepting Authority	2017/18 Band D Equivalent £	Meeting Date
Police & Crime Commissioner	tbc	tbc
Lancashire Combines Fire Authority	65.50	20th February 2017
Lancashire County Council	1,221.74	9th February 2017
South Ribble Borough Council	208.38	1st March 2017
Total	**tbc**	

Residents living in a property located within the boundaries of a Parish/Town Council will have to pay an additional amount of council tax (i.e. added to the amounts in the previous table) to pay for the services of the respective Parish/Town Council. The Parish/Town Councils have each agreed and confirmed their precepts. The table below compares each of the precepts notified for 2017/18 with that for the current year.

	2016/17		**2017/18**	
Parish/ Town Council	**Precept £**	**Band D Equivalent £**	**Precept £**	**Band D Equivalent £**
Farington	50,000	**23.45**	50,000	**23.00**
Hutton	22,000	**24.82**	22,000	**24.75**
Longton	83,200	**27.01**	73,200	**23.72**
Penwortham	127,600	**17.18**	170,000	**22.64**
Much Hoole	14,963	**21.55**	52,969	**75.65**
Little Hoole	17,500	**21.97**	22,500	**28.04**
Samlesbury & Cuerdale	5,000	**10.28**	7,000	**14.12**
Total	**320,263**		**397,669**	

Council Tax - South Ribble Borough Council

The current Band D equivalent tax for the council, excluding parish/town council precepts is £208.38. Council Tax increases in recent years have been held below inflation with no increase being applied in 2010/11, 2011/12, 2013/14, 2014/15, 2015/16 and 2016/17. Subject to Government rules regarding a Council Tax referendum, the council has discretion over the level of Council Tax it needs to levy to deliver local services. However, Council Tax should not be levied unnecessarily and be justifiable in terms of the services it is being used to fund. With these caveats in mind, Council is required to determine the 2017/18 Band D equivalent Council Tax that is recommended to the Council within the Council Tax Setting report on this agenda.

The net expenditure of the Borough Council, excluding parish/town Council precepts and after contributions to/from reserves has to be met from funding from the Formula Grant, with the balance being met by Council Tax. The Borough Council's Council Tax base for 2017/18 has been determined as 35,287.6 Band D equivalent properties (2016/17 - 34,815.6). This increase reflects an increase in both newly occupied properties and empty homes being brought back into use.

In-year collection rates for Council Tax are continuing to hold up and do not appear to have been adversely affected beyond that predicted in previous years. Therefore in calculating the tax base applicable for 2017/18 the allowance for estimated losses on collection has been maintained at 2.00%. This also reflects the significant impact of continued backdated re-bandings of properties. However, every effort will continue to be made to maximise collection rates and minimise any amounts that may ultimately prove to be unrecoverable.

In determining the Council Tax level legislation also requires the Council to take into account any surplus or deficit on the Collection Fund. The requisite calculations have been finalised and there is a forecast surplus on the Collection fund of £1,079,761. The Council's share of this surplus amounts to £145,012, which has been taken into account in determining the revenue budget for 2017/18 detailed in **Appendix A**.

Council Tax Increase - Limitations

The Localism Act introduced the power for the Secretary of State to set principles each year under which council tax increases are determined as being excessive. This can apply to South Ribble Borough Council, Lancashire County Council, Fire, the Police and Crime Commissioner or Town and Parish councils. In all such cases, South Ribble Borough Council has to make arrangements to hold a local referendum for residents. Costs can be recovered from the relevant precepting authority. Draft thresholds have been published for the 2017/18 financial year. The Government proposes to set a threshold of 5% for upper-tier local authorities with social care responsibilities, and for district councils, increases of less than 2% or up to and including £5 (whichever is higher) above the authority's relevant basic amount of council tax for 2016/17 can be made without triggering a referendum.

J. Treasury Strategy 2017/18

The Local Government Act 2003 gave local authorities greater discretion over capital expenditure by allowing prudential borrowing. It also sought to strengthen governance by making compliance with the Chartered Institute of Public Finance and Accountancy (CIPFA)'s Prudential Code and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable; the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.

Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual MRP policy statement to be made to the full Council prior to the start of each year.

Finally local authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the Department for Communities and Local Government (DCLG), to prepare an annual Investment Strategy to identify how that discretion should be applied. The Treasury Strategy is attached in **Appendix J** and brings together these related requirements. The Governance Committee's role is to scrutinise these policies and practices, while the Council is required to approve them.

The report includes the following:-

- Prudential Indicators
- Treasury Reporting
- Borrowing and Investment Projections
- Borrowing Strategy
- Use of Treasury Advisors
- Performance Indicators
- Investment strategy

The Treasury Management Policy Statement was updated and approved by Council on 2nd March 2016. This report has been prepared in accordance with the approved Policy. The Council's Treasury Management Practices (TMPs) were also updated and approved by Council on 2nd March 2016. No changes to the TMPs are required at present.

With regards to the Prudential Indicators 2017/18 to 2019/20, local authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties. To do this however increases a Council's indebtedness and ultimately leads to a charge to the revenue budget. To manage that process, Councils must set certain Indicators. These are designed to indicate that the expenditure is prudent and affordable. The relevant indicators for South Ribble Borough Council are presented in **Appendix J2**.

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. It deals with "*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"* (CIPFA) .

INVESTMENT STRATEGY 2017/18

Under the Power in Section (15) (1) of the Local Government Act 2003 the DCLG has issued Guidance on Local Government Investments. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity ahead of yield. This strategy follows the guidance.

South Ribble Borough Council's Strategy for 2017/18

The draft Investment Strategy for 2017/18 was presented to Governance Committee for consideration on 1ST February 2017.

<u>Objectives</u>

The Council's investment priorities are:
- The security of capital and
- The liquidity of its investments.

The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful, and this Council will not engage in such activity. The Council will restrict borrowing in excess of its immediate need, to that envisaged to be required in the following eighteen months.

Changes to the Financial Institutions and Investment Criteria (2017/18 Treasury Strategy) for approval by Council are set out in bold within the table on page 11 in **Appendix J.**

Appendices attached to this report		Description
Appendix	**Title**	
A	2017/18 General Fund Summary and MTFS	Latest revised estimate for the current year and future years' estimates to 2019/20.
B	2016/17 Revised Estimate	The 2016/17 Projected Out-turn summary of key budget variations to the 2016/17 approved Original Budget for 2016/17 as included in Appendix A.
C	2016/17 Budget Efficiency Programme	Actual performance in achieving the efficiency targets incorporated into budget forecasts in 2016/17.
D	2017/18 Medium Term Financial Strategy	Proposed financial plan to bridge the forecasted budget shortfall to 2019/20.
E	2017/18 Capital Programme Estimates and Financing	Summary of the projected expenditure on Capital projects and how these will be financed.
F	General Reserve and Earmarked Reserves	Detailed breakdown of the General Balance Reserve and Earmarked Reserves and forecasts to 2019/20.
G	Report of the Chief Finance Officer (s151)	Comments of the Chief Finance Officer (s151) with regard to the 2017/18 Budget and MTFS.
H	Revenue Budget – Key Budget Assumptions	Key assumptions used in compiling the revenue budget forecasts within the MTFS.
I	City Deal 2017/18 Budget Implications Summary	How City Deal impacts on the budget and 2017/18 MTFS.
J	Key Risks to the Medium Term Financial Strategy	Potential risks to the MTFS and the mitigating action(s) to be monitored during the year.
K	Treasury Strategy 2017/18 to 2019/20	Proposed Treasury Strategy to 2019/20

BACKGROUND DOCUMENTS

2017/18 Provisional Local Government Finance Settlement – December 2016
2017/18 Final Local Government Finance Settlement – 21st February 2017
Financial Strategy, Budget and Council Tax 2016/17 - Cabinet 10th February 2016
Treasury Management Strategy for 2016/17 - Cabinet 10th February 2016
Corporate Plan and Risk Register – Cabinet 20th February 2017
Corporate Improvement Plan – Cabinet 20th February 2017
Treasury Management Strategy 2017/18 - Cabinet 20th February 2017
Pay Policy 2017/18 – Cabinet 20th February 2017

WIDER IMPLICATIONS - In the preparation of this report, consideration has been given to the impact of its proposals in all the areas shown below. A risk assessment has also been carried out. The table shows the implications in respect of each of these.

FINANCIAL	The financial implications relating to this report are set out in the body of this report and the Report of the Chief Finance Officer (s151) is attached at **Appendix G**.
LEGAL	The budget has been set with reference to all relevant legal requirements set out in the Local Government Finance Act 1992 and all other related legislation, statutory instruments and regulations. Cabinet is under a legal duty to prepare and agree budget proposals which then must be referred to full Council for their consideration. Members will fully appreciate that there is a legal duty to set a lawful budget in time. For all practical purposes Council needs to set this budget at this meeting on the 1st of March 2017. Members jointly and severally (individually and collectively) have a fiduciary duty to Council Tax payers. This means they have a duty to facilitate the setting of a lawful budget. Failure to set a lawful budget may result in legal challenge by way of judicial review proceedings. More generally any such failure could result in loss of income, significant additional administrative costs as well as reputational damage. There is a further risk that a failure to set a lawful budget in a timely fashion could result in intervention from the Secretary of State.
RISK	As acknowledged throughout the report the Council is exposed to increasing and significant financial risk. Delivery of the MTFS is paramount in delivering a balanced budget over the medium to longer term and mitigates this risk. For further details please refer to Appendices G and J.
OTHER (see below)	The budget proposals, if agreed, may result in a reduction in employee costs, which will be addressed in accordance with the Council's suite of human resource policies. Close liaison with the Trade Unions and employees has been and will continue to be on-going. An equality impact is required to be carried out on the budget proposals contained in this report for 2017/18, taking into account the requirements of The Equality Act 2010, and the specific public sector provisions.

Asset Management	*Corporate Plans and Policies*	*Efficiency Savings*	*Equality, Diversity and Community Cohesion*
Freedom of Information/ Data Protection	*Health and Safety*	*Human Rights Act 1998*	*Implementing Electronic Government*
Respect Agenda	*Staffing*	*Sustainability*	*Training and Development*

2017/18 GENERAL FUND SUMMARY and MTFS
REVENUE ESTIMATES 2016/17 TO 2019/20

Portfolio	ORIGINAL 2016/17 £000	REVISED 2016/17 £000	FORECAST 2017/18 £000	FORECAST 2018/19 £000	FORECAST 2019/20 £000
Leader	1,508	1,610	1,621	1,554	1,685
Finance	320	310	862	880	901
Corporate Support and Assets	5,345	4,915	5,277	5,279	5,414
Neighbourhoods & Streetscene	4,071	4,759	4,887	5,850	5,921
Public Health, Safety & Wellbeing	481	486	549	470	478
Regeneration and Leisure	1,085	2,304	1,485	1,488	1,409
Strategic Planning and Housing	(9)	(35)	221	181	126
TOTAL	**12,801**	**14,349**	**14,902**	**15,702**	**15,934**
Efficiency targets	(550)	0	(261)	(261)	(261)
Investment Interest	(165)	(188)	(69)	(55)	(96)
Interest Payable	120	120	120	120	120
Depreciation	(1,946)	(2,940)	(2,940)	(2,940)	(2,940)
Provision for Repayment of Debt	1,033	1,024	1,018	1,069	1,070
Revenue Contributions to Capital	0	12	0	0	0
Revenue funded from capital	(465)	(607)	(607)	(607)	(607)
Cont'n (from)/to Earmarked Reserves	2,701	2,528	1,509	1,420	909
Cont'n (from)/to General Fund Balances	0	0	0	0	0
BOROUGH COUNCIL BUDGET REQUIREMENT	**13,529**	**14,298**	**13,672**	**14,448**	**14,129**
Parish/Town Council Precepts	320	320	398	398	398
TOTAL BUDGET REQUIREMENT	**13,849**	**14,618**	**14,070**	**14,846**	**14,527**
FUNDED BY:					
New Homes Bonus	(973)	(1,744)	(681)	(390)	(117)
Revenue Support Grant/Tariff adj.	(1,007)	(1,007)	(346)	0	490
Transition Grant	0	(92)	(92)	0	0
Business Rates Retention	(4,003)	(4,000)	(3,916)	(3,643)	(3,643)
Business Rates Retention - Collection Fund Surplus	(300)	(300)	(251)	0	0
Parish Precepts	(320)	(320)	(398)	(398)	(398)
Council Tax	(7,255)	(7,255)	(7,353)	(7,413)	(7,473)
Council Tax - Collection fund balances	9	(145)	(145)	0	0
TOTAL FUNDING	**(13,849)**	**(14,863)**	**(13,182)**	**(11,844)**	**(11,141)**
Forecast Budget (Surplus)/Deficit	**0**	**(245)**	**888**	**3,002**	**3,386**
2017/18 Approved MTFS in 2017/18			**(874)**	**(504)**	**(504)**
2017/18 Approved MTFS in 2018/19 – Garden Waste Charges			**-**	**(450)**	**(540)**
Investment in the Corporate Improvement Plan			**200**	**200**	**200**
Expanding Capacity and one-off costs to deliver the 2017/18 MTFS to 2019/20			**86**	**25**	**25**
Cont'n from General Reserve Balances			**(300)**	**(261)**	**-**
Forecast Budget (Surplus)/Deficit	**0**	**(245)**	**0**	**2,012**	**2,567**
2017/18 MTFS Forecasted Delivery Profile to 2019				**(2,012)**	**(2,567)**

2016/17 REVISED ESTIMATE SUMMARY OF KEY VARIANCES TO ORIGINAL ESTIMATE

Appendix B

Details	Projected Outturn Variances Under / (Over) spend	
	£000	**£000**
Expenditure		
Employee Costs – Capacity Support		*(70)
Employee Related Costs		(38)
Premises		30
Transport		22
Supplies and services		(21)
Licensing additional costs		*(94)
Sub Total - Expenditure		**(171)**
**Approved Supplementary estimates*		
Income		
Building Control fees deficit		(43)
Housing Benefit/Council Tax Support net over-recovery		106
Car Parking income		(19)
Consideration for release of restricted covenant		21
Council Tax support admin grant		21
Council Tax court costs recovered		(40)
Interest on Investments		23
Investment property income		28
Land Charges income		(12)
Planning application fees		280
Police election & referendum funding		18
Public Realm funding shortfall		(65)
Sub Total - Income		**318**
Other Minor Variations		12
Carry forward of underspend to 2017/18		(61)
Budget Efficiency Programme		(8)
Business Rates Retention	30	
Transfer to BRR Equalisation Reserve	(30)	0
Projected Out-turn Budget Variation – General Fund		**90**
Collection Fund adjustment in 2016/17 Final Accounts		155
Projected Out-turn Budget Variation – incl. Collection Fund Adj.		**245**
Effect on Reserves:		
Transfer to/(from) General Reserves – Original Forecast		0
Transfer to General Reserve – Projected Out-turn Variation		(245)
FORECAST MOVEMENT		**(245)**

2016/17 Budget Efficiency Programme

Budget Efficiency Targets	Budget Efficiency Savings Targets (FY) 2016/17 £000	Projected Outturn 2016/17 £000	Target Exceeded/ (Shortfall) 2016/17 £000	Recurring Budget Efficiency Savings £000
Business Transformation:				
Neighbourhood, Environment & Asset Management Directorate	(150)	-	*(150)	-
Print and Post Review	(30)	(55)	25	(85)
Shared Assurance Services Restructure	(20)	(20)	-	(20)
Review of Vacant Posts	(216)	(16)	**(200)	(16)
Base Budget Review	(100)	(80)	*(20)	(80)
Sub-Total	**(516)**	**(171)**	**(345)**	**(201)**
Staff Turnover Savings	(100)	(437)	337	(100) annual target
Total – Full year	**(616)**	**(608)**	**(8)**	**(301)**

* to be delivered in 2017/18
** will not be delivered in 2016/17 or 2017/18

Appendix D

2017/18 Medium Term Financial Strategy

FOREWORD AND INTRODUCTION

The aim of this strategy is to set out in financial terms the impact of the Councils existing policy commitments and the likely resources available to meet them to support the Council's Corporate Plan. This Medium Term Financial Strategy (MTFS) plans a route by which the budget gap could be bridged in order to deliver the Corporate Plan. For a number of successive years local authorities have faced fundamental changes to funding and a period of significant budget reductions and challenges.

