APPENDIX E

PRUDENTIAL INDICATOR STATEMENT 2015/2016

AFFORDABILITY

1. The actual capital expenditure that was incurred in 2013/2014 and the estimates of capital expenditure to be incurred for the current and future years are:

	2013/2014 £000 Actual	2014/2015 £000 Estimate	2015/2016 £000 Estimate	2016/2017 £000 Estimate	2017/2018 £000 Estimate
Total Capital Expenditure	32,433	76,743	49,286	22,391	5,303

2. Estimates of capital expenditure estimates are updated twice yearly.

3. Estimates of the ratio of financing costs to net revenue stream (estimate of Council net budget) for the current and future years, and the actual figures for 2013/2014 are in the table below. The percentage of the budget for financing capital increases as the Councils net budget deceases.

Ratio of Financing Costs to Net Revenue Expenditure

	2013/2014 Actual	2014/2015 Estimate	2015/2016 Estimate	2016/2017 Estimate	2017/2018 Estimate
Capital Financing Estimate £000's	10,644	10,215	9,900	9,750	9,750
Estimated Council net Budget £000's	130,600	119,566	110,628	104,944	99,951
Ratio of Financing Costs	8.2%	8.5%	8.9%	9.3%	9.8%

4. The estimates of financing costs include current commitments and the proposals consistent with the capital programme.

5. It is important to consider the ratio of financing costs to our overall net budget. The Councils current capital programme is based on an additional revenue cost of £400,000 per annum over the medium term. As our net expenditure decreases, in line with reductions in government resources, the proportion of our capital financing costs form a greater proportion of our overall expenditure. At this point it is considered that our Capital financing is affordable. Should Capital financing costs exceed 10% or should the Council not achieve agreed budget reductions then the position and recommendations will need to be reconsidered.

6. Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual requirement at 31 March 2014 are:

Capital Financing Requirement

31/03/14 £000 Actual	31/03/15 £000 Estimate	31/03/16 £000 Estimate	31/03/17 £000 Estimate	31/03/18 £000 Estimate
140,787	162,004	165,830	165,967	161,013

7. The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, Middlesbrough Council does not associate borrowing with particular items or types of expenditure. The authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

8. Middlesbrough Council has, at any point in time, a number of cash flows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.

9. CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as a key indicator of prudence:

> "In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

10. The authority had no difficulty meeting this requirement in 2013/2014 nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report.

Net Borrowing

31/03/14 £000 Actual	31/03/15 £000 Estimate	31/03/16 £000 Estimate	31/03/17 £000 Estimate	31/03/18 £000 Estimate
60,321	81,538	85,364	85,501	80,547

11. In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt net of investments for the next three financial years. These limits separately identify borrowing from other long term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the Chief Finance Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Council.

Authorised Limit for External Debt

	2014/2015 £000	2015/2016 £000	2016/2017 £000	2017/2018 £000
Borrowing	189,000	207,700	212,000	211,200
Other long term liabilities	2,500	2,500	2,500	2,500
Total	191,500	210,200	214,500	213,700

12. The Chief Finance Officer, and those officers with delegated responsibility under the agreed Treasury Management Practices, can arrange new long-term loans up to the following limits:

Required Financing

	2014/2015 £000 Estimate	2015/2016 £000 Estimate	2016/2017 £000 Estimate	2017/2018 £000 Estimate
Long-term Borrowing	20,000	30,000	15,000	10,000
Restructuring	10,000	30,000	20,000	20,000
Total	30,000	60,000	35,000	30,000

13. These limits are consistent with the authority's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Chief Finance Officer confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

14. The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the Chief Finance Officers' estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for

example for unusual cash movements, and equates to the maximum of external debt projected by this estimate.

15. The operational boundary represents a key management tool for in year monitoring by the Chief Finance Officer. Within the operational boundary, figures for borrowing and other long term liabilities are separately identified. The Council is also asked to delegate authority to the Chief Finance Officer, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to the Council at its next meeting following the change.

Operational Boundary for External Debt

	2014/2015 £000	2015/2016 £000	2016/2017 £000	2017/2018 £000
Borrowing	160,000	184,000	187,400	185,700
Other long term liabilities	2,500	2,500	2,500	2,500
Total	162,500	186,500	189,900	188,200

16. The Council's actual external debt at 31 March 2014 was £86.5 million, comprising only long term, there was no short term borrowing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time.

17. In taking its decisions on this budget report, the Council is asked to note that the authorised limit determined for 2015/2016 (see paragraph 10 above) will be the statutory limit determined under clause 3(1) of the Local Government Finance Act 2003.

