

Item No: 3.1	Classification: Open	Date: 20 February 2008	Meeting Name: Council Assembly
Report title:		Treasury Management Strategy - Including Annual Investment Strategy, Prudential Indicators and Annual Minimum Revenue Provision Statement	
Wards or Groups affected:		All	
From:		Finance Director	

RECOMMENDATIONS

1. That the Council Assembly:
 - (i) agrees the treasury management strategy, comprising the Debt Management Strategy set out in paragraphs 17 to 24 and the Annual Investment Strategy 2008/09 set out in Appendix A
 - (ii) agrees the prudential indicators covering capital finance, authorised limitations on borrowing, and cash management for the years 2008/09 to 2010/11 set out in Appendix B.
 - (iii) agrees the Annual Minimum Revenue Provision Statement 2008/09, for the setting aside of prudent sums from revenue to reduce debt liabilities arising from capital expenditure, as set out in Appendix C, and
 - (iv) agrees capital allowances of £152m, as set out in paragraph 46 of this report, enabling the council to continue retaining capital receipts for affordable housing and regeneration.

BACKGROUND INFORMATION

2. The report is about treasury management, which deals with debt and investments strategies. Borrowing is carried out to fund new capital expenditure and refinance existing debt. This may be supplemented with temporary borrowing to meet temporary cash flow or funding commitments. Any cash not immediately used in spending is held in deposits and investments with large high rated banks or bonds to earn interest.
3. Both borrowing and investments are managed according to arrangements set out in the Code of Practice on Treasury Management in the Public Services, issued by the Chartered Institute of Public Finance and Accounting (CIPFA) first published 1992 and updated subsequently. Investment management is also subject to guidelines issued by the Government. Under the guidelines the Council Assembly is responsible for agreeing an annual investment strategy, where cash is managed prudently with capital preservation being a key objective. From April 2007 local authorities will be subject to new accounting standards on debt liabilities and investment assets. The standards deal with valuation, risk management and reporting in the council's published Statement of Accounts.

4. The Council Assembly is also responsible for agreeing a series of prudential indicators on capital finance, borrowing and investments to help assess the affordability, prudence and sustainability of these activities. The indicators are part of a self-regulating regime brought in by the Local Government Act 2003, supporting regulations and the Prudential Code for Capital Finance in Local Authorities issued by CIPFA.
5. The Annual Minimum Revenue Provision Statement is a new requirement coming into effect from April 2008. It replaces complex detailed statutory regulations, about sums that must be met from revenue to reduce debt liabilities arising from capital expenditure, with simpler flexible guidance having statutory force. The council already makes provisions each year in accordance with existing regulations, but the guidance now calls for an annual statement to be prepared each year about these sums, and requires that a prudent provision be made from revenue accounts to ensure that debt, particularly self financed debt, is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits.
6. The report further asks for a formal decision concerning the capital allowance, which enables the council to carry on retaining receipts for affordable housing and regeneration that would otherwise pass to the Government under pooling arrangements. The council relies on securing these exemptions from pooling to invest in affordable housing and regeneration.
7. Under financial delegation previously agreed by Council Assembly, the Finance Director is responsible for all executive and operational decisions on borrowings and investments. The recommendations in this report will enable the Director to carry out his responsibilities in this area.