The Government's Spending Review 2015 was announced in 2015/16 closely followed by the Local Government Finance Settlement covering four years from 2016/17 to 2019/20. The settlement published significant reductions to the Revenue Support Grant (RSG) during the MTFS period to the point that it is completely withdrawn for 2018/19. In 2019/20 the direction of the grant reverses and the Council becomes required to make a grant payment to Central Government in the form of a 'Tariff Adjustment.' It is not known how the 'Tariff Adjustment' will be applied thereafter and therefore the scale of risk cannot be accurately quantified at this stage. The publication also launched the consultation process titled 'Sharpening the Incentive of NHB' in respect of proposals to reduce the value of funds to be awarded via the NHB core grant distribution scheme. This has now been done and implemented within the settlement for 2017/18 as detailed in this report.

In summary, the structure of core grant income continues to be transformed and by the end of the MTFS period is comprised of only locally generated sources, that is, Council Tax and Business Rates Retention (BRR) reduced by the offsetting 'Tariff Adjustment' payment. There will also be the potential qualification for NHB dependent on the delivery of new homes in the borough although this is due to be accelerated by the City Deal agreement. BRR income is particularly vulnerable to annual and significant fluctuations which increases the Council's exposure to financial risk with the regime's parameters being externally driven and outwith the influence of the Council. Therefore the Council's MTFS must demonstrate resilience and flexibility in order to respond to core income structural changes and variables such as tax base decline resulting from the appeals process and the possible negative impact from re-valuation rounds and downward national economic performance.

Despite these financial challenges the administration's financial aims are to support and invest in the corporate priorities, which are:

Clean, Green and Safe
Strong South Ribble in the Heart of a Prosperous Lancashire
Strong and Healthy Communities
Efficient, Effective and Exceptional Council

FINANCIAL OUTLOOK AND KEY BUDGET CHALLENGES

This section sets out the financial challenges facing the Council in delivering its corporate priorities within a balanced and affordable budget.

The budget forecast in **Appendix A** attached identifies that by 2019/20 the unadjusted budget deficit will be in the region of £3.4m. All forecasts are built upon a number of assumptions, which are based upon the best information available at this time. The main reasons for an increasing budget gap being the expiry of the Cost Sharing Agreement with LCC £0.909m, the reduction of core funding which totals £1.300m since 2016/17 and changes applied to the NHB grant allocation system circa. £0.600m.

Budget (Headroom)/Gap 2017/18 to 2019/20

Year	Budget (Headroom)/Gap £m	Cumulative Budget (Headroom)/Gap £m
2017/18	0.888	0.888
2018/19	2.114	3.002
2019/20	0.384	3.386

HOW THE FINANCIAL CHALLENGE WILL BE MET

At a summary level there are options available for the Council to consider with regard to balancing the budget by 2019/20.

THE STRATEGY

To achieve a reduction in net expenditure the Council's Strategy will be:

- **To deliver a balanced budget over the Financial Planning Period to 2019/20**
- **Introduce a charging policy for the collection of Garden Waste**
- **To identify the savings required to balance the budget seeking to minimise the impact on front line service users**
- **To be entrepreneurial and prioritise property investments that grow the Council's income**
- **Work with collaboratively with partners**

FINANCIAL CONTEXT

The strategy below seeks to close the budget gap by 2019/20. In order to protect front line services the priority of this MTFS is to seek to apply an appropriate balance between maximising income opportunities and reducing costs. To this end £3.386m will be sought from various options by 2019/20. The table below sets out the MTFS targets that aim to balance the budget over the medium term:

	2019/20 £m
2017/18 MTFS Forecasted Budget Deficit to 2019/20	**3.386**
INCREASING INCOME	
Charging for the Collection of Garden Waste with effect from 1 April 2018	(0.540)
Council Tax Increases w.e.f. 2018/19	(0.457)
Borough Investment Account – Net Investment in the Council's Assets to Generate Income	(0.300)
BRR – Growing the Tax Base	(0.250)
Council Tax Base Growth from City Deal	(0.150)
New Income Generation Schemes	(0.150)
Review of Car Parking Charges	(0.110)
Charging for Replacement Waste Bins	(0.060)
Sub – Total Income	**(2.017)**
REDUCING EXPENDITURE	
Expansion of Shared Services including One Public Estate Co-location and Collaboration	(0.750)
Business Transformation Programme Incl. review of non-statutory functions and a Business Analysis Review of non-staffing costs	(0.500)
Strategic Review of Reserves	(0.300)
Contribution to Police Community Support Officers	(0.044)
Sub – Total Expenditure	**(1.594)**
TOTAL BUDGET EFFICIENCIES TO 2019/20	**(3.611)**
2017/18 MTFS to 2019/20 - Budget Deficit/(Surplus)	**(0.225)**
Investment in the Corporate Improvement Plan and Expanding Capacity to deliver the MTFS	0.225
2017/18 MTFS to 2019/20 - Budget Deficit/(Surplus)	**Balanced Budget**

These options will be worked into more detailed project plans and be delivered within a project and performance framework allowing for consultation where applicable. A summary of grouped options is provided below:

New Income Generation Schemes

Developing income generating scheme by building on a consultation report from Grant Thornton on possible options, for example, Care Home Provision, Loans for Housing and Energy Supply.

Expansion of Shared Services including One Public Estate Co-location and Collaboration

Shared services continue to be a significant method by which councils generate savings and capacity for service delivery. Nationally, there are many examples of shared services, ranging from individual posts and services to full shared management teams. South Ribble and Chorley Councils are the most obvious partners for developing further shared services, given the strong track record of joint working and similarities between the two. A paper will be presented to Cabinet meetings that sets out a joint ambition to create a close working relationship, with the ultimate aim to develop shared services serving two independent and sovereign councils. This work will mean some upfront investment, although costs will be able to be contained within existing resources. Cost savings achieved by other district councils would suggest that a 10% saving would be achievable over the long term by sharing officer structures and key contracts. A target saving of £0.750m by 2019/20 is included within this strategy.

Strategic Review of Reserves

A streamlining of contributions into reserves at a level to be determined that does not destabilise the Council's financial resilience.

Business Transformation Programme

Project based review of non-statutory functions and the non-staffing running expenses of the Authority.

LINKS TO OTHER FINANCIAL STRATEGIES

The MTFS includes the financial implications of the Capital Programme and the Reserves Strategy both of which are detailed in this report specifically in **Appendix E** and **Appendix F** respectively. The Treasury Strategy in **Appendix J** was approved by cabinet on 20th February 2017, however a summary of the main points are below:

Treasury Strategy

The Chartered Institute of Public Finance and Accounting published Code of Practice for Treasury Management (Local Government Act 2003) also requires Council's to have regard to the prudential code. The primary requirements are to:

- Create and maintain a treasury management policy statement which sets out the policies and objectives to the Council's treasury management achievements.
- Create and maintain treasury management practices which set out the manner in which the Council will seek to achieve its policies and objectives.
- Provide the Cabinet with an annual strategy report.
- Specify to whom the responsibility for implementing and monitoring treasury management activities is delegated.

In all respects the Council complies with the above and reviews these requirements in the annual Treasury Strategy and also in the Treasury Mid-Year Review reports.

In respect of Council Strategy for Treasury Management the principles will be as follows:-

The Council will:

- **Have regard to the prudential code, and set prudential indicators to ensure the Council's capital investment plans are affordable, prudent, and sustainable.**
- **Make decisions regarding borrowing and investment based upon the latest information, look to optimise returns on investment, and to minimise borrowing costs.**
- **Ensure the costs of borrowing are reflected in revenue forecasts.**
- **Comply with guidance relating to investments, ensuring that capital is kept secure, and liquidity is maintained at an appropriate level.**
- **Not engage purely in borrowing to invest or lend on to make a return, as this is unlawful.**
- **Agree a set of investment instruments which the Council can use based upon monitoring risk.**

The prudential indicators, targets and measures will be agreed as part of the budget setting process via the production of the annual Treasury Management Strategy.

2017/18 Capital Programme Estimates and Financing

Capital Budget 2016/17

The forecasted out-turn position for 2016/17 Capital programme is set out in the table below. It details the schemes that have been delivered against the Original Estimate for Capital Expenditure in 2016/17 approved in March 2016. The original budget was £5.421m and the forecasted Out-turn is expected to be £2.628m. The variation being caused by the re-phasing of a number of 2015/16 Capital Projects into the 2016/17 budget, the re-profiling of parts of the 2017/18 Capital Programme into future years and underspends on projects due to cost efficiencies being achieved in year. Strengthened budget setting and profiling procedures have been implemented to improve the robustness of the Capital Programme delivery profile following feedback received from the Council's Governance Committee.

Capital Programme 2017/18 to 2019/20

NEW CAPITAL INVESTMENT

The proposed Capital Programme to 2019/20 includes new investment into our assets in the sum of £0.330m to help safeguard a heritage asset in Worden Hall and to facilitate an increase in opportunities to generate income on a commercial basis within the Civic Centre's Banqueting Suite.

The original core Capital Programme for 2016/17 as approval last year has been updated. The costs of three schemes have increased and some schemes have been proactively re-phased in anticipation of additional workload being accommodated to deliver the Corporate Plan, the Corporate Improvement Plan, the MTFS and any actions approved post the forthcoming Peer Review. The following table provides a Summary of the Capital Programme 2017/18 to 2019/20 listed on **Appendix E**:

Capital Expenditure	2017/18 £m	2018/19 £m	2019/20 £m	Total £m
Original Capital Programme	4.091	2.053	2.379	8.523
New Investment Schemes	0.213	0.330	-	0.543
Earmarked Capital Projects	0.100	2.379	-	2.479
Total Capital Programme	**4.404**	**4.762**	**2.379**	**11.545**

The Capital Programme has been financed using the following monies, a breakdown is included in the tables below:-

- Capital Receipts the Council has collected including Developer's Section 106 Contributions. Affordable Housing Section 106 Contributions.
- Right to Buy Capital Receipt.
- Contributions from Earmarked Reserves such as Asset Management and City Deal investment.
- Revenue Contributions.
- Grants.
- Borrowing

This Capital Programme will be financed by the following as set out in more detail in **Appendix E** including **£3.323m** from Earmarked Reserves:

Capital Financing	2017/18 £m	2018/19 £m	2019/20 £m	Total £m
Grants	0.617	0.566	0.544	1.727
External Contributions – City Deal	0.075	-	-	0.075
Capital Receipts	0.500	0.707	0.220	1.427
Reserves	1.642	1.271	0.410	3.323
Revenue Contributions	0.024	-	-	0.024
Developer's Contributions Section 106	0.576	1.920	-	2.496
Borrowing	0.970	0.298	1.205	2.473
Total Capital Programme	**4.404**	**4.762**	**2.379**	**11.545**

Housing Capital Allocations

Our Housing service is the only area in which we currently receive annual capital expenditure funding support from the Government. From 2015/16 the government funding for Disabled Facilities Grants (DFGs), previously provided by DCLG, is now provided by the Department of Health (DH). This DH funding is included in the *Better Care Fund (BCF)* which aims to bring about integration of health and social care spending. Local housing authorities, social services, health and social housing providers have all been contributors to the adaptations provision. Under this new regime, local authorities still have to meet their legal obligations to provide DFGs but the funding is allocated by Lancashire County Council who have overall responsibility for the *Better Care Fund.* In 2016/17 the Council received Disabled Facilities Grant funding of £543,377 from the Department of Health (DH) via Lancashire County Council. The DFG expenditure forecasts assume that this level of capital funding will continue beyond 2016/17 and to 2019/20.

Prudential Code

Capital expenditure incurred by the Council is controlled and governed by guidance set out in the Prudential Code for Capital Finance in Local Authorities (the Code). The professional code of practice sets out a framework for self-regulation of capital spending, in effect, allowing councils to invest in capital projects without any limit as long as they are affordable, prudent and sustainable. The Code allows the council to determine the appropriate level of capital investment to properly deliver quality public services, subject to affordability. Members' involvement in the decision making and monitoring process is considered essential in order that the Council can demonstrate capital expenditure plans are affordable, external borrowing is prudent and sustainable and that treasury decisions are taken in accordance with good practice. The detail in this regard was approved at Cabinet on 20th February 2017 in relation to the Council's Treasury Management Strategy and is contained in **Appendix J**.