Council Tax Incremental Effects

18. In terms of the incremental effect on Band D council tax of capital expenditure decisions are:

2015/2016	2016/2017	2017/2018
£17.19	£17.19	£17.19

19. These forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the totality of the capital and revenue plans recommended in the budget report. There are no known significant variations beyond this timeframe that would result from past events and decisions or the proposals in this budget report.

PRUDENCE

20. Middlesbrough Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

21. It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2015/2016, 2016/2017 and 2017/2018 of 100% of its estimated gross outstanding principal sums.

22. It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2015/2016, 2016/2017 and 2017/2018 of 40% of its estimated gross outstanding principal sums.

23. This means that the Chief Finance Officer will manage fixed interest rate exposures within the range 60% to 100% and variable interest rate exposures within the range 0% to 40%. This is a continuation of current practice.

24. It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	**Lower limit**
under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	20%

25. Currently investments are limited to a maximum of 5 years, with the deals being arranged so that the maturity will be no more than 5 years and one month after the date the deal is arranged.

26. The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

ANNUAL INVESTMENT STRATEGY & TREASURY MANAGEMENT POLICY STATEMENT 2015/2016

27. In accordance with revised guidance from the Department for Communities and Local Government (DCLG) a local authority must prepare and publish an Annual Investment Strategy which must be approved by full Council before the start of the financial year to which it relates.

28. The DCLG guidance offers authorities greater freedom in the way in which it invests monies, providing that prior approval is received from Members by approving the Annual Investment Strategy.

29. The Local Government Act 2003, which also introduced the Prudential Code, requires that a local authority must have regard to such guidance as the Secretary of State issues relating to prudent investment practice.

30. In addition the Chartered Institute of Public Finance & Accountancy (CIPFA) has published a revised Code of Practice for Treasury Management in the Public Services. This replaces the 2002 Code which had been adopted in full by Middlesbrough Council. The revised Code requires the Council to clearly state, in the Annual Investment Strategy document, its policy on effective control, and monitoring of its treasury management function. These controls are set out in Treasury Management Practices (TMP's) which have been approved as part of acceptance of the 2002 Code.

31. The revised Strategy, showing where the Guidance has determined Council policy, can be set out:

ANNUAL INVESTMENT STRATEGY 2015/2016

32. Middlesbrough Council will create and maintain as the cornerstones for effective treasury management:

    - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;

    - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

33. The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

34. Middlesbrough Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, a mid-year review which will include an annual report on the previous year,

in the form prescribed in its TMP's. Revised Strategies could be presented to the Council for approval at other time during the year if the Chief Finance Officer felt that significant changes to the risk assessment of significant parts of the authority's investments had occurred.

35. Middlesbrough Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Chief Finance Officer, and for the execution and administration of treasury management decisions to the Head of Investments & Treasury Management, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management.*

36. Middlesbrough Council nominates the Executive to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

37. The Council has, for some time, been very circumspect in its use of credit rating agencies. The section on Specified Investments sets out the current policy. Ratings are monitored on a monthly basis, or more frequently if information is received from the treasury management consultant or other recognised source. Decisions regarding inclusion on the Approved List are made on the basis of market intelligence drawn from a number of sources.

38. All staff involved in treasury management, will, under the supervision of the Head of Investments & Treasury Management, act in accordance with the treasury management practices and procedures, as defined by the Council. Such staff will undertake relevant training, identified during the Council's induction process and, on an on-going basis, the Council's appraisal policy.

39. The general policy objective contained in the guidance is that local authorities should invest prudently the short-term cash surpluses held on behalf of their communities. The guidance emphasises that priority should be given to security and liquidity rather than yield. Within that framework the authority must determine a category of borrowers, who must be of "high credit quality" classified as **Specified Investments**, with whom it can invest surplus cash with minimal procedural formalities and further identify a category of borrowers classified as **Non-Specified Investments**, with whom it can also invest but subject to prescribed limits.

40. Although the guidance definition of Non-Specified Investments is "one not meeting the definition of a Specified Investment", the authority is required to identify which categories of investments are identified as prudent to use and the limits on any such investment either individually or in total. It is because some organisations do not subscribe to credit rating agencies that they have to be included as Non-Specified Investments, rather than any concern over their creditworthiness.

41. The guidance defines investment in such a way as to exclude pension fund and trust fund investments. In practice Middlesbrough Council, in its role as Administering Authority for the Teesside Pension Fund, follows the same procedures as approved by Members as part of compliance with the CIPFA Code of Practice, albeit with different limits.

LIMITS & DEFINITION OF SPECIFIED INVESTMENTS

42. The following are currently determined as meeting the criteria for Specified Investments:

43. The investment is made with the UK Government, or a local authority (as defined in the Local Government Act 2003), or a police authority, or fire, or a UK Nationalised Industry, or UK Bank, or UK Building Society.