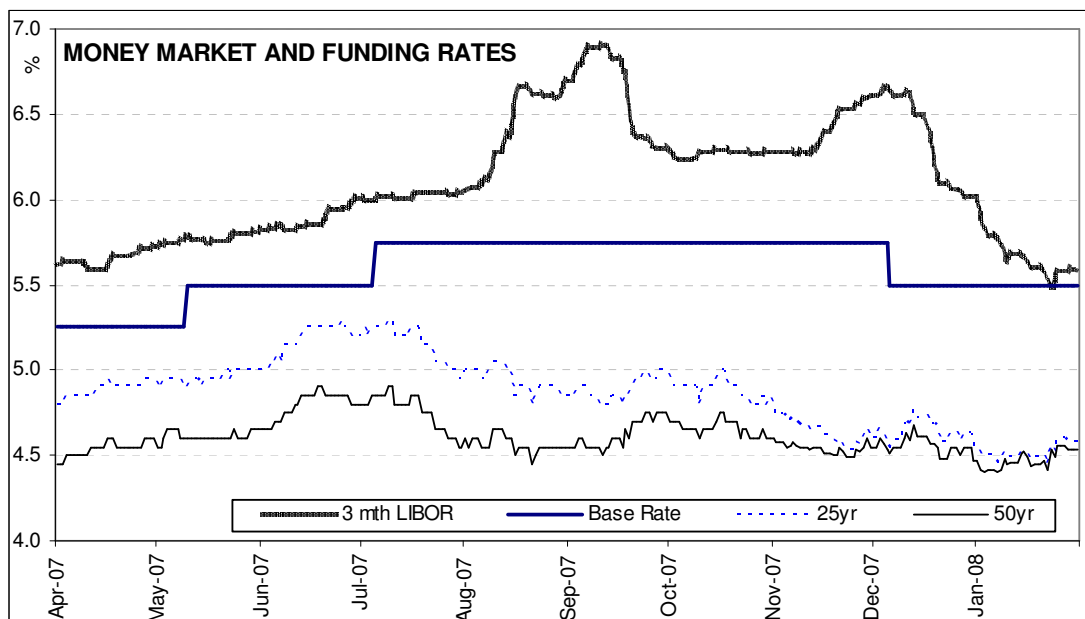
KEY ISSUES FOR CONSIDERATION

Treasury Management Strategy Borrowing and Investments

Background - Developments in Financial Markets

8. Since the summer of 2007 financial markets in industrialised countries have been under considerable strain. Concerns over the rising rate of mortgage delinquencies, particularly “subprime” or high risk mortgages with adjustable interest rates in the United States, raised questions over the value of complex financial and credit products based on those mortgages. Investors lost confidence in the value of these products and became unwilling to hold on to such investments. As a result, pooled funds using these products shrunk significantly. Large commercial banks and financial institutions, which often sponsored these products, came under increasing pressure to fill in the funding shortfall by taking these products on to their own balance sheets. As bank balance sheets swelled with increasing sums of non-performing loans and assets whose value was materially impaired, the banks began to report large losses, and have protected their own balance sheets by reducing lending to other financial institutions and more recently to firms and households.
9. The uncertainty these developments created led to sharp falls in equity markets across the world, which continued into January 2008, although there has been a small recovery at the time of writing. Investors have moved funds from the money markets into the relative safety of government bonds, lowering bond yields. The actions of the banks and the withdrawal of funds by investors, have both contributed to large rises in the cost of short term borrowing.

10. Central banks have acted to reduce pressure on the financial markets by increasing support through lending facilities to commercial banks. A number of central banks have reduced their domestic base rates. In the US rates have fallen by 2.25% since September 2007 to just 3%. In the UK rates were cut by 0.25% in December 2007 to 5.50% (this report has been prepared before the next decision date of 7 February). The European Central Bank has yet to reduce its rates, held at 4.00%. This action has helped bring down the cost of short term money market borrowing. However, equity markets continue to be under pressure and a marked slow down in economic growth remains a significant concern. The financial markets continue to expect further easing in monetary policy, but bond yields are still considered vulnerable to market developments.
11. Southwark's principal source of long term borrowing for capital is the Public Works Loans Board (PWLB, a division of HM Treasury), where lower bond yields have helped interest rates on new loans to remain low. The council has no short term money market borrowing, but the rise in money market rates, resulting from a shortage of liquidity in the market, has helped improve investment yields. However, as money market rates are now back to tracking the reduction in base rates, returns will now not be as firm as they were before December. If bond yields rise, perhaps as the markets shifts focus away from near term risk to growth and towards concerns over long term inflation, the cost of new borrowing will also rise.
12. The chart below shows the history of recent trends in UK interest rates. LIBOR is the cost of short term money market funds. The 25 year and 50 year lines show the rates payable on new long term loans from the PWLB for those periods.



Background – Financial Instruments

13. CIPFA, the body responsible for issuing guidance on how accounting standards are to apply to the local authorities (the Statement of Recommended Practice, SORP), has issued detailed guidance on new accounting standards covering “financial instruments”, principally debts and investments. The SORP draws on three UK commercial sector Financial Reporting Standards (FRS): - FRS 25, FRS 26 and FRS 29 concerning disclosure, measurement and the presentation of information in balance sheets and revenue accounts.