Other Key Points

Importantly the proposed Capital Programme is fully funded and the revenue implications have been incorporated within the Revenue Estimates summary at **Appendix A.** Finally, the practice of including a budget allowance for professional/technical fees within Capital Programme project estimates has continued. This ensures we have the capacity (people and skills) and money to deliver a realistic programme of works.

2017/18 Capital Programme Estimates and Financing

2017/18 Proposed Capital Programme Expenditure to 2019/20

Scheme Name	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Academy (Revs & Bens) print management service			9,500	-	-	-
Business Transformation - Customer Contact			30,000	30,000	-	-
Business Transformation - Mobile Working			-	-	22,000	-
Call Centre system upgrade			3,930	-	-	25,000
Capita Revenues & Benefits system			25,212	-	-	-
CAPS system replacement			8,773	-	-	-
Desktop replacement programme			-	-	-	185,000
Electronic Document & Records Management System (EDRMS)			-	22,000	-	-
Financial Management Information Systems (FMIS)			-	20,000	-	-
IT hardware replacement			25,666	40,000	40,000	40,000
Licencing system (LALPAC)			7,100	-	-	-
SAN server replacement			-	85,029	-	-
Sorce - intranet			5,000	-	-	-
Web Firmstep - cloud based			9,557	10,000	10,000	10,000
Corporate Support and Shared Services			**124,738**	**207,029**	**72,000**	**260,000**

Scheme Name	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Civic centre - Resurfacing of car park			-	-	-	50,000
Investment Property Heaton St - Roof refurbishment			-	-	20,000	-
Investment Property Middleforth - Asbestos removal and demolition			-	-	100,000	-
Investment Property Farm Yard cottages - New roofs			-	50,000	-	-
Investment Property Middleforth / Bison Place - Redevelopment of units			-	5,000	495,000	-
Investment Property Worden Craft Units - Infrastructure upgrade			-	55,000	-	-
Momentum business centre			587,807	-	-	-
Moss Side Depot - Fire suppression works			-	50,000	-	-
Bamber Bridge refurbishment of pavilion			128	-	-	-
Gregson Lane replacement pavilion			-	30,000	-	-
St Cuthbert's replacement pavilion			-	-	50,000	-
Wesley Street development			-	54,976	-	-
Management of Assets			**587,935**	**244,976**	**665,000**	**50,000**

Scheme Name	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Open Spaces			113,021	117,779	100,000	100,000
Farington Lodges improvements			-	-	100,000	-
Gregson Green - Drainage Scheme			58,287	50,608	-	-
Hurst Grange Park		Y	9,660	40,340	-	-
Hurst Grange Park development plan			-	50,000	-	-
Moss Side Sports Facilities - Car park extension		Y	7,500	102,500	-	-
St Mary's, Penwortham - Churchyard wall repairs			-	76,950	-	-
Vehicles and Plant replacement programme			261,687	970,000	298,000	1,205,000
Withy Grove Park		Y	-	250,000	-	-
Worden Park - Extension to overflow car park			109,356	-	-	-
Worden Park - Refurbishment of Vinehouse			40,000	58,000	-	-
Worden Park - Replacement conservatory / greenhouse			2,995	190,005	-	-
Worden Park - Toilet facilities improvements			-	225,000	-	-
Neighbourhoods and Streetscene			**602,506**	**2,131,182**	**498,000**	**1,305,000**

Scheme Name	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Feasibility & Surveys - Design and development	Y		18,000	20,000	20,000	20,000
St Catherine's Park - Memorial & peace garden, pathways, footbridge, seating, etc.	Y		72,637	-	-	-
Cuerden Park visitor centre		Y	3,500	-	-	-
Bamber Bridge - Regeneration	Y	Y	360,000	80,000	-	-
Leyland - Gateway features	Y		50,000	75,000	-	-
Leyland - Regeneration			-	285,000	-	-
Leyland - Town Team			5,488	-	-	-
Longton Village - Regeneration			26,286	7,000	-	-
Walmer Bridge Improvements		Y	20,000	73,500	-	-
Hutton overflow car park		Y	30,000	-	-	-
Leyland Fox Lane Sports & Social Club		Y	46,000	-	-	-
Lostock Hall Football Facility		Y	-	150,000	-	-
Malt Kin Fold - Contribution to extension of track		Y	12,800	-	-	
Walton-le-dale Community Centre car park refurbishment		Y	-	75,000	-	-
Regeneration, Leisure & Healthy Communities			**644,711**	**765,500**	**20,000**	**20,000**

Scheme Name	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Disabled Facilities Grants			439,929	544,000	544,000	544,000
Disabled Facilities Grants - additional funding			167,502	41,875		
Empty Properties			36,000	32,000	32,000	-
Private Sector home improvement grants			-	100,000	200,000	200,000
Strategic Planning and Housing			**643,431**	**717,875**	**776,000**	**744,000**
Performance Reward Grant (PRG)			24,250	24,500	22,203	-
South Ribble Partnership (PRG)			**24,250**	**24,500**	**22,203**	**-**
Capital Expenditure Total			**2,627,571**	**4,091,062**	**2,053,203**	**2,379,000**

The table below lists the changes made to existing scheme with regard to re-pricing.

Increases to Existing Capital Schemes	Increase 2016/17 £	Increase 2017/18 £	Increase 2018/19 £	Increase 2019/20 £
IT – EDRMS upgrade	-	10,707	-	-
Moss Side car park	-	60,000	-	-
Worden Park toilets	-	75,000	-	-
Total Increase	**0**	**145,707**	**0**	**0**

2017/18 Proposed Capital Programme Financing to 2019/20

Capital Financing	Revised 2016/17	Estimate 2017/18	Estimate 2018/19	Estimate 2019/20
Grants	645,967	617,375	566,203	544,000
External Contributions – City Deal	432,637	75,000	-	-
External Contributions – Other	69,623	-	-	-
Capital Receipts	49,488	491,976	252,000	220,000
Reserves	978,709	1,378,371	907,000	410,000
Revenue Contributions	11,750	-	-	-
Section 106	189,460	558,340	30,000	-
Borrowing	249,937	970,000	298,000	1,205,000
Capital Financing Total	**2,627,571**	**4,091,062**	**2,053,203**	**2,379,000**

The following Capital Schemes and Projects are already approved and within the Capital Programme, however, their delivery is wholly dependent on events happening outside of the control of the Council and therefore may be subject to non-manageable variation. For clarification the Capital Financing to fund their delivery has been identified as earmarked to reserve the commitment.

Earmarked Schemes

Scheme Name	City Deal	S106	Revised 2016/17	Estimate 2017/18	Estimate 2018/19	Estimate 2019/20
IT – Business continuity & disaster recovery			-	100,000	34,355	-
Affordable Housing		Y	-	-	1,345,000	-
Extra Care Housing Scheme		Y	-	-	1,000,000	-
Total Earmarked Schemes			**0**	**100,000**	**2,379,355**	**0**

Earmarked Capital Financing

Funding Source	Revised 2016/17	Estimate 2017/18	Estimate 2018/19	Estimate 2019/20
Reserves	-	100,000	34,355	-
Capital Receipts	-	-	455,000	-
Section 106	-	-	1,890,000	-
Total Earmarked Capital Financing	**0**	**100,000**	**2,379,355**	**0**

The table below lists the new Capital Projects for approval as per Recommendation 9 of this report.

Proposed New Investments	City Deal	S106	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Bamber Bridge railway station			-	5,000	-	-
Civic Centre – Banqueting suite and kitchen improvements			-	-	80,000	-
Civic Centre – CCTV			-	10,000	-	-
Civic Centre – Relocation of staff			-	20,000	-	-
Civic Centre – Swipe card security system			-	31,000	-	-
Civic Centre – Toilets refurbishment			-	50,000	-	-
Property Compulsory Purchase			3,000	8,000	-	-
IT – Committee Management system			-	20,000	-	-
IT – HR system upgrade (Selima)			-	20,000	-	-
Leyland Loop		Y	-	17,500	-	-
Lostock Hall Academy arts trail			-	7,000	-	-
McNamara Memorial			-	7,500	-	-
Polling Booths			-	5,460	-	-
Priory Park improvements			-	12,000	-	-
Worden Hall structural works			-	-	250,000	-
New Investment Total			**3,000**	**213,460**	**330,000**	**0**

Proposed Capital Financing	Revised 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Capital Receipts	3,000	8,000	-	-
Reserves	-	163,960	330,000	-
Revenue Contributions	-	24,000	-	-
Section 106	-	17,500	-	-
Capital Financing Total	**3,000**	**213,460**	**330,000**	**0**

General Reserve, Earmarked Reserves and Capital Reserves

Revenue Reserves

The financial implications resulting from this proposed budget on the General Reserve is detailed in the table below. A contribution from the General Reserve totalling £0.561m over the period of the MTFS is required to balance the base budget base on an assessment of the MTFS delivery profile. To support this timetable contributions from balances are planned in 2017/18 and 2018/19 in the sum of £0.300m and £0.261m respectively. It should be noted that any delay in delivering the MTFS profiled timetable will increase these planned contributions, however, any over-achievement of targets will reduce the level of contributions required.

KEY 2017/18 BUDGET MESSAGE – Reserves Strategy

The reserves strategy is to retain the General Reserve at a level that is no lower than £4.0m by the end of the three year period contained within the 2017/18 MTFS to 2019/20.

This aim will therefore be the first call on uncommitted in year budget variations and City Deal receipts over and above those needed to support approved borough schemes. This Reserves Strategy will be monitored on a monthly basis and reported to Governance Committee on a quarterly basis in the Budget Management Reports.

The requirement for financial reserves is acknowledged in statute. The Local Government Act 2003 requires billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating its budget requirement. These existing safeguards are further reinforced through the external auditor's audit and inspection processes, whereby the financial performance and standing of an authority is assessed and categorised. One aspect of the authority's financial standing that is assessed is the level of financial reserves.

As part of the budget setting process, the council is required to confirm the adequacy of reserves in the light of its final spending plans. The level of reserves held by the council, both general and those earmarked for specific purposes, is a decision for the council in the context of the financial risks facing it. There is no specific guidance on what constitutes a reasonable level of reserves as the circumstances facing each individual local authority will differ, however, some criticism was aimed at authorities that did not match their maximum potential exposure to a loss of an investment as allowed in their Treasury Strategy.

The adequacy of reserves is a review that is undertaken twice a year, firstly as part of budget setting and forecasting the financial pressure and risk and secondly as part of the year end account closure process when actual circumstances throughout the year, and possibly new risk, has emerged. Therefore the Council has considered its level of reserves in the light of the information within the Final Local Government Finance Settlement and the MTFS budget forecasted budget deficit to 2019/20.

It is important that any decision in this regard is taken in the context of the Medium Term Financial Strategy and is not based on just a single one year view. As referred to in this report, the financial challenges to Councils are increasing with the embedding of a very much transformed Local Government core grant funding structure whereby significant funding steams are increasingly uncertain and therefore financial risk. BRR operates within parameters are constantly fluctuating. RSG has been totally withdrawn and the Council is fully reliant on locally collected income streams to constitute its core funding.

The introduction of a Tariff Adjustment which in affect continues the annual reduction of RSG into a negative deduction from local taxation earned is very much an unknown quantum at this time, however, from the funding trends published since the Comprehensive Spending Review in 2010 it is expected to continue beyond the period of the MTFS.

Building on the funding ethos and the aim to deliver a balanced budget within this MTFS, the Council continues to set aside funds to be used to generate recurring income for the Council to support the base budget and reduce the budget deficit. Subsequently, a two stage approach is being taken to reshape the total reserves structure as apart of budget setting in February 2017 and as part of closing the account in June 2017. These reviews will set the Borough Investment Account total to facilitate income generation schemes and create a diverse and self-sustaining income portfolio that will enable the Council to further bridge the funding gap. This option minimises the impact on residents and the contribution that is required from reducing expenditure and increasing other income streams such as Council Tax.

G*eneral Reserve -* This reserve is needed to deal with unplanned/unforeseen expenditure or losses in income. The level of General Reserves is kept under review as the council continues to introduce improvements to its performance monitoring and risk management systems.

Earmarked Reserves - The council has established earmarked reserves to meet 'known or predicted liabilities' where the impact of the expenditure would otherwise cause a significant variation to the council's annual expenditure. During the period of the 2017/18 MTFS the total held in Earmarked Reserves reduces from £13.219m to £7.654m equating to a decrease of 42.1%. This overall reduction has been brought about by the following:-

- Expenditure on assets to convert the Borough Investment Account into recurring income streams as part of the objectives of the MTFS to achieve financial self-sufficiency.
- Strategic Review of Reserves aimed at decreasing the annual contribution into Earmarked Reserves as per the MTFS.
- Capital Financing of projects within the 2017/18 Capital Programme to 2019/20.
- Application of the Homeless Prevention Grant.

Funds have also been set aside from the income generated via the Business Rates Retention due to the extensive lack of clarity on the financial implications of significant changes over the period of this MTFS. As the BRR income makes up a higher proportion of overall income the impact of any future risk to its reduction becomes greater. This reserve is therefore shown as increasing over the period to 2019/20, however, the following should be noted:-

- The reserve contains the income currently anticipated from City Deal. The implication of the potential changes to BRR and actual changes introduced to NHB, mean that the City Deal financial framework is under assessment and therefore the estimated contributions from CD into the reserve may potentially reduce over this period at which point the Reserves Strategy will need to be reviewed.
- The recent national re-valuation exercise undertaken by the VOA (not the Council) has triggered the start of a new opportunity for business owners to appeal against the re-valuation anytime over the subsequent four year period.
- Due to the appeals process the rateable value of the tax base will only ever decline over time.
- Should only one of the largest business premises be removed from the ratings list then the impact on the base budget would be a reduction in income of circa. £0.550m. This presents a much larger financial risk when compared to variations to the Council Tax Base.

- The BRR is being reviewed by Central Government and the impact on any BRR growth achieved to date in respect of growth achieved, or how the retention value to the Council will be calculated. In addition the Baseline Funding assessment that is part of determining what income may be retained is due to be re-set by Central Government by no later than 2020/21.
- The BRR tax base is more volatile than Council Tax as the economic cycle means that invariably there is likely to a future period of recession. In addition the make up the tax base may change over time e.g. fewer higher value premises to high volume lower value properties all of which impacts of income and risk.
- With effect from 2016/17 the Base Budget includes additional income of circa. £1.400m to reflect growth in the tax base and the benefits of joining the Lancashire BRR Pooling Agreement. Therefore this is the financial risk the Council is exposed to, in addition to managing risk within a volatile tax base, should tax base growth be transferred to Central Government and also if the annually renewed Lancashire Pooling Agreement dissolves.
- Inflationary increases applied to BRR are critical but are determined outwith the Council.