44. The investment is made with a Money Market Fund which, at the time the investment is made, has a rating of AAA.

45. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document. which, at the time the investment is made, has a short-term "investment grade" rating with either Standard & Poors, Moody's Investors Search Ltd or Fitch Ratings Ltd (or in the case of a subsidiary the parent has such a rating). Where ratings awarded differ between the rating agencies any one award below investment grade will prevent the investment being categorised as a Specified Investment. The rating of all listed bodies must be monitored on a monthly basis. Where officers become aware of a downward revision of rating, that moves the body out of the "investment grade" category, between such monthly checks, the body should be removed from the list of Specified Investments and, if considered appropriate, the investment should be recalled.

46. All Specified Investments must be denominated in sterling and must be one where the authority may require it to be repaid or redeemed within 12 months of the date on which the investment is made and must be considered of high credit quality. This is defined as having met the criteria set out above. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The minimum % of the total of all investments which must be Specified Investments, at the time the investment is made, is 70%
- The maximum investment with any one counterparty is £15 million, except for the Debt Management Office which is limitless.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.

LIMITS & DEFINITION OF NON-SPECIFIED INVESTMENTS

47. These categories of investment currently meet the criteria for Non-Specified investments:

48. The investment is made with a UK bank, or UK building society, or a UK subsidiary of an overseas bank.

49. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document, which is not a Specified Investment.

50. The investment is for a period of one year or longer.

51. All Non-Specified Investments must be denominated in sterling. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum % of the total of all investments which can be Non-Specified Investments, at the time the investment is made, is 30%
- The maximum investment with any one counterparty is £15 million
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.
- The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

52. The maximum period for which an investment can be made is five years, with the maturity date no more than 5 years and 1 month from the time the deal is agreed.

53. As referred to in paragraph 8 of the Prudential Indicators Statement borrowing should be kept at, or below, the expected capital financing requirement over the medium term to reduce the risk of exposure to interest rate fluctuations. The balance of 'net borrowing' (loans less investments) should also be monitored to, where prudent, minimise interest rate differences.

54. The Council considers that it is empowered by Section 12 of the Local Government Act 2003 for the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future. While not "borrowing to invest" it is prudent to invest monies raised in advance of expenditure. As required by the Guidance such investment is permitted providing the anticipated expenditure is within this or the next financial year or within a period of eighteen months, whichever is the greater.

TREASURY MANAGEMENT POLICY STATEMENT

55. This organisation defines its treasury management activities as:
The management of the organisation'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.

56. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage those risks.

57. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

MINIMUM REVENUE PROVISION POLICY 2015/2016

INTRODUCTION

58. Local authorities are required each year to set aside some of their revenues as provision for debt repayment. There is a simple duty for an authority each year to make an amount of revenue provision which it considers to be “prudent”. (Minimum Revenue Provision) MRP Guidance makes recommendations to authorities on the interpretation of that term.

59. Authorities are legally obliged to “have regard” to any such guidance – which is exactly the same duty as applies to other statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG Guidance on Investments.

60. Authorities are asked to prepare an annual statement of their policy on making MRP.

MEANING OF “PRUDENT PROVISION”

61. The main part to the guidance is concerned with the interpretation of the term “prudent provision”. The guidance proposes a number of options. It explains that provision for repayment of the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

62. For debt which is supported by (Revenue Support Grant) RSG, authorities will be able to continue to use the formulae in regulations, since the RSG is calculated on that basis.

Option 2: CFR Method

63. This is a technically simpler alternative to Option 1 and may also be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement (CFR), which is easily derived from the balance sheet, it avoids the complexities of the formulae in the regulations.

Option 3: Asset Life Method

64. For new borrowing under the Prudential system for which no Government support is being given, there will be two options. Option 3 is to make provision in **equal annual instalments** over the estimated life of the asset for which the borrowing is

undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach.

65. The formula allows an authority to make **voluntary extra provision** in any year.

66. In the case of the construction of a new building or infrastructure, MRP would not have to be charged until the new asset came into service. This “**MRP holiday**” would be perhaps 2 or 3 years in the case of major projects and could make them more affordable. There would be a similar effect in the case of Option 4 under normal depreciation rules.

Option 4: Depreciation Method

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

68. Authorities will normally need to follow the standard procedures for calculating deprecation provision with some exceptions.

2015/2016 MINIMUM REVENUE PROVISION STATEMENT FOR MIDDLESBROUGH

69. The Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council. The statement should indicate which of the options listed above are to be followed in the financial year.

70. For supported capital expenditure Middlesbrough intends to use option 2, the CFR Method. This is the simpler of the two options.

71. For unsupported capital expenditure Middlesbrough intends to use option 4, the depreciation method.