14. The accounting standards extend the use of “fair value” in measuring financial assets and liabilities, with changes in value being reflected in revenue accounts. Fair value is defined as the amount an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arms length transaction, which may not be the value at which something, such as an investment, was originally bought. Debt redemption costs are also now required to be reflected in revenue accounts as soon as they arise, rather than spread out over several years as previously. The SORP reflects these principles. However, as changes in fair value and debt redemption costs can adversely affect local authority revenue accounts, local taxation levels and the capacity to deliver services, the Government has introduced regulations to enable the most adverse revenue consequences to be reversed out of the Accounts and for premiums arising from debt refinancing to be spread over many years.
15. The SORP’s disclosure requirements aim to inform users of the accounts about the scale and significance of financial instruments for the authority’s financial position and performance together with details about the risks arising from financial instruments and how they are managed. The risks include:
 - a) Credit risk - risk of loss from failure of a counterparty to meet its liabilities, e.g. a bank with whom deposits are placed fails to return the investment.
 - b) Liquidity risk - difficulty in securing funding for new spend, rolling over maturing debt or meeting immediate cash requirements.
 - c) Market risk - adverse market movements affecting valuations; e.g rising interest rates reduce the value of long term investments such as bonds while falling rates increase the value of debt liabilities.
16. This report draws on the principles set out in the SORP, and the specific detailed requirements will be addressed in the Statement of Accounts for 2007/08. For the future, CIPFA is now reviewing the Code of Practice on Treasury Management in the Public Services (which primarily deals with arrangements over debts and investments) and the Prudential Code for Capital Finance in Local Authorities (which links treasury management and capital finance). These codes may develop the principles in the SORP still further.

Debt Management Strategy

17. Debt management is about borrowing to refinance existing debts (which at December 2007 was £716m) and borrowing to meet that element of capital spend that is not met from other resources, i.e. capital receipts from asset sales, grants and revenue funding. Borrowing for capital takes two forms: supported borrowing, which is associated with Government support for interest and loan repayment, and self-financed prudential borrowing, the cost of which attracts no revenue support from the Government. There are no plans in 2008/09 for any prudential borrowing at the moment, but it is possible there may need to be some in the future to deal with funding requirements in future capital programme. Appendix B details prudential indicators for 2008/09 – 20010/11, including information on debt funding required for capital spend in that period.
18. When borrowing to meet capital spend, the approach is to borrow in long-term maturities when rates are particularly low, as they are now. Low long term rates help lower the average rate of interest, reducing liquidity and refinancing risks. Conversely when rates are high, shorter term or variable

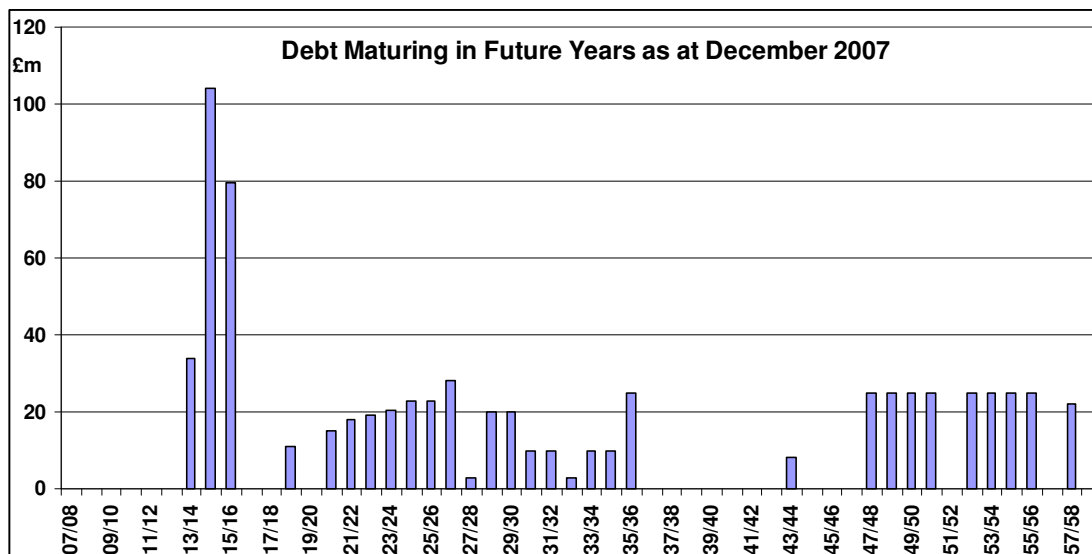
rate borrowing is preferable, as it raises the chances of securing lower rate funding when rates do eventually fall.