The Table below highlights the projected levels of revenue reserves, based upon ***provisional forecasted*** budget figures within this report. in particular the MTFS delivery timetable.

Reserves	Projected Balances			
	31 March 2017 £000	31 March 2018 £000	31 March 2019 £000	31 March 2020 £000
General Reserve	**4,320**	**4,019**	**3,758**	**4,158**
Earmarked Reserves				
ICT Strategy	927	580	473	363
Elections	82	112	142	52
Asset Management	1,465	669	0	199
Public Open Space Commuted Sums	1,535	1,476	1,417	1,358
Vehicles, Plant & Equipment	0	0	0	0
Local Plans	80	80	80	80
Housing Needs Survey	85	60	50	70
Leisure Sites Repair & Maintenance	160	160	160	160
Performance Reward Grant	50	30	23	23
New Burdens Grant	153	153	78	78
Organisational Restructure Costs	385	385	385	385
Equalisation Reserve – BRR & City Deal	3,359	3,803	4,122	4,199
Borough Investment Account	3,824	0	0	0
Other	1,114	1,053	925	687
Sub Total Earmarked Reserves	**13,219**	**8,561**	**7,855**	**7,654**
Total Reserves	**17,539**	**12,580**	**11,613**	**11,812**

Capital Reserves

The following table provides a detailed forecast of the capital receipts reserves for the period up to 31st March 2020. Capital receipts are used to support the Council's Capital Programme and the figures below have been adjusted to take into consideration the proposed funding of the Capital Programme in **Appendix E.** The financing of the Capital Programme to 2019/20 reduce the Capital Reserve available from £2.037m to £0.609m in 2019/20 which is a reduction of 70% with the Preserved Right to Buy being fully allocated to support investment priorities identified.

Reserve	Projected Balance 31/03/17 £000	Projected Balance 31/03/18 £000	Projected Balance 31/03/19 £000	Projected Balance 31/03/20 £000
Capital Receipts Reserve	558	503	503	503
Earmarked Receipts	459	146	126	106
Preserved Right to Buy Receipts	1,020	888	201	nil
Total	**2,037**	**1,537**	**830**	**609**

Report of the Chief Finance Officer (s151)

BACKGROUND

Under the requirements of Section 25 of the Local Government Act 2003 the Statutory Finance Officer is required to advise members when setting the budget as to the robustness of the estimates and the adequacy of working balances.

THE ROBUSTNESS OF ESTIMATES

In terms of the budget proposals, once again in 2017/18 a thorough reassessment of the budgets has been undertaken by Directors and their accountants based upon the latest information available. In terms of the key assumptions contained particularly in the 2017/18 budget these are shown in the MTFS but are summarised for convenience below:

Key 2018/18 Budget and MTFS Assumptions

The table below shows the key assumptions made in forecasting forward the Council's financial position.

Assumption	2017/18	2018/19	2019/20
Council Tax Increases	0.0%	0.0%	0.0%
Revenue Support Grant (RSG)	£0.346m	-	-
Tariff Adjustment	-	-	£0.494m
BRR Baseline Funding Level	£2.191m	£2.262m	£2.342m
Total New Homes Bonus Receipts after City Deal contributions	£0.681m	£0.390m	£0.117m
Pension Fund - Future Service Contribution	14.9%	14.9%	14.9%
Pension Fund Deficit Recovery profile (cumulative)	£0.656m	£1.336m	£2.041m
Additional Business Rates through membership of Lancashire Pooling Arrangement	£0.787m	£0.787m	£0.787m
Lancashire Waste Partnership Income Expires as at 31/03/18	£0.907m	-	-
Pay Award	1.0%	1.0%	1.0%
Average Treasury Investment Returns	0.31%	0.31%	0.58%

In terms of the key assumptions I would make the following comments to confirm their validity:-

Council Tax Increases

The Administration's aim in their future strategy remains to contain future increases to within the referendum limits. In **Appendix A** the forecast budget position in future years does not take account of any potential council tax increases. The MTFS, however, models the impact of limited council tax increases. As the council tax is decided annually it will be for the council to determine if any actual increases are implemented. A prudent approach is therefore being taken to forward forecasting council tax yield. If housing growth continues at the current rate it is likely that council tax yield will be greater and an allowance has been made for this within the base budget forecasts and budget deficit to 2019/20. The MTFS also contains an estimate of additional Council Tax that will be generated over and over previous trends due to the acceleration of residential homes facilitated by City Deal. That said the increase in new homes provided within the borough is dependent on developers progressing sites.

Council Tax Freeze in 2017/18

The Administration is proposing to freeze council tax in 2017/18, but there is no council tax freeze grant available as some previous years. The Local Government Finance Settlement allocations are also now calculated with Central Government making the assumption, and making an allowance, that Council Tax will be increased within the referendum limit. Therefore not increasing Council tax impacts on two core income streams.

Reduction in Grant Settlement and Tariff Adjustment

Central Government is progressing its intention to completely remove Revenue Support Grant by the year 2019/20, at the same time replacing it with a remodelling business rate retention scheme. In fact South Ribble Council's RSG income has been completely removed one year earlier with effect from 2018/19. The risks with this for the Council is that we have the certainty of the Revenue Support Grant reductions but the uncertainty of the new business rate system, the details of which will not be embedded on a permanent basis for some years to come. For this reason the forward estimates for business rates income are a challenge but have been set at what is considered a realistic level at this time supported an equalisation account earmarked reserve and a level of working balances in the General Reserve which I recommend the Council should hold to mitigate against some of this risk. The Council will also start to pay a Tariff Adjustment (or so-called Negative RSG) with effect from 2019/20 in the sum of £0.494m. As there are few details available about how this 'payment' will be adjusted in future years, and there is no obvious bottom line level, this poses a significant risk until its parameters are communicated and fully understood.

New Homes Bonus

The Government in its finance settlement for 2017/18 included amendments to the way New Homes Bonus (NHB) is distributed with the intention of redistributing circa. £800m to Council's providing adult social care services. The key change being that that NHB earned is only received for a 4 year period instead of 6 years with a transitional years in 2017/18 when that years the grant will be received for 5 years. In addition the allocation in 2017/18 and onwards will be reduced using a 'deadweight adjustment.' This assumes that the Council should at least expand the housing base by 0.4% per annum with any growth below this level not applicable for grant award. This has had a significant effect on the resources available to the Council and is a third way in which the Council's core income can be reduced outwith its own control when added to the retraction of Revenue Support Grant and the introduction of the 'Tariff Adjustment' (or so called Negative RSG). As NHB is a key funding stream of City Deal the Resource Review will report on its impact and so the relevant adjustment can be made to the CD Finance Model.

Business Rates Retention - BRR

The budget report explains the volatile nature of this particular core income stream and why accurate forecasting of future receipts is problematic. The income levels contained within the budget are based upon a set of assumptions that may impact on the total amount collected in future years, in particular the outcomes within the appeals process. In respect of making a provision for this issue, I have modelled a flat rate assumption of 4.7% based on Central Government's multiplier adjustment and I also reviewed each past appeal claim since 2010 on this ratings list. This has enabled an estimated value of possible future successful appeals awarded by the Valuation Office Agency (VOA) to be taken into account.

Forecasting future losses in income due to appeals and deletions remains extremely difficult, however, especially in the light of the recent national ratings list revaluation by the VOA and the changes to be implemented to the Appeals process as past trends will not necessary be a true reflection on future submissions, decisions and outcomes; again all outwith the influence and control of the Council.

BRR is also a key income stream into City Deal and therefore any variations to the whole regime will need to be fed into the Resource Review for consideration with regard to revising and updating the CD Finance model. For these reasons I am not building any estimated growth into the base budget forecasts assumptions which I believe is a prudent approach. Instead a target has been added to the MTFS for a budget management working group to pro-actively pursue via a project management framework.

With regard to the additional income resulting from being a member of the new Lancashire BRR Pooling Agreement, budgeted income from 2017/18 is estimated based on the current level of receipts. Although there is a significant financial benefit to being a member of the pooling arrangements this presents a significant risk as identified in this report should the Pool, which has to be renewed each year, dissolve.

Pension Fund Contributions

Contributions to the pension fund are budgeted for and are calculated on actual contribution rates determined by the pension fund actuary. A review of these contributions has taken place and as such the assumptions regarding the contributions are accurate.

Pay Award

The estimates for 2017/18 are based upon the most recent announcement of actual pay award, so in that respect are robust. Future years are based upon the fact that pay restraint is likely to continue.

Treasury Investment Returns

The rates of return are based on forecast provided by the Council's treasury advisors with a margin for achieving a better performance consistent with that achieved in previous years through pro-active management of cash flow and cash balances.

MEDIUM TERM FINANCIAL STRATEGY

The MTFS sets out the Council's plans to bridge the funding gap as summarised below:

Total Summary Budget Efficiency Options to 2019/20

STRATEGY	2018/19 £m	2019/20 £m
INCREASING INCOME		
Subscription based Garden Waste Collection Service	0.450	0.540
Review of Car Parking Charges	0.110	0.110
Council Tax Increases	0.227	0.457
Growing the Borough's Council Tax Base	0.050	0.150
Investing in Income Generating Assets	0.300	0.300
Growing the Borough's Business Rates Tax Base	0.250	0.250
A Charging Policy for Replacement Bins	0.060	0.060
Entrepreneurial Income Generation Schemes	-	0.150
Sub-total Income	**1.447**	**2.017**
REDUCING COSTS		
Expansion of Shared Services including Review of Major Contract, One Public Estate Co-location and Collaboration	0.250	0.750
Business Transformation incl. Non-statutory Services and a Business Analysis Project of Non-staffing Costs	0.300	0.500
Strategic Review of Reserves	0.300	0.300
Retraction of Contribution to Police Community Support Officers	0.044	0.044
Sub-total Expenditure	**0.894**	**1.594**
ADJUSTMENTS TO RESERVES		
One-off Reduction of Contributions to Reserves	0.625	-
Contribution from General Reserve	0.261	-
Sub-total Adjustment to Reserves	**0.886**	**-**
Total Resources Available to Balance the Budget	**3.227**	**3.611**
Investment in the Corporate Improvement Plan and Capacity to Deliver the 2017/18 MTFS	(0.225)	(0.225)
Forecasted Budget Deficit (Appendix A)	**3.002**	**3.386**

Delivering the MTFS

The forecasted budget deficit in is circa £3.6m to 2019/20, the above targets seek to reduce net expenditure by this amount. Some of the above options are based on targets and it is essential that these are worked up into more detailed project plans in the first quarter of 2017/18 to further test and give assurance in respect of deliverability. The timetable of delivery will be challenging for the Council to achieve in additional to other very key projects within the Corporate Plan and the implementation of the Corporate Improvement Plan.

I note that the MTFS delivery timetable makes use of contributions from General Reserves, however the current profile does allow for a contribution back into the General Reserve to maintain the level above £4.0m.

The budget proposals within this report make a provision for investment into increasing capacity and additional skills into the work force, such as entrepreneurial and commercial skills which will also be key in the successful delivery of the MTFS budget efficiency financial plan. Actions within the authority to fill vacant statutory posts and also facilitate effective consultation and timely, effective and efficient decision making by the use of robust policies, project and performance management are also essential to maintain pace and keep the programme on track.

The strategy shows that broadly speaking the administration will attempt to bridge the gap by generating additional revenue of £2.0m and reducing costs by £1.6m. Based upon the analysis of risk I have undertaken that this is not unrealistic, however the timeframe is challenging and it will require the Council to focus in particular upon business reviews and an agile Investment Strategy. As above, increasing capacity in, and upskilling the workforce; robust project and performance monitoring; and timely, effective decision making will all play an essential role in achieving the MTFS.

OTHER RISKS

The most significant known future risk facing the Council is the announcement by the County Council that from 2018 it will stop paying recycling credits to the Council. This amounts to over £0.900m for this Council and represents a major significant risk to all collection authorities in Lancashire. This step change with regard to the Council's level of income is reflected in the significantly large increase in the forecasted budget deficit between 2017/18 and 2018/19.

LEVELS OF RESERVES

The budget for 2017/18 has been established on the basis of utilising working balances to fund expenditure, however this MTFS indicates that working balances should be no less than £4.0m by the end of the MTFS period to 2019/20. This level is based upon risk contained in the budget particularly around future levels of government funding, the Treasury Strategy and the challenging delivery profile of the budget efficiency options to balance the budget by 2019/20.

Published report indicate that it is likely that further reductions to funding will be made within the local government sector given that a number of commitments have been made to protecting other public services. For this reason I feel that it is important to reconsider the level of working balances required.

In my view the Council should look to have a level of working balances that at least cover:

a. The expected budget deficit moving forward, and
b. The risk of loss of deposits should future baking crisis occur.

The MTFS sets out that based upon current assumptions the Councils budget deficit could reach £3.6m by 2019/20 and the draft Treasury Strategy included a recommendation to increase deposit limits to £5.0m (as detailed in **Appendix J, page 11 Financial Institutions and Investment Criteria 2017/18 Treasury Strategy**). Therefore I believe that over time the Council should look to increase its levels of general reserve from no less than £4.0 to no less than £5.0m, which would cover the sum of a deposit or more than enough to clear the expected deficit and maintain some General Reserve should the Council not be in a position to make the adjustments required in its budget within this MTFS timeframe, although obviously it will be seeking to do this.

In relation to the Treasury Strategy, individual deposit levels are currently restricted to £4.0m, however, to enable better rates to be accessed a limit of £5.0m on particular deposits is proposed within the Treasury Report in **Appendix J**. One of the lessons for Councils who were affected by the Icelandic banking crisis was that they should at least have the minimum level of working balances to cover any potential loss of deposits should a banking crisis occur. For this reason I think it appropriate to increase the level of working balances.

By the end of 2016/17 the level of the General Reserve is expected to be £4.320m, however the planned delivery profile of the MTFS includes contributions to balance the budget in 2017/18 and 2018/19 totalling £0.561m and as reflected in **Appendix F**. Therefore the MTFS also includes an intension to make a contribution back into the General Reserve to bring the level back to over £4.0m by 2019/20 but this of course will be dependent on the Council's resource position and its success in achieving its fiscal targets.

Appendix H

REVENUE BUDGET – KEY BUDGET ASSUMPTIONS

	2017/18	2018/19	2019/20
Start- Up Funding Assessment			
Consists of:			
Revenue Support Grant	£0.346m	nil	nil
Baseline Funding level	£2.191m	£2.262m	£2.342m
Tariff Adjustment	nil	nil	(£0.494m)
Council Tax Increases	0%	0%	0%
New Homes Bonus Funding (NHB) after City Deal contributions	£0.681m	£0.390m	£0.117m
Nationally agreed employee pay award	1%	1%	1%
Employer's Pension Contribution Rates	14.9%	14.9%	14.9%
Employer's National Insurance Increase	Based on current rates	Based on current rates	Based on current rates

	2017/18	2018/19	2019/20
Investment returns (average)	0.31%	0.31%	0.58%
Key Income estimates	Proposed revision of car parking charges in 2016/17, no other significant changes	As at 2017/18 levels	As at 2017/18 levels
BRR Pooling Agreement – Anticipated Increased Retained Business Rates Income	£0.787m	£0.787m	£0.787m

Appendix I

City Deal 2017/18 Budget Implications Summary

City Deal Financial Model

The City Deal Finance model was developed and agreed with members and officers involved in the setting up of the City Deal arrangement. The model is based on income expected to be received from various income streams generated from developing residential and commercial sites with the matching expenditure being incurred delivering a program of relevant City Deal projects.

Income

When the City Deal model was formed it was anticipated that the contribution of income from South Ribble would come from the following sources:-

- Community Infrastructure Levy (CIL) receipts from residential and retail development (£17.471m)
- CIL Plus which is an assumption of additional revenue from development (£18.029m)
- New Homes Bonus (£25.409m)
- Business Rates (£4.350m)

The level of income from these sources is wholly dependent on the building of new homes and commercial floor space. The granting of planning permission and working with developers to enable sites to come forward is therefore key to the anticipated income being generated and received.

The target number of new homes in South Ribble on City Deal sites is 7,905. This includes an additional 1,000 properties not allocated to specific sites. The current forecast for new home building is in the region of 8,300 new properties. Therefore the volume of houses forecast should meet the City Deal targets, however this is dependent on developers actually bringing them forward.

In terms of commercial floor space the vast majority of income arising will be generated from the Cuerden Strategic site. A major Planning Application for the development of Cuerden was received at the end of January 2017.

Key Finance Model Assumptions

The original key assumptions on the level of income generated within the City Deal Finance Model are also impacted upon by the ongoing Central Government changes to CIL, New Homes Bonus and Business Rates Retention. These national policy changes impact directly on the City Deal Financial Model. The model therefore needs to be monitored and all changes identified and reported in a timely manner to enable solutions to be sought, agreed and implemented. The City Resource Review Group forecasts the impact of these changes and reports to the City Deal Executive. A report clarifying the impact of core income streams is scheduled to go to the April meeting of the City Deal Executive. Members will be updated on the report following this meeting.

By way of illustration, changes to the New Homes Bonus (NHB) scheme announced in the Provisional and Final Local Government Finance Settlements have resulted in the following reduction in payments which the Council pay over to the City Deal Fund, under the agreed City Deal Heads of Terms:

	New Homes Bonus Receipts – City Deal			
	2017/18 £000	2018/19 £000	2019/20 £000	2020/21 £000
NHB – Original assumption on previous NHB scheme	376	376	575	1,147
NHB – Revised assumptions on new NHB scheme	195	195	195	195
Reduction in funding	**181**	**181**	**380**	**952**

Expenditure

The **City Deal Infrastructure Delivery Plan** sets out the projects and programmes to be funded and the forecast resources. Some funding 'pots' are project specific with the rest being pooled.

The 'central' City Deal expenditure budgets are managed and monitored by LCC. The majority of the expenditure is procured by LCC. The current Resource Review is also looking at value for money on these projects in addition to the impact of changes to income stream receipts. There are two expenditure lines in the model where South Ribble can draw down funding to apply to borough projects subject to prior approval by the City Deal Executive. One of the key controls of City Deal is that approval to commence a delivery project within the borough, the written agreement confirming permission to reclaim costs must be in place. These 'central' budget costs can be reclaimed from the City Deal Budget Lines being as follows:-

- Community/Green Infrastructure (£6.448m)
- Public Transport Corridors & Local Centres - South Ribble (£12.125m)

Please note, however, that the Public Transport Corridors & Local Centres budget line is a total budget for both the Public Transport Corridors/highways works procured by LCC and the regeneration of the Local Centres undertaken by the Community Works team at South Ribble. In addition there is an expenditure line called 'Community Provision' in the model. The Council also receives £492,200 annually for a 10 year period to mitigate potential financial risks that could impact on the Council. There are no restrictions on how this is spent, however, it is not recommended that it is incorporated into the base budget as it is a temporary income allocation for the purpose of risk management. Therefore this funding is budgeted to be transferred into earmarked reserves.

The table below summarises the current position in relation to funding received by South Ribble which has been paid over to City Deal and amounts claimed from the City Deal Fund, giving a net cash flow of £579,441.

Net Payments and Receipts to/(from) City Deal

	Payments to City Deal Fund (£)				Receipts from City Deal Fund (£)		
Year	**Business rates**	**NHB**	**CIL**	**Total Payments**	**Community Provision**	**Project Expenditure Reimbursed**	**Total Receipts**
2014/15	42,431	0	0	**42,431**	(492,200)	0	**(492,200)**
2015/16	84,862	198,310	0	**283,172**	(492,200)	(299,372)	**(791,572)**
2016/17	0	770,327	241,724	**1,012,051**	(492,200)	(141,123)	**(633,323)**
Total	**127,293**	**968,637**	**241,724**	**1,337,654**	**(1,476,600)**	**(440,495)**	**(1,917,095)**
Net City Deal receipts to-date							**(579,441)**

A further claim for £0.224m has just been submitted for reimbursement which relates primarily to expenditure on the Bamber Bridge regeneration project.

Project Implementation

The finance received from new development together with other sources of funding is being used to provide key infrastructure projects and to fund community infrastructure. Within South Ribble the key infrastructure includes the following:-

- Penwortham By-pass
- Widening to dual carriageway standard and improvements to junctions along the A582 South Ribble Western Distributor and B5253
- Completion of the Cross Borough Link Road

Some of the works outlined above have been implemented, some are currently underway and others are planned within the next 5 years.

We have already completed or part completed several city deal projects some of the following examples give some idea as to how City Deal funding is assisting with delivery of regeneration projects in the borough:

- Recently works began in Bamber Bridge including the central garden & Iron Tree amongst the £3.35m scheme. These have been largely funded from City Deal PT/Corridor budgets.
- Worden Park entrance, connecting paths and roads have been paid for by City Deal Community Infrastructure funding - £0.155m
- Contributions to masterplans. As reported to cabinet, three masterplans for Penwortham, Leyland and Lostock Hall have been commissioned through City Deal. The value of these is £0.100m which will be paid from a central City Deal PT/Corridors budget. In addition, local works including landmark features and open spaces have been built and developed. For example, Leyland Tractor, footpaths links and signage.
- St. Catherine's Park was opened during last summer to commemorate the Queen's 90^{th} birthday. A large proportion of the cost of these works was reclaimed from City Deal Community Infrastructure budget.

The City Deal Agreement presents a significant investment within the Borough with many projects that are still developing. Substantial contributions from City Deal to fund the Capital Programme are available including the ongoing regeneration in Bamber Bridge, Central Parks development and masterplan, potential regeneration of the area around Leyland Station.

Some revenue funding is also received, for example, the development of a Leisure Strategy. In addition, South Ribble and Preston both hold City Deal budgets for Community Infrastructure. A City Deal working team is developing a strategy to ensure projects and scheme suggestions for this budget, to the value of approximately £7.0m for South Ribble, are in line with both local and City Deal aims and objectives, which will be included within future budgets as they are finalised and approved.

Key Risks to the Medium Term Financial Strategy

Risk Area Identified	Potential Impact of Risk	Mitigation
Efficiency Targets and MTFS	Failure to deliver efficiency targets and the MTFS leading to a funding shortfall.	• Ensure that targets are realistic and deliverable within the timescales envisaged. • Allocate ownership and develop an action plan(s) for delivering the efficiencies and monitor delivery. • Governance arrangement and project methodology to be adhered to. • Maintain an adequate level of General Reserve.
Business Rates Retention	Multi-year impact of Business Rates Retention scheme. Business Rates tax base falls. Planned changes and adjustments to the regime through to 2019/20.	• Planned tax base growth to be delivered via City Deal • Robust forecast modelling and scenario forward planning undertaken as part of budget process • Adequate level of reserves • Maintenance of Equalisation Account
BRR Pooling Agreement	Change to the Pooling Agreement arrangement made available by Central Government. The Lancashire Pooling Agreement is dissolved.	• Planned tax base growth to be delivered via City Deal • Extensive modelling and scenario forward planning undertaken as part of budget process • Adequate level of reserves • Maintenance of Equalisation Account
Pay Inflation	Budget provision insufficient to cover actual pay settlements for years 2017/18 and beyond	• Maintain an adequate level of General Reserve
Pension Increases	Budget provision insufficient to cover the costs of implementing the results of the next triennial review. Triennial re-valuation impacts on Deficit Recovery Plan and contributions.	• Maintain an adequate level of General Reserve • Ensure any decisions regarding early retirement/ill health retirement are in accordance with the Council’s policies.
Planning Fees Income	Significant income budget which is demand led and significant fluctuations could lead to a shortfall in funding.	• The income estimate has been rigorously challenged during the budget process. • Maintain an adequate level of General Reserve.
Land Charges – Search Fee Income	Significant income budget which is demand led and significant fluctuations could lead to a shortfall in funding	• The income estimate has been rigorously challenged during the budget process • Maintain an adequate level of General Reserve

Risk Area Identified	Potential Impact of Risk	Mitigation
Core Funding	Shortfall in actual grant funding compared with budget provision as per the provisional and final settlements to 2019/20. Volatility in retained business rate income as this will be determined by business expansion/ contraction in the area. Introduction of new Tariff Adjustment with no detail to its scale, profile and longevity	• Assumptions contained in MTFS. • Adequate level of General Reserve and Earmarked Reserve. • Deliver planned efficiencies within the MTFS.
New Homes Bonus (NHB)	Shortfall in actual grant funding compared with budget provision. Recent changes to NHB be extended in future years.	• A cautious approach has been taken in anticipating additional funding from this source beyond 2016/17. • The funding detail of City Deal is being reviewed by an external consultant.
Government Council Tax Capping	Government consider that budget decisions taken by the Council should be subject to capping. Increases over the cap would require a Council Tax referendum.	• Council considers Government guidance when setting its budget and council tax. • The Council Tax freeze being proposed for 2017/18 will not present any issues.
Interest Rates	Interest rate forecasts vary from the assumptions made in the financial forecasts resulting in a shortfall in investment interest and/or additional borrowing costs.	• Professional and specialist advice taken on interest rate forecasts • Cash flow modelled against anticipated financial forecasts and expenditure/income profiles • Treasury Management Strategy and Policies kept under review.
Financial Market Failure	Loss of investments and interest.	• Professional and specialist advice taken to support decisions. • Treasury Management Strategy and Policies kept under review.
Capital Programme	Funding shortfall due to overspending, unforeseen circumstances etc. Large variations from original budget to Capital Out-turn position.	• Capital Programme fully funded. • More detailed estimates/appraisal required before schemes are approved/ progressed. • Earmarked revenue and capital reserves maintained to at an adequate level. • Robust challenge to inclusion of Projects included in the Capital Programme and formal sign off procedure introduced.

All the above risks will also be mitigated by rigorous and regular monitoring of the Council's financial position throughout the course of the year so that appropriate corrective can be taken as appropriate. The Governance Committee has a key role to play in this respect.

REPORT TO	DATE OF MEETING
APPENDIX J **Council**	**1 March 2017**

Report template revised July 2012

SOUTH RIBBLE BOROUGH COUNCIL
forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Strategy 2017/18 to 2019/20	**Finance**	**M L Jackson**	**App J**

SUMMARY AND LINK TO CORPORATE PRIORITIES

To present for the consideration of Council the Prudential Indicators for the financial years to 2019/20; and the Treasury Management Strategy and Treasury Indicators, Investment Strategy, and Minimum Revenue Provision Policy Statement for 2017/18.

RECOMMENDATIONS

That Council is asked to approve:

5. The Prudential Indicators for 2017/18 to 2019/20 in **Appendix J2**.

6. The Treasury Management Strategy and Treasury Indicators for 2017/18 including Table 9 in **Appendix J2**.

7. The Annual Investment Strategy 2017/18 including Financial Institutions and Investment Criteria.

8. The Annual Minimum Revenue Provision (MRP) Policy Statement 2017/18.

DETAILS AND REASONING

The Local Government Act 2003 gave local authorities greater discretion over capital expenditure by allowing prudential borrowing. It also sought to strengthen governance by making compliance with the Chartered Institute of Public Finance and Accountancy (CIPFA)'s Prudential Code and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable; the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.

Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual MRP policy statement to be made to the full Council prior to the start of each year.

Finally local authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the Department for Communities and Local Government (DCLG), to prepare an annual Investment Strategy to identify how that discretion should be applied.

This report therefore brings together these related requirements. The Governance Committee's role is to scrutinise these policies and practices, while the Council is required to approve them.

TREASURY MANAGEMENT POLICY STATEMENT & TREASURY MANAGEMENT PRACTICES (TMPs)

The Treasury Management Policy Statement was updated and approved by Council on 2nd March 2016. This report has been prepared in accordance with the approved Policy.

The Council's Treasury Management Practices (TMPs) were also updated and approved by Council on 2nd March 2016. No changes to the TMPs are required at present.

PRUDENTIAL INDICATORS 2017/18 to 2019/20

Local authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties. To do this however increases a Council's indebtedness and ultimately leads to a charge to the revenue budget.

To manage that process, Councils must set certain Indicators. These are designed to indicate that the expenditure is prudent and affordable. The relevant indicators for South Ribble Borough Council are presented in **Appendix J2**.