19. In relation to refinancing existing debts, the availability of low rates also enables existing high rate loans to be repaid prematurely and refinanced with new cheaper rate loans, subject to redemption costs or premiums, which can be high. However in Southwark's case, as the Housing Revenue Account (HRA) accounts for around 85% of all debt and much of the premiums are rebated as Housing subsidy spread over a number of years (maximum 10 years) refinancing becomes more affordable. Indeed a refinancing exercise was carried out in July and August 2007, detailed in the update below and reported to Council Assembly in September 2007.
20. As mentioned above, the council currently only borrows from the PWLB. The PWLB provides funding for capital spend and debt refinancing at both fixed and variable rates. Rates are close to the cost of borrowing by the Government itself and therefore lower than comparable borrowing from the commercial sector.
21. However, long term commercial sector loans can be attractive when rates are lower than those available from the PWLB. This is possible as loans are tied to call-option which give the lender (the bank) the right to raise rates at set intervals during the loan term. These options are more likely to be exercised when rates are favourable to the lender (the bank) rather than the borrower, which makes the loan not as attractive as it might first appear, especially when rates as a whole have risen since the loan was first taken.
22. Southwark currently has no call-option loans of this kind, and any use of these products in future would be fairly limited, to contain exposure to unexpected upward revisions to rates. The principal source of funds is expected to be the PWLB. As it can provide all capital borrowing needs, no other credit lines are currently needed.
23. The council may also access the money markets for temporary borrowing to meet cash flow requirement or short-term refinancing need. No credit lines are needed to secure funds from these markets and, despite recent turmoil, these markets remain accessible to local authorities.
24. The Finance Director will keep under review options to refinance existing debt and take on debt for capital spend in the light of developments in the financial markets and support arrangements and any activity undertaken will be within existing delegation arrangement under financial standing orders and prudential indicators and limits set out in Appendix B.

Debt Management – Update to December 2007

25. In April 2007, £22m of new loans were taken to meet supported capital spend for 2007/08. The loans were for a term of 50 years at a rate of 4.45%, low by historical standards and well below the council's average rate of interest on long term debt of 8.77% in 2006/07. Further low rates loans were added by refinancing £200m of high rate debt (at rates between 9% and 10.75% maturing between 2009 and 2014), with 45+ year debt at rates between 4.75% and 4.60%. This action has lowered the average rate of interest payable on debt from 8.77% in 2006/07 to 7.6% in 2007/08 and 7.1% thereafter, and has reduced exposure to risk of higher long term funding rates in the future. The lower average rate also helps improve levels at which prudential borrowing for new capital spend becomes more attractive and affordable.

26. The refinancing became possible when the Government introduced regulations that changed the way the new financial instruments accounting standards applied to councils from 2007/08. The accounting standards would have made it difficult to spread the cost of premiums over several years, but statutory regulations issued by the Government referred to in paragraph 14 above changed that, and mean that the £26m in premiums arising from the July and August refinancing can now be spread over many years. In addition HRA premiums (which represent 85% of premiums) are matched by Housing Subsidy reimbursements, payable in instalments spread over 7 years with support being received at the average rate of interest. The remaining premiums are spread over 45 years, while the benefits of lower interest payments start accruing straight away.
27. Despite this activity, the average rate of interest in long term debt is still high relative to current rates and many other local authorities. The average reflects a long period between the 1970's and early 1990's, unlike now, when high capital spending and debt funding coincided with years of high inflation and high interest rates. However, as most of the interest payable on debt is reimbursed in support by the Government, the impact on council finances from the high rate is minimal. Housing Revenue Account (HRA) Subsidy is currently paid on 85% of debt at the council's own average rate, and an allowance is included in Formulae Grant for the General Fund element.
28. The level of debt as at 31 December 2007 stands at £716m, which is an increase of £22m during the year. All loans are at fixed rates, from the PWLB. The amount that fall out for refinance in futures years is set out in the chart below.