Prudential Indicator 1 - Capital Expenditure

Table 1 in **Appendix J2** summarises the latest estimates of capital expenditure, and the methods of financing the capital programme for 2016/17 to 2019/20. It shows separately the cost of capital works at Leisure Centres, undertaken by Serco on behalf of South Ribble Community Leisure Trust. Since the assets are owned by the Council, this has to be accounted for as a form of finance lease.

Prudential Indicator 2 – Capital Financing Requirement (CFR)

The CFR is a measure of the Council's indebtedness resulting from its capital programme. It increases when the Council incurs unfinanced (borrowing) capital expenditure or finance lease liabilities. Its importance lies in the fact that it results in a charge to the revenue account, either from the lessor to discharge his debt, or an internal charge to make provision to finance the expenditure (the Minimum Revenue Provision - MRP).

It should be noted that this indebtedness does not result in the Council having an immediate need to take out additional borrowings. This is because the Council has various reserves, and the cash which supports those reserves can be used temporarily as internal borrowing instead of external borrowing.

The CFR is important therefore because it creates a charge to the Council's General Fund, which therefore has an impact on Council Tax. Table 2 in **Appendix J2** shows how the CFR is changing over the next few years.

Table 6 (Operational Boundary Prudential Indicator) presented in **Appendix J2** shows that no external borrowing to finance capital expenditure is currently planned in the period 2016/17 to 2019/20. The difference between the CFR and other long-term liabilities indicates the level of internal borrowing used to finance capital investment. The opportunity cost of using internal resources rather than external borrowing is the loss of interest that could have been earned had the cash been invested. However, the rate of interest payable on borrowing would be higher.

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator, presented as Table 3 in **Appendix J2**, shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxation including the net local share retained business rates), that is required to meet the costs associated with capital financing (interest and principal, net of interest received).

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

Table 4 in **Appendix J2** shows the cumulative effect on Council Tax levels of the changes between the capital programme reported in this strategy and the programme submitted a year ago. It has to be stressed that the complexity, and notional nature, of the calculations mean that the figures should only be treated as being indicative.

TREASURY MANAGEMENT STRATEGY 2017/18

BACKGROUND

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. It deals with "*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*" (CIPFA) .

Prudential Indicators 5 and 6

The Council has a statutory obligation to have regard to the CIPFA Code of Practice, and is required to adopt both the Code and the Treasury Management Policy Statement therein. The CIPFA Code of Practice was adopted by Council on 3 March 2010, as was the Treasury Management Policy Statement. The TM Policy Statement was then updated and approved by Council on 2 March 2016. Adoption of the CIPFA Code of Practice and the TM Policy Statement adoption is reflected in Financial Regulations (Treasury Management – investments, borrowings, and trust funds).

REPORTING

This strategy statement has been prepared in accordance with the current Code. A mid-year monitoring report and a final report on actual activity, after the year-end, will be submitted to the Council. Additional reports will be made to the Governance Committee during the year as required.

BORROWING AND INVESTMENT PROJECTIONS

The Council's borrowings and investment are inter-related. Table 5 in **Appendix J2** details the expected changes in borrowings and cash available for investment, consistent with the capital and revenue budgets. No borrowing is currently envisaged in the period under review, as cash balances are expected to remain at an adequate level. It is unlikely that investment interest rates will exceed interest rates on borrowing for the foreseeable future, so there would be a "cost of carry" should any external borrowing become necessary. The Council would be paying more interest on the borrowing than it would earn on the investment of the cash funds available over and above those needed in the bank account to cover day to day transactions.

Prudential Indicator 7 - Net Borrowing compared to CFR

The Prudential Code requires authorities to make comparison between net borrowing and the Capital Financing Requirement. At its greatest, net borrowing (**Appendix J2** - Table 5) should not exceed the current year's CFR plus the estimated increases in CFR for the following two years (see **Appendix J2** -Table 2). The figures reported in **Appendix J2** meet this requirement.

Prudential Indicator 8 - The Operational Boundary for External Debt

The Council is required to set two limits on its external debt (i.e. the amounts it owes to lessors and any amounts it borrows directly). The first is the Operational Boundary. This should reflect the most likely, but not worst case scenario consistent with the Council's budget proposals.

As shown in Table 5 in **Appendix J2**, whilst the CFR (Prudential Indicator 2) is being temporarily financed from internal cash balances/cash flow it is not expected that additional external borrowings will be required in the years covered by this strategy. The proposed Operational Boundary Prudential Indicator, presented a Table 6 in **Appendix J2**, therefore reflects the expected leasing liabilities.

<u>Prudential Indicator 9 - The Authorised Limit</u>

This is the second limit. It should allow headroom above the Operational Boundary to accommodate the fluctuations that can occur in cash flows. The proposed Authorised Limit Prudential Indicator is presented as Table 7 in **Appendix J2**.

ECONOMIC OUTLOOK AND EXPECTED MOVEMENT IN INTEREST RATES

The report of the Council's treasury advisors, Capital Asset Services, is attached at **Appendix J1**.

Capita indicate that investment returns are likely to remain relatively low during 2017/18, but will start to improve from 2019/20 onwards. Bank Rate is not expected to increase until the June quarter of 2019.

BORROWING STRATEGY

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt. This is possible because cash, supporting the Council's reserves, balances and cash flow, has been used as a temporary measure. This strategy is prudent as investment returns are low and the range of counterparties is narrow. External borrowing to finance capital expenditure would tend to increase cash balances further, but the likelihood is that the average rate of return would fall as a result of having to place cash with counterparties offering lower interest rates, including other local authorities and the Debt Management Office (DMO).

Table 5 in **Appendix J2** shows that cash balances should remain adequate throughout the period. On this basis no further long-term borrowing should be necessary, although there is the possibility of short-term borrowings being necessary to cover fluctuations in cash flow, particularly at the end of the financial year.

ICELANDIC INVESTMENT

<u>Heritable</u>

No further repayment in respect of the Heritable claim has been received to date during 2016/17. So far a total of £1.974m has been received, and the Council is aiming to recover the remaining £0.040m balance of the original claim submitted in 2008. Any further repayments by Heritable would benefit the council's revenue budget, as the balance of the investment has been impaired in full in the balance sheet, which means that no value has been attributed to it.

TREASURY MANAGEMENT LIMITS ON ACTIVITY

The Authority is required to set the following Treasury Indicators. The purpose of these is to minimise the risk resulting from movements in interest rates.

Treasury Indicator 1 – Upper limit on Variable rate exposure

The Council is exposed to interest rate movements on its invested cash. The amount varies significantly over the course of the year, and during each month, and is affected by changes to the timing of receipts and payments. At any one point, much of the balance will consist of cash collected (typically business rates and council tax) on behalf of other bodies – Government, County, Police, and Fire – which will be paid over shortly afterwards. During 2016/17 this indicator was increased from £42.0m to £45.0m, reflecting experience in the first half of the year. In early January, cash balances peaked at £44.1m, just under the upper limit. This is usually when the balance is at its highest, and it is not anticipated that it will be as close to the upper limit for the remainder of 2016/17.

It is proposed that the indicator be set to £46.0m for 2017/18, and be kept at the same level for the following three years, to be reviewed annually or mid-year if necessary.

Table 8 - Upper limit on variable rate exposure	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Upper limit -	45.0	46.0	46.0	46.0

Treasury Indicator 2 – Upper limit on fixed rate exposure

The Council is exposed to fixed rate interest on the finance lease liabilities. The maximum estimated exposure is based on the Operational Boundary (other long-term liabilities in Table 6 in **Appendix J2**). Treasury Indicator 2 is presented as Table 9 in **Appendix J2**.

Treasury Indicator 3 - Maturity structure of borrowing

The Council is required to determine upper and lower limits for the maturity structure of its borrowings. The Council will have no long-term external borrowings at 31/3/17, and none are currently envisaged over the period covered by this strategy. Therefore the upper and lower limits are shown in Table 10 following.

Table 10 - Maturity structure of borrowing	2017/18 Lower Limit	2017/18 Upper Limit
Under 12 months	0%	0%
12 months to 2 years	0%	0%
2 to 5 years	0%	0%
5 to 10 years	0%	0%
10 years and above	0%	0%

Use of the Council's cash balances instead of external debt is a form of temporary internal borrowing at a variable rate. The cost of the internal borrowing is effectively the rate of interest that could have been earned had the cash remained available for investment rather than being used to finance capital expenditure temporarily. The opportunity cost of internal borrowing will remain low while average interest rates achievable continue to be low.

<u>Treasury Indicator 4 – Total principal sums invested for greater than 364 days</u>

It is not planned to make any investments for banks or buildings societies periods over 364 days. Such investments would be "non-specified", as explained in the Investment Strategy below. However, because of the limited availability of suitable high credit quality banks and building societies as investment counterparties, **it is proposed that the maximum period for investments with UK local authorities should be increased to 2 years; that the limit per local authority should be no more than £5m; and that no more than £5m should be invested for greater than one year.** This proposal is reflected in the list of investment counterparties presented in the Investment Strategy below.

USE OF TREASURY ADVISORS

The Council recognises that responsibility for treasury decisions cannot be delegated to its treasury advisor, but remain its responsibility at all times.

PERFORMANCE INDICATORS

Investments – the generally accepted indicator is 7-day LIBID (The London Interbank Bid rate). This is the rate that could be obtained by the "passive" deposit of money onto the money market. Active investment, in normal times, should outperform this. Average 7-day LIBID plus 15% has been set as a performance indicator for Shared Financial Services. As indicated in the Treasury Management Activity report, actual investment returns have exceeded this target, and the approach to investment will continue to be use of high credit quality counterparties offering a better return than the Debt Management Office, where possible. Changes to the investment counterparty limits as recommended in the Investment Strategy will help the council to achieve its rate of return performance target.

INVESTMENT STRATEGY 2017/18

Introduction

Under the Power in Section (15) (1) of the Local Government Act 2003 the DCLG has issued Guidance on Local Government Investments. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity ahead of yield. This strategy follows the guidance.

The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.

The specific issues to be addressed in the Investment Strategy are as follows:-

- How "high" credit quality is to be determined.
- How credit ratings are to be monitored.
- To what extent risk assessment is based upon credit ratings, and what other sources of information on credit risk are used.
- The procedures for determining which non-specified investments might prudently be used
- Which categories of non-specified investments the Council may use.
- The upper limits for the amounts which may be held in each category of non-specified investment and the overall total.
- The procedures to determine the maximum periods for which funds may be committed.
- The process adopted for reviewing and addressing the needs of Council members and treasury management staff for training in investment management.
- The Authority's policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed, and (b) periods between borrowing and expenditure.

South Ribble Borough Council's Strategy for 2017/18

The draft Investment Strategy for 2017/18 was presented to Governance Committee for consideration on 1ST February 2017.

Objectives

The Council's investment priorities are:

- The security of capital and
- The liquidity of its investments.

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

The borrowing of monies purely to invest or on-lend and make a return is unlawful, and this Council will not engage in such activity. The Council will restrict borrowing in excess of its immediate need, to that envisaged to be required in the following eighteen months.

Use of Specified and Non-Specified Investments

Specified investments are those

- made with high "quality" institutions, the UK Government or a local authority,
- are for periods of less than one year; and
- are denominated in sterling.

Other investments are “non-specified”. These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

Council policy in recent years has been only to make specified investments. While this remains the proposal in respect of banks and building societies, members are asked to consider increasing the maximum period for investments with UK local authorities to two years, subject to a maximum of £5m being invested for over one year. Such investments would be technically “non-specified”, which in theory reflects a greater degree of risk associated with less liquid investments. However, despite the financial challenges which local authorities are facing at present and for the foreseeable future, there is no reason at present to regard the risk associated with a 2-year investment with local authorities as being unacceptable.

The use of Property Funds has been removed from the proposed list of Investment Counterparties. This option has not been pursued since its inclusion within the strategy as very few funds are relevant to the investment of our cash balances for treasury management purposes. In addition, this option has become less attractive since the EU “Brexit” referendum, as some property funds were frozen temporarily to prevent cash withdrawals, and there is no certainty this would not happen again.

Counterparty Selection Criteria

In determining which institutions are “High Quality” the Council uses the creditworthiness service provided by Capital Asset Services. This combines the credit ratings from all three rating agencies (Fitch, Moody’s, and Standard & Poor’s) in a sophisticated modelling process. It does not however rely solely on these ratings, but also uses

- Credit watches and credit outlooks from the agencies
- Credit Default Spreads (CDS) to give early warning of likely changes in ratings
- Sovereign ratings to select counterparties from only the most credit worthy countries

These factors are combined in a scoring system, and results in counterparties being colour coded:

- Yellow (UK Government & Local Authorities) – 5 years **
- Purple – recommended maximum duration 2 years
- Blue (used for nationalised and part nationalised UK Banks)– 1 year
- Orange – 1 year
- Red – 6 months
- Green – 3 months
- No colour – not to be used

** The proposed Investment Strategy restricts deposits with Local Authorities to two years, and with the Debt Management Office to 6 months (the maximum period currently offered by the DMO).

Monitoring of Credit Ratings

Capital Asset Services supply rating warnings and changes immediately following their issuance by the rating agencies. The colour coded counterparty lists are reissued weekly, updated by such changes. Members of the Shared Financial Services’ Financial Accountancy team are also registered with the three credit rating agencies so that ratings can be checked online independently of Capita. Capita’s credit rating documents are also available online on its Passport web site.

Capita’s advice in respect of specific types of investment counterparties is presented as **Appendix J1**. In addition, Capita have provided advice about the Markets in Financial Instruments Directive (MiFID). Implementation of the directive from early 2018 has the potential for restricting access to certain investment types, which could have an impact on investment earnings. The full implications of implementing the directive may not be known for some time. It is even possible that it could restrict the ability of local authorities to lend to each other, which would tend to mean that more councils would rely on the DMO as a “safe haven” for their cash, admittedly at a very low rate of interest.

Time and money Limits

The limits applying to each category of institution are specified in the table following – “Financial Institutions and Investment Criteria”. The changes proposed from the limits for 2016/17 are highlighted in bold. Specifically the proposed changes are as follows:

- UK Local Authorities – increase maximum period to 2 years, increase investment limit to £5m per authority, maximum of £5m can be invested for more than one year
- UK-incorporated Institutions (banks and building societies) – increase investment limit to £5m per group or independent institution
- Non-UK Banks (currently EU banks with UK offices accepting deposits in sterling) – increase investment limit to £4m per group or independent institution, and maximum invested in this category of institution to £8m
- Money Market Funds (MMFS - CNAV) – increase investment limit to £5m per fund

Non-UK banks would be considered only if they had a suggested investment duration of at least 6 months, and this had been consistent for a long period. Investments would be restricted to a limited selection of EU countries, but not all of the maximum of £8m would be invested in banks from the same country.

The council has used three “instant access” MMFs during 2016/17: BlackRock, Federated, and Standard Life. Deposits tend to be placed for short periods to help manage the council’s cash flow. The interest rates offered during 2016/17 have continued to decline, but they are still better than available from the DMO.

Member and Staff Training

We will be scheduling appropriate awareness training for councillors in 2017/18. Treasury management staff in the Shared Financial Services’ Financial Accountancy team will attend seminars provided by Capita Asset Services where appropriate.

Financial Institutions and Investment Criteria (2017/18 Treasury Strategy)

Investment Counterparties 2017/18

Category	Institutions	CAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts /Term Deposits / Certificates of Deposit (CDs)				
Government related/guaranteed	DMADF (DMO) UK Local Authority	Yellow Yellow	6 months **2 years**	Unlimited **£5m per LA**
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£5m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange Red Green	1 year 6 months 3 months	**£5m per group (or independent institution)**
Non-UK Banks	Non-UK banks of high credit quality	Orange Red Green	1 year 6 months 3 months	**£4m per group (or independent institution); £8m in total for this category**
Money Market Funds				
Money Market Funds (CNAV) **	MMFs of high credit quality - AAA rated		Instant access	**£5m per fund**
Enhanced Money Market Funds (VNAV)	EMMFs of high credit quality - AAA rated		T+2 or T+3	£3m per fund; £6m in total for this category
Property Funds				
Property Funds	Specific Funds to be selected based on CAS guidance & undertaking due diligence checks			**Delete** this category

Changes from the Investment Counterparties maximum periods and limits for 2016/17 are in **bold.**

** Funds used by the council in 2016/17 were BlackRock, Federated, and Standard Life.

ANNUAL STATEMENT OF MINIMUM REVENUE PROVISION (MRP) POLICY 2017/18

Regulations specify the minimum provision that a Council must make for the repayment of its debt. This is referred to as the Minimum Revenue Provision (MRP).

The Council will assess their MRP for 2017/18 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2017/18 relates to debt incurred prior to 2008/9. MRP will continue to be charged on this at the rate of 4%, in accordance with option 1 of the guidance. There are some capital schemes since then which generate a further MRP liability (i.e. capital expenditure which is not financed by any grant or contribution e.g. vehicles). The MRP liability on this will be based on the estimated useful life of the asset, using the equal annual instalment method of calculation (option 3 of the guidance).

Estimated life periods will be determined under by determined by the Council's Chief Financial Officer with reference to the guidance. As some types of capital expenditure are not capable of being related to an individual asset, the MRP will be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	The financial implications are covered in the report.
LEGAL	The strategy ensures compliance with various regulations and statutory codes of practice.
RISK	The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities.
THE IMPACT ON EQUALITY	There are no adverse implications for equality issues.
OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS

CIPFA Treasury Management in the Public Services: Code of Practice & Guidance Notes
CIPFA Prudential Code for Capital Finance in Local Authorities
CIPFA Standards of Professional Practice: Treasury Management
DCLG Guidance on Local Government Investments
DCLG Guidance on Minimum Revenue Provision

APPENDIX J1

The following is the advice of the Council's treasury management consultants Capita Asset Services

Investment Counterparties

We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy - reflected in a 0.25% Bank Rate. As a consequence, authorities are not getting much of a return from deposits. Against this backdrop it is, nevertheless, easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures. In this respect, we are seeing an increase in investment "opportunities" being offered to clients or being discussed in the wider press. What then, should you consider when these are offered?

Do not look at the return, look at the product.

We suggest that you "look under the bonnet" when considering pooled investment vehicles, although this applies to any investment opportunity. It is not enough that other councils are investing in a scheme or an investment opportunity: you are tasked through market rules to understand the "product" and appreciate the risks before investing. A quotation from the Financial Conduct Authority puts the environment in context.

The main risks in the industry for the coming year are firms designing products that: -
- aren't in the long-term interest of consumers
- don't respond to their needs
- encompass a lack of transparency on what's being sold
- lead to a poor understanding by consumers of risk
- shift toward more complex structured products that lack oversight.

Alternative investment instruments

The particular asset classes we have spoken on at our seminars include the following:
- Enhanced Money Market Funds
- Corporate Bonds - direct, passive and active external management
- Property Funds
- Equity Funds

There are varying degrees of risks associated with such asset classes and these need comprehensive appreciation. It is not just credit risk that needs to be understood, but liquidity and interest rate / market risk as well, although these can often be intertwined. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk. By carefully considering and understanding the nature of these risks, an informed decision can be taken.

Property funds

A number of our clients are actively considering, or have already commenced investing in property funds. Where not already undertaken, this may require an addition to your list of non-specified investments in your Annual Investment Strategy (AIS). You may wish to specify an appropriate monetary limit based upon an assessment of your reserves and balances going forward.

Each authority will also need to evaluate whether investing in a particular property fund will qualify as being capital expenditure or not. If deemed capital expenditure an application (spending) of capital resources would be required. Authorities should seek guidance on the status of any fund they may consider using. Appropriate due diligence should also be undertaken before investment of this type is undertaken.

Building societies

Only five building societies, at the time of writing, have the necessary ratings to render them suitable for consideration by clients who follow our suggested credit assessment methodology. This is a limited number, as the great majority of building societies do not have credit ratings, while a few do have ratings but they are not high enough ratings to qualify to get into one of our suggested colour bands. If clients wish to use building societies as part of their own strategy, then they need to consider what metrics they will use to determine suitability and how these will be monitored.

Challenger banks

The vast majority of local authorities do not include challenger banks in their counterparty lists. At present, they do not have credit ratings and so would fall outside of most investment strategy criteria. However, we expect that some of these entities may get ratings in coming years, so we will continue to keep this area under review.

Money Market Funds (MMFs)

Over the next few years, the EU will be working on developing proposals which may require these funds to move from Constant net asset value (CNAV) to Low Volatility net asset value (LVNAV). These reforms are still to be agreed and are unlikely to be ready for implementation in 2017/18. Whenever these changes occur, we will advise clients on the implications and how best these can be approached.

Money Market Fund Reform update January 2017

Following on from our Newsflash on the 16th November in respect of the announcement that an agreement on the EU Money Market Funds' Regulation has finally been struck by the European Parliament, Council and Commission, we have set out below the details of the proposed Regulation. While a legal review is still to occur, the detail of the Regulation has been set, which paves the way for final approval of the new rules during the first quarter of 2017.

The Regulation provides investors with an option for investing their short-term cash in two types of Money Market Funds ("MMFs"):

- Short-term MMFs - Funds that maintain the existing conservative investment restrictions currently provided under the European Securities and Market Authorities (ESMA) Short-Term Money Market Fund definition, including a maximum Weighted Average Maturity (WAM) of 60 days (inclusive of Floating Rate Note interest rate reset days) and maximum Weighted Average Life (WAL) of 120 days (inclusive of Floating Rate Note maturity dates);
- Standard MMFs – Funds that reflect the existing ESMA Money Market Fund definition – maximum WAM of 6 months and maximum WAL of one year.

In addition, three structural options:

- Public Debt Constant Net Asset Value ("CNAV") MMFs - must invest 99.5% of their assets into government debt instruments, reverse repos collateralised with government debt, cash, and are permitted to maintain a constant dealing NAV. This Fund is already in existence and there is no change proposed to the current structure;

- Low Volatility NAV (“LVNAV”) MMFs - permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the Fund does not deviate from the dealing NAV by more than 20 basis points (bps). This is a much more stringent approach, as currently on a CNAV Fund they have a 50bps buffer;
- Variable NAV (“VNAV”) MMFs – Funds which price their assets using market pricing and therefore offer a fluctuating dealing NAV. No change to the current approach.

Credit analysis/rating and stress testing:

The Regulation requires that MMF managers perform a rigorous internal credit quality assessment of money market instruments, as well as implementing a prudent stress testing regime. Moreover, such credit analysis is to be undertaken by individuals separate from the team responsible for the day-to-day management of the MMF portfolio.
There was a proposal to abolish MMFs from obtaining an external fund rating. This has not been approved and MMFs may continue to carry external fund ratings which must be disclosed in the prospectus and marketing materials

Liquidity fees and redemption gates:

Similar to existing rules and practices in Europe, liquidity gates and redemption fees are put in place to protect public debt CNAVs and LVNAVs in times of stress. Under the new rules, the application of a fee/gate would be optional if weekly liquidity falls below 30% and net redemptions from the fund exceed 10% in one day. However, if weekly liquidity falls below 10%, some form of action (either a gate or a fee) would be mandatory.

Portfolio diversification and transparency:

The new rules strengthen requirements for portfolio diversification and transparency for all MMFs, providing for weekly disclosure of portfolio information and formalised reporting to regulators.

Implementation period:

Following the final adoption of the Regulation, there will be an 18-month period of implementation for existing MMFs; as a result, the approved changes are not anticipated to have an immediate impact on MMFs. We expect the Regulation to become effective in the second half of 2018.

As previously suggested, this would mean that no changes to Investment Strategy documents will be needed for this financial year, and next year 2017/18 as well.

We will continue to monitor progress on the evolution of MMF reform and report back to clients on this. In the meantime, if you wish to discuss this, or a related matter in more detail, then please do not hesitate to get in contact with the Credit and Investment Team.

<u>Commentary on Investment Issues (mid-January 2017)</u>

There is a high degree of volatility in the global markets. The initial downside pressures resulting from the UK Brexit decision reverted back higher in more recent times over the potential inflation threat building in the UK economy. Interest rate expectations have been similarly affected, first pushing lower in anticipation of a near-term rate cut, to more recently, where there is no expectation of any change in either direction for some while to come. This volatility could remain in situ for some time to come, certainly until there is greater clarity surrounding the consequences for the economy of the vote, and the deal that can be negotiated around a withdrawal.

While the economic outlook for the UK and US improved through much of 2014, 2015 saw something of a slowing in activity, especially through the latter stages of the year. This weakening has also flowed through much of this year. While the domestic situation remains reasonably positive, especially in the US, underlying, and in some cases growing, international concerns are expected to see the respective central banks hold back from previously projected levels of policy tightening. In the US, after the recent FOMC policy minutes, the markets (futures contracts), are now pricing in a two-thirds chance of rate increase this December. The elephant in the room remains Trump. Markets are trying to fathom what his presidency will actually mean in terms of fiscal stimulus, and what impact this could have on monetary policy going forwards.

Closer to home markets have increasingly priced in no change in Bank Rate for the foreseeable future. However, less than a month ago, it was pricing in a near certainty of a rate cut before year end. Such volatility in expectations will persist.

For the Eurozone the future remains tepid at best, in spite of ECB policy action and a bounce in growth in the first quarter of the year. Growth pulled back in Q2, as expected and stayed relatively weak in Q3. Progress within the currency bloc will continue to be hampered by a number of fundamental issues, not least stubbornly high unemployment, in all bar one or two countries.

The actions/words, or inactions, of central bankers are likely to continue to be the key themes dominating market sentiment in the coming months. However, in light of the change in UK political/economic outlook there will be an increased level of political influence on the markets for some time, as the process of extracting the UK from the EU commences, and, in all probability, drags on. The Trump election success in the US adds to the weight that politics will have on market sentiment.

Central banks have undertaken enormous support programmes in recent years, in an effort to stabilise the world economy. However, can they be unwound without causing material market turbulence in the future – such as that seen in emerging markets in early 2014? While the US has already commenced minimising the levels of increased support, the full unwinding of policy support for major economies will take many years to accomplish. Equally, how easily can the UK reverse forty years of EU membership without any detrimental effect to itself or its former partners, and will this prove a test case / template that other EU members might watch with a view to similar action, with the risk of a break-up of the EU.

Counterparty quality remains the key factor when making investment decisions. Policy rates are not expected to tighten for some considerable time. As such, some of the longer dated deals on offer continue to present some potential advantage.

As with any investment, please check that these are both suitable for your own individual strategy, and allowable within the confines of your investment strategy.

Markets in Financial Instruments Directive (MiFID II)

The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients linked to ‘financial instruments’ (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. The new MiFID II environment is set to commence on 3rd January 2018, having been delayed by a year due to slower than anticipated progress in a number of key areas.

There is a key change affecting Local Authorities. Under the new regime, Local Authorities will be deemed “Retail” clients by default. They will have the option to “opt-up” to “Professional” client status, or remain as “Retail”. Treasury Solutions currently categorise their clients as “Per Se Professional” but this is being replaced by the “opt-up” procedure.

In order to opt-up, clients will need to meet qualitative and quantitative test criteria.

Qualitative Test Criteria

"Firms must undertake an adequate assessment of the expertise, experience and knowledge of the client to give reasonable assurance in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved (COBS 3.5.3R(1))"

The qualitative test criteria are provided as guidance and it will be down to each investment counterparty to set its particular criteria. Rather than a simple pro-forma that could be used to meet each individual request, there are likely to be differences in each approach from each individual financial institution and fund manager. The differences could simply depend on the nature of the potential investment a client may make with the entity, or there could be other factors that also play a role. Unfortunately, what is likely to be consistent is that each approach will require a lot of form filling!

Quantitative Test Criteria

- A re-calibrated quantitative test (based on COBS 3.5.3R(2)) – the criteria in paragraph (a) and the criteria in either paragraph (b) or (c) must be satisfied:
- the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds £15,000,000
- (b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters
- (c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged

While some elements of this part of the opt-up criteria will be relatively simple to meet, even here there are some elements that could be open to interpretation. For example, with the £15m portfolio – at what stage would this be calculated? Would this be a balance sheet date, which could prove an issue for some clients who normally wind down balances at year end? Other options could be quarter end positions over a period of time, which would show average balances that could allow some clients to better meet the stated requirement than a balance sheet position would.

Another consideration would be how to satisfy sections (b) / (c) when you might be considering a new asset class for investing. For example, if you were considering a Short Dated Bond Fund as a new type of investment, you would struggle to meet the requirements of (b), and may even have issues dealing with (c) as well, even if you have been working in a professional position for at least one year. It could be that undertaking a formal selection process would allow you to meet criteria, or by some other means. However, once again, without clear guidance as to how investment counterparties are going to produce their own assessment processes, it is difficult to say at this stage.