29. The market value of these loans under the new accounting standards if all loans were settled at 31 December 2007 was £916m, much higher than the face value of £716m. The difference is due to interest rates on many of the loans being higher than those prevailing for new loans in December, and an element from additional costs introduced by the PWLB in November 2007 in the redemption of debt. The sums available to redeem loans are currently limited to amounts set aside as Minimum Revenue Provision, but may be enhanced by voluntary set aside from capital receipts. Loans falling for refinance beyond these sums are replaced with new borrowing.

Investment Management and Annual Investment Strategy

30. Cash balances averaged £306m over the course of 2006/07 and in the nine months to December 2007 have averaged £307m. Day to day investment management is carried out by an in-house operation and three investment management firms: Invesco Asset Management Ltd (part of the large UK investment group AMVESCAP), AllianceBernstein Ltd (part of AllianceBernstein Holding a large US based global investment management group and majority owned by AXA Financial, the financial group) and Credit Suisse Asset Management Ltd (part of Credit Suisse, the large Swiss based international banking and investment group).
31. External managers provide access to liquid instruments and maturities beyond one year, and provide expertise to help the council enhance long term returns, with capital preservation, liquidity, low market risk and prudence as priorities, all within the investment strategy agreed by Council Assembly.
32. The Annual Investment Strategy for 2008/09, drawn up according to investment guidelines issued by the Government in 2004, requiring Council Assembly approval is set out in Appendix A. As in previous years, capital preservation and liquidity remain high priorities.

Investment Management – Update to December 2007

33. From April to December 2007, investments were spread over many high-rated institutions, in accordance with the ratings in Appendix A. The actual counterparty exposure as at 31 December 2007 is out in the table below. The sums held by external managers are held in liquid marketable instruments (CD's and bond) and in-house funds are held in time deposits or call accounts. Current ratings are shown for each counterparty. In the table the counterparty ratings refer to long and short term ratings issued by Fitch or Moody's rating agencies.

INVESTMENT COUNTERPARTY & RATINGS Exposure at 31 Dec 2007 £m	In House	Alliance Bernstein	Credit Suisse	Invesco	Total
Bonds 1 Year to 5 Years					
European Investment Bk (Europe) (AAA)			2.5		2.5
HM Treasury -Gilts (UK)		3.3	8.6		11.9
Deposits/Certificates of Deposits & Bonds of up to 1 year					
ABN AMRO Bank (Netherlands) (AA-/F1+)				4.3	4.3
Alliance & Leicester (UK) (AA-/F1+)		5.1		6.7	11.8
Allied Irish Bank (Ireland) (AA-/F1+)	20.4	2.6	3.9	6.6	33.5
Banco Bilbao Vizc. Argent. (Spain) (AA-/F1+)			4.0		4.0
Bank of Ireland (Ireland) (AA-/F1+)		5.2	5.1		10.3
Bank of Montreal (Canada) (AA-/F1+)			1.0		1.0
Bank of Scotland (UK) (AA+/F1+)	0.1			3.9	4.0
Barclays Bank (UK) (AA+/F1+)	10.0			5.0	15.0
Credit Suisse (Switzerland) (AA-/F1+)				2.8	2.8
Deutsche Bank AG (AA-/F1+)	20.4	5.2			25.6
Dexia Bk Belgium (Belgium) (AA+/F1+)		2.5		3.0	5.5
European Investment Bk (Europe) (AAA)		4.8	4.0		8.8
HM Treasury -Gilts (UK)		0.7			0.7
HSBC Bank (UK) (AA/F1+)		0.1			0.1
HSH Nordbank (Germany) (Aa2/P1)		2.5			2.5
Intesa Sanpaolo (Spain) (AA-/F1+)			4.9		4.9
Intl Bk Reconst & Devt (World Bk) (AAA)		4.6			4.6
Lloyds Bank (UK) (AA+/F1+)		2.5			2.5
National Australia Bank (Australia) (AA/F1+)	5.0				5.0
Nationwide Building Society (UK) (AA-/F1+)	20.3	5.2	4.0		29.5
Nordea Bank (Finland) (AA-/F1+)				4.0	4.0
Royal Bk of Scotland/NatWest) (UK) (AA+/F1+)	21.0			6.0	27.0
Santander Cent Hispano/Abbey Natnl (Spain/UK) (AA-/F1+)		2.5	4.9		7.4
Societies Generale (AA-/F1+)		5.2	1.0	3.2	9.4
UBS AG (AA/F1+)	20.3		4.9	6.1	31.3
Unicredito Italiano (Italy) (A+/F1+)			2.9		2.9
Total All £m	117.5	52.0	51.7	51.6	272.8