It is important to note that the option to opt-up is not a one off exercise. It will need to be undertaken with each and every counterparty / fund manager that a client may wish to transact. In some circumstances it may even be the case that a client may not wish to take up the option to opt up, preferring instead to maintain its "Retail" status. However, as highlighted in the consultation process, the decision to maintain "Retail" status may limit the investment options available, compared to "Professional" status. The decision may rest on what options are available under each status, and which is, therefore, most appropriate for each individual client. As such, there may be instances where a client is deemed "Professional" by some counterparties, but "Retail by others.

Capita Asset Services - Treasury Solutions are discussing these matters with investment counterparties including financial institutions and fund managers. These discussions have been on-going since MiFID II was first proposed and will continue through to its implementation and beyond.

We will help you where possible, and keep you updated as pertinent information materialises. In addition, our discussions with you will focus on the implications for retaining “Retail” status, in terms of the product set and any additional “protection” (this is not monetary, but the way that a client is treated) that may be provided.

We expect that as a retail customer or as a professional customer you will be able to access and place deposits as you do today but there remains a deal of uncertainty as to how the new regime will be implemented for investments and the implications it may have for you. However, we would stress that financial institutions and fund managers will not be looking to narrow their potential Local Authority customer base by making opt-up criteria (where appropriate) too complex or time consuming to complete.

Economic Background

UK. GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.6%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC), meeting of 4th August** was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The **MPC meeting of 3 November** left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, **consumers** have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in quarter 4 grew reasonably strongly, increasing by 1.2% and added 0.1% to GDP growth. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, by December it had fallen back to -7 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.6% in December. However, prices paid by factories for inputs are rising very strongly although producer output prices are still lagging well behind.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. **House prices** have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

USA. The American economy had a patchy 2015 with sharp swings in the quarterly **growth rate** leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.5% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the **presidential election** in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the **bond market and bond yields** rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in **investor sentiment** away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

EZ. In the Eurozone, **the ECB** commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of

€60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.
- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.
- **4 December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.

- **French presidential election;** first round 13 April; second round 7 May 2017.
- **French National Assembly election June 2017.**
- **German Federal election August – 22 October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of **free movement of people** within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Asia. Economic growth in **China** has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in **Japan** is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries. There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.

- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

CAPITA ASSET SERVICES' FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

We have pointed out consistently that the Fed. Rate is likely to go up more quickly and more strongly than Bank Rate in the UK. While there is normally a high degree of correlation between treasury and gilt yields, we would expect to see a growing decoupling between the two i.e. we would expect US yields to go up faster than UK yields. We will need to monitor this area closely and the resulting effect on PWLB rates.

The overall balance of risks to economic recovery in the UK remains to the downside, particularly with the current uncertainty over the final terms, and impact, of Brexit.

We would, as always, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are at present. We are experiencing exceptional levels of volatility which are highly correlated to geo-political and sovereign debt crisis developments. Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

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

- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Our target borrowing rates and the current PWLB (certainty) borrowing rates are set out below.

PWLB debt	Current borrowing rate as at 8.2.17	Target borrowing rate now (Q1 2017)	Target borrowing rate previous (Q1 2017)
5 year	1.38%	1.60%	1.60%
10 year	2.11%	2.30%	2.30%
25 year	2.78%	2.90%	2.90%
50 year	2.54%	2.70%	2.70%

Borrowing advice

Although yields have risen from their low points, yields are still at historic lows and borrowing should be considered if appropriate to your strategy. We still see value in the 40yr to 50yr range at present but that view would be negated if Bank Rate does not climb to at least 2.5% over the coming years. Accordingly, clients will need to review and assess their risk appetite in terms of any underlying borrowing requirement they may have, and also project forward their position in respect of cash backed resources.

Any new borrowing should also take into account the continuing cost of carry, the difference between investment earnings and borrowing rates, especially as our forecasts indicate that Bank Rate may not rise from 0.25% until June 2019 and then will only rise slowly.

Proposed new PWLB Local Infrastructure Rate

At the Autumn Statement 2016, the government announced that it would consult on lending local authorities up to £1 billion at a new Local Infrastructure Rate of gilts + 60 basis points to support infrastructure projects that are high value for money. Loans at the new rate would be available for a period of three years, with a maximum term of 50 years.

The government would like further input from stakeholders before proceeding with this policy and so clients may wish to respond to this consultation exercise. Clients may also wish to consider what the potential impact could be on their capital programmes and the financing of the same.

Our suggested budgeted investment earnings rates for investments up to about three months duration in each financial year for the next seven years are as follows:

Average earnings in each year	Now	Previously
2016/17	0.25%	0.25%
2017/18	0.25%	0.10%
2018/19	0.25%	0.25%
2019/20	0.50%	0.50%
2020/21	0.75%	0.75%
2021/22	1.00%	1.00%
2022/23	1.50%	1.25%
2023/24	1.75%	1.50%
Later years	2.75%	2.50%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged. Negative, (or positive), developments could significantly impact safe-haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

Comparison of Interest Rate Forecasts – Treasury Strategy 2016/17 (Feb 16), Treasury Activity Monitoring (Aug 16), and Treasury Strategy 2017/18 (Feb 17)

	Bank Rate %			PWLB Borrowing Rates % (including 0.20% certainty rate adjustment)											
				5 year			10 year			25 year			50 year		
	Feb 17	Aug 16	Feb 16	Feb 17	Aug 16	Feb 16	Feb 17	Aug 16	Feb 16	Feb 17	Aug 16	Feb 16	Feb 17	Aug 16	Feb 16
Mar-17	0.25	0.10	0.75	1.60	1.00	2.20	2.30	1.50	2.70	2.90	2.30	3.50	2.70	2.10	3.30
Jun-17	0.25	0.10	0.75	1.60	1.10	2.30	2.30	1.60	2.80	2.90	2.40	3.50	2.70	2.20	3.30
Sep-17	0.25	0.10	1.00	1.60	1.10	2.40	2.30	1.60	2.90	2.90	2.40	3.60	2.70	2.20	3.40
Dec-17	0.25	0.10	1.00	1.60	1.10	2.60	2.30	1.60	3.00	3.00	2.40	3.60	2.80	2.20	3.40
Mar-18	0.25	0.10	1.25	1.70	1.10	2.70	2.30	1.60	3.10	3.00	2.40	3.70	2.80	2.20	3.50
Jun-18	0.25	0.25	1.25	1.70	1.20	2.80	2.40	1.70	3.30	3.00	2.50	3.70	2.80	2.30	3.60
Sep-18	0.25	0.25	1.50	1.70	1.20	2.90	2.40	1.70	3.40	3.10	2.50	3.70	2.90	2.30	3.60
Dec-18	0.25	0.25	1.50	1.80	1.20	3.00	2.40	1.70	3.50	3.10	2.50	3.80	2.90	2.30	3.70
Mar-19	0.25	0.25	1.75	1.80	1.20	3.10	2.50	1.70	3.60	3.20	2.50	3.80	3.00	2.30	3.70
Jun-19	0.50	0.50		1.90	1.30		2.50	1.80		3.20	2.60		3.00	2.40	
Sep-19	0.50			1.90			2.60			3.30			3.10		
Dec-19	0.75			2.00			2.60			3.30			3.10		
Mar-20	0.75			2.00			2.70			3.40			3.20		

Capital Economics have estimated that borrowing rates will increase from the June quarter of 2017 onwards, and that the first increase in Bank Rate will be in the December quarter of 2018.

Prudential Indicators and Treasury Indicators 2017/18 to 2019/20

These tables were omitted from the report **Treasury Strategy 2017/18 to 2019/20**. All figures are derived from the proposed revenue budget and capital programme for 2017/18 to 2019/20. Proposed budgets had not been finalised at the time of writing the report.

Where appropriate, Prudential Indicators and Treasury Indicators for 2016/17 have been revised to reflect the forecast outturn for the revenue budget and capital programme.

Prudential Indicator 1 - Capital Expenditure

Table 1 summarises the latest estimates of capital expenditure, and the methods of financing the capital programme for 2016/17 to 2019/20. It shows separately the cost of capital works at Leisure Centres, undertaken by Serco on behalf of South Ribble Community Leisure Trust. Since the assets are owned by the Council, this has to be accounted for as a form of finance lease.

Table 1 – Capital Expenditure	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Capital expenditure under Leisure Contract – treated as a finance lease (affects the CFR see Prudential Indicator 2 below)	18	124	104	0
Capital expenditure incurred directly by the Council	2,630	4,404	4,762	2,379
Less Capital resources				
Capital receipts	(52)	(500)	(707)	(220)
Grants & contributions	(1,338)	(1,268)	(2,486)	(544)
Revenue and reserves	(990)	(1,666)	(1,271)	(410)
Unfinanced amount (affects the CFR see Prudential Indicator 2 below)	250	970	298	1,205

Prudential Indicator 2 – Capital Financing Requirement (CFR)

The CFR is a measure of the Council's indebtedness resulting from its capital programme. It increases when the Council incurs unfinanced (borrowing) capital expenditure or finance lease liabilities. Its importance lies in the fact that it results in a charge to the revenue account, either from the lessor to discharge his debt, or an internal charge to make provision to finance the expenditure (the Minimum Revenue Provision - MRP).

Table 2 – Capital Financing Requirement (CFR)	31/3/16 Actual £'000	31/3/17 Revised £'000	31/3/18 Estimate £'000	31/3/19 Estimate £'000	31/3/20 Estimate £'000
Actual or Estimated CFR	**5,902**	**5,146**	**5,222**	**4,555**	**5,357**
Reasons for the annual change in the CFR					
Additional finance lease liability		18	124	104	0
Unfinanced capital expenditure (as above)		250	970	298	1,205
Repayment of finance lease		(246)	(246)	(246)	(246)
Annual revenue charge (MRP)		(778)	(772)	(823)	(824)

Table 6 (Operational Boundary Prudential Indicator) presented below shows that no external borrowing to finance capital expenditure is currently planned in the period 2016/17 to 2019/20. The difference between the CFR and other long-term liabilities indicates the level of internal borrowing used to finance capital investment. The opportunity cost of using internal resources rather than external borrowing is the loss of interest that could have been earned had the cash been invested. However, the rate of interest payable on borrowing would be higher.

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator, presented as Table 3, shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxation including the net local share of retained business rates), that is required to meet the costs associated with capital financing (interest and principal, net of interest receivable).

Table 3 – Ratio of financing costs to net revenue stream	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
Ratio	**7.47**	**8.36**	**9.91**	**10.18**

The ratio is increasing largely as a result of the reduction in government grant funding within the net revenue stream total. However, currently there is uncertainty about the impact of 100% retention of business rates by local authorities, which is due to be implemented before the end of the current parliament. Any increase in the value of business rates retained by the council would help to offset the reduction in government funding, and therefore would tend to reduce this ratio.

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

Table 4 shows the cumulative effect on Council Tax levels of the changes between the capital programme reported in this strategy and the programme submitted a year ago. It has to be stressed that the complexity, and notional nature, of the calculations mean that the figures should only be treated as being indicative.

Table 4 – Impact of capital investment decisions on Band D Council Tax	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £
Increase/(decrease) in Band D charge	**2.41**	**(1.81)**	**2.52**	**6.69**

Borrowing and Investment Projections

The Council's borrowings and investment are inter-related. Table 5 details the expected changes in borrowings and cash available for investment, consistent with the capital and revenue budgets. No borrowing is currently envisaged in the period under review, as cash balances are expected to remain at an adequate level. It is unlikely that investment interest rates will exceed interest rates on borrowing for the foreseeable future, so there would be a "cost of carry" should any external borrowing become necessary. The Council would be paying more interest on the borrowing than it would earn on the investment of the cash funds available over and above those needed in the bank account to cover day to day transactions.

Table 5 – Borrowing and Investments	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Borrowing	0	0	0	0
Less surplus cash available for investment	(31,000)	(25,000)	(20,000)	(17,500)
Net borrowing	**(31,000)**	**(25,000)**	**(20,000)**	**(17,500)**

Prudential Indicator 8 - The Operational Boundary for External Debt

The Council is required to set two limits on its external debt (i.e. the amounts it owes to lessors and any amounts it borrows directly). The first is the Operational Boundary. This should reflect the most likely, but not worst case scenario consistent with the Council's budget proposals.

As shown in Table 5, whilst the CFR (Prudential Indicator 2) is being temporarily financed from internal cash balances/cash flow it is not expected that additional external borrowings will be required in the years covered by this strategy. The proposed Operational Boundary Prudential Indicator, presented as Table 6, therefore reflects the expected leasing liabilities.

Table 6 – Operational Boundary	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Borrowings	0	0	0	0
Other long-term liabilities	735	543	331	15
Operational boundary	**735**	**543**	**331**	**15**

Prudential Indicator 9 - The Authorised Limit

This is the second limit. It should allow headroom above the Operational Boundary to accommodate the fluctuations that can occur in cash flows. The proposed Authorised Limit Prudential Indicator is presented as Table 7.

Table 7 - Authorised Limit	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Borrowings	3,000	3,000	3,000	3,000
Other long-term liabilities	735	543	331	15
Authorised limit	**3,735**	**3,543**	**3,331**	**3,015**

Treasury Indicator 2 – Upper limit on fixed rate exposure

The Council is exposed to fixed rate interest on the finance lease liabilities. The maximum estimated exposure is based on the Operational Boundary (other long-term liabilities in Table 6). Treasury Indicator 2 is presented as Table 9.

Table 9 - Upper limit on fixed rate exposure	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Upper limit -	**0.74**	**0.54**	**0.33**	**0.02**

Treasury Indicator 4 – Total principal sums invested for greater than 364 days

It is not planned to make any investments for banks or buildings societies periods over 364 days. Such investments would be “non-specified”, as explained in the Investment Strategy. However, because of the limited availability of suitable high credit quality banks and building societies as investment counterparties, **it is proposed that the maximum period for investments with UK local authorities should be increased to 2 years; that the limit per local authority should be no more than £5m; and that no more than £5m should be invested for greater than one year.**

Table 11 - Total principal sums invested for greater than 364 days	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
UK Government	0	0	0	0
UK Local Authorities	0	5	5	5
UK Banks & Building Societies	0	0	0	0
Non-UK Banks	0	0	0	0
Money Market Funds	0	0	0	0
Total	**0**	**5**	**5**	**5**