34. The average return for the 9 months to December 2007 was 4.6% against average base rates of 4.2% and average short term money market returns of 4.5%. The exposure to longer term money market deposits, CD's and bonds, particularly by the managers, helped raise overall investment returns. In house funds focused on meeting day to day cash volatility using a number of call account and short term deposits. Cash balances are expected to fall as year end approaches when the flow of receipts slows and expenditure picks up. Thereafter balances will only grow gradually.

Annual Minimum Revenue Provision Statement

35. When the council funds its capital programme through borrowing (rather than from asset sales, grants or revenue contributions), a minimum revenue provision (MRP) is required each year to pay off some of this debt. The council has been making these provisions each year as required by the Local Authorities (Capital Finance and Accounting) regulations issued under the

Local Government Act 2003. However from April 2008 these regulations will be replaced by statutory guidance, a consultation draft of which was issued in November 2007 and is attached at Appendix C – Annex 1.

36. Under the guidance, a prudent provision should be made to reduce debt used to fund capital expenditure. The main idea is for the provision to be over a period bearing some relation to that over which the asset continues to provide a service, particularly on debt taken out for prudential or self-financing purposes, rather than borrowing supported by the Government through revenue grant.
37. The guidance proposes four options which it regards as prudent:
 - a) Regulatory Method
 - b) CFR (Capital Finance Requirement) Method
 - c) Asset Life Method
 - d) Depreciation Method
38. The Regulatory and CFR Methods are similar to existing arrangements and are only available for capital borrowing supported by the Government through RSG. The CFR Method is simpler but more expensive than the Regulatory Method.
39. The Asset Life method makes equal annual instalment over the estimated life of the asset for which the borrowing was undertaken. This method is also recommended where the borrowing relates to funding expenditure that is capitalised by direction or regulation.
40. Under the fourth option, the Depreciation Method, MRP is calculated under rules for depreciation accounting and refers directly to asset valuations rather than the financing underlying the asset. It is more complex than the other three methods, and the method of calculation may require to be refined further before implementation.
41. The Government recommends the Asset Life and Depreciation Methods for self financed prudential borrowing. Although the council currently has no plans to undertake any such borrowing in 2008/09, the MRP statement would still need to refer to it.
42. The Annual MRP (Minimum Revenue Provision) Statement 2008/09 drawing on these principles and recommended for approval by Council Assembly is set out in Appendix C.

Capital Allowance

43. As part of the Local Government Act 2003, a proportion of the proceeds from HRA asset sales are paid over to a Government 'pool'. The percentage paid over differs according to the type of receipt, but typically 75% of dwelling sales, and 50% of the sales of other HRA assets.
44. Receipts from social homebuy, non right to buy dwellings, land, shops and other assets can be exempt from pooling provided the money is used in the council's own affordable housing or regeneration programmes. This exemption does not apply to right to buy sales. The amount which may be exempt from pooling is known as the capital allowance. Council spending relies on securing these exemptions from pooling.
45. The capital allowance balance agreed by Council Assembly in February 2007 was £137.5m. This now requires updating to reflect planned expenditure on

affordable housing and regeneration programmes, which rely on the availability of capital receipts that would otherwise be paid to the Government. After taking into account the receipts that have already been drawn against the existing allowance, an additional £14.5m needs to be added to reflect existing planned expenditure, bringing the total allowance requiring approval to £152m.

46. Council Assembly is recommended to agree a capital allowance of £152m to enable the council to carry on retaining capital receipts for affordable housing and regeneration that would otherwise have to be passed on to the Government under pooling arrangements. The level of allowances required in the future will be kept under review as the capital programme develops.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Strategic Director of Legal and Democratic Services

47. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Code of Practice on Treasury Management, both published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment management strategies, determining or changing borrowing limits or prudential indicators.
48. Reference should also be made to the Department of Communities and Local Government (DCLG, previously the ODPM) Guidance on Local Authority Investments issued in 2004. The Council Assembly should determine borrowing limits annually before the start of the year the limits relate to and approve the prudential indicators and approve borrowing and investment management strategies.
49. Regulations under the 2003 Act specify that the council may retain certain capital receipts provided they are used in affordable housing or regeneration. Council Assembly is being asked to agree the capital allowance to enable receipts to be retained by the council.
50. Statutory guidance on the MRP (Minimum Revenue Provision) (issued as draft in November 2007) was produced under amendments made to section 21(1A) of the Local Government Act 2003 by section 238(2) of the Local Government and Public Involvement in Health Act to 2007. The MRP guidance requires the Council Assembly to determine an annual strategy to prudently set aside sums to repay debt liabilities arising from capital expenditure.
51. Members are advised to give approval to the recommendations contained in paragraph one of this report and doing so confirms that the council is complying with its duty under the Local Authorities (Capital Finance & Accounting) (Amendment) (England) Regulations 2007 that its capital investment and borrowing plans are affordable, prudent, and sustainable.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Prudential Code for Capital Finance in Local Authorities. Code of Practice on Treasury Management in the Public Services ODPM Investment Guidelines. SORP 2007, Statement of Recommended Practice	Financial Management Services, Strategic Services Department	Dennis Callaghan, Chief Accountant (020 7525 4375)

APPENDICES

No.	Title
Appendix A	Annual Investment Strategy 2008/09 – Recommended for Approval
Appendix B	Prudential Indicators 2008/09 to 2010/11– Recommended for Approval
Appendix C	Annual Minimum Revenue Provision Statement 2008/09 – Recommended for Approval
Appendix C – Annex 1	Guidance on Minimum Revenue Provision - Issued by the Secretary of State under section 21(1(A) of the Local Government Act 2003- Consultation Draft issued November 2007

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Finance Director	
Report Author	Simon Hughes, Assistant Finance Director	
Version	Final	
Version Date	February 7 2008	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments Included
Strategic Director of Legal and Democratic Services	Yes	Yes
Final Report Sent to Constitutional Support Services	February 7 2008	

ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

ANNUAL INVESTMENT STRATEGY 2008/09

1 INVESTMENT OBJECTIVES

- 1.1 The council's investment objectives are to preserve principal, provide liquidity and secure a reasonable return. Cash investments may only be placed with specified and non-specified investments, which shall at all times be managed prudently.
- 1.2 Specified investments are investments up to one year with high liquidity and credit qualities (section 4). Non-specified investments are investments that exceed one year and so are potentially more responsive to liquidity, credit, and market factors (section 5). Prudent exposure to non-specified investments helps raise the level and sources of investment returns over the long term.
- 1.3 The Finance Director is responsible for this strategy and its management. External specialists and fund managers shall assist in advising or executing elements of the strategy.

2 CREDIT REQUIREMENTS

- 2.1 Credit risk arises where sums are placed with institutions (an issuer of investments) other than the UK Government or UK local authorities. It is the risk that the institution with whom investments are held fails to meet its obligations to investors. To contain exposure to this risk, reference shall be made to the following ratings, which are considered high and above the minimum regarded as investment grade by ratings agencies and indicate a low risk of default.

a) Issuer and Issue Rating

Issuer and Issue Rating Rating Agency	Minimum Short Term Rating	Minimum Long Term Rating	Maximum exposure up to 1 year £m	Maximum exposure 1 year to 5 years £m
Fitch Ratings	Issuer: F1+ Issue: F1	Issuer AA- Issue: A-	40	30
Moody's Investor Services	Issuer:P1 Issue: P1	Issuer: Aa3 Issue: A3	40	30
Standard & Poor's	Issuer:A-1+ Issue: A1	Issuer: AA- Issue: A-	40	30
Fitch Ratings	Issuer: F1	Issuer: A+	20	0
Moody's Investor Services	Issuer: P1	Issuer: A1	20	0
Standard & Poor's	Issuer: A1	Issuer: A+	20	0

ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

b) Fund Ratings

Fund Rating Rating Agency	Minimum Short Term Rating	Minimum Fund Value £m	Maximum exposure £m
Fitch Ratings	AAA	1000	50
Moody's Investor Services	Aaa	1000	50
Standard & Poor's	AAA	1000	50
Fitch Ratings	A+	200	Up to 10% of fund value max £25 m
Moody's Investor Services	A1	200	Up to 10% of fund value max £25 m
Standard & Poor's	A+	200	Max of up to 10% of fund value max £25 m

- 2.2 Funds that are not separately rated may be considered where investments that make up the fund meet the minimum issue rating set out in the table above.
- 2.3 Ratings shall be reviewed at least twice a year. In the event of adverse rating changes, investments may be recalled prior to maturity where it would be prudent to do so.
- 2.4 Exposure to any one institution shall be diversified as is consistent with securing a reasonable return.
- 2.5 Credit requirements shall not apply to UK Government investments or local authorities, as neither is regarded as having credit risk.
- 2.6 There shall be no upper limit on exposure to the UK Government for credit risk purposes and the limit on exposure to any one local authority shall be £40m. Exposure to National Westminster Bank/ the Royal Bank of Scotland or HSBC Bank may be exceeded if it is necessary to be fully invested in the short term.
- 2.7 The Finance Director shall have discretion to vary the minimum rating or limits as appropriate to market conditions or developments where prudent.

3 OVERALL LIQUIDITY AND MATURITY CONSTRAINTS

- 3.1 The first call on investments shall usually be cash flow requirements and normally not less than £60m of overall investments shall be held in maturities up to one year.
- 3.2 Overall investments shall only have a low or low to moderately low sensitivity to market factors. As a guide, the average maturity of investments shall be below three years.

ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

4 SPECIFIED INVESTMENTS

- 4.1 Specified investments shall consist of the following categories of investments, subject to being denominated in sterling, meeting credit requirements set out above and not exceeding one year.

Specified Investments - in Sterling, meeting credit requirements and not beyond one year	
A	Bonds, bills, term deposits and accounts with the UK Government or UK Local Authorities
B	Fixed term deposits, accounts, certificates of deposits, commercial paper and senior unsubordinated notes and bonds with banks and UK building societies
C	Money Market Funds with stable asset values

- 4.2 These specified investments have high capital preservation and liquidity characteristics, and as such there shall be no upper limit on sums held in them. However investment requirements and market conditions may justify prudent exposure to longer term investments or other non-specified investments.

5 NON-SPECIFIED INVESTMENTS

- 5.1 Non specified investments shall consist of the following categories of investments, which shall be in sterling and meet applicable credit requirements.

Non-Specified Investments – maturities beyond one year, in Sterling and meeting credit requirements	
A	Bonds issued by the UK Government or Supranational bodies
B	Fixed term deposits and certificates of deposits with banks and UK building societies
C	Senior unsubordinated bonds and notes issued by banks and UK building societies
D	Bond funds

- 5.2 Details concerning the use, characteristics and limits applying to non-specified investments are set out below. The upper limit on exposure to non-specified investments as a whole shall be 50% of all investments. Overall liquidity, market and three year average constraints shall also be observed.

ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

Non specified Investments- Usage, Characteristics and Limits	
A	<p>Bonds issued by the UK Government or Supranational bodies</p> <p><i>i) Typical usage</i></p> <ul style="list-style-type: none">- To capture additional yields that may be available from investing longer from time to time, or- To benefit from short and long run rate expectations. <p><i>ii) Characteristics</i></p> <ul style="list-style-type: none">- These bonds are highly liquid and of high credit quality, however prices are sensitive to expectations about the future course of interest rates, inflation and financial conditions generally. As well as moving favourably, prices can move adversely, risking income – the longer the bond the more sensitive its price to these factors. But the principal is protected if held to maturity. Limits are placed to contain exposure to this risk and positions are managed through external fund managers or with assistance from consultants. <p><i>iii) Limits</i></p> <ul style="list-style-type: none">- No more than 50% of investments may be placed in this category.- No one bond may have a maturity exceeding 10 years or the equivalent benchmark. No maturity limit applies to index linked or variable rate bonds.

ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

B	<p>Fixed term deposits and certificates of deposits with banks and UK building societies</p> <p><i>i) Typical usage</i></p> <ul style="list-style-type: none">- To capture additional yields that may be available from investing longer from time to time,- To protect investments from falling rates over the long term, or- To secure a given return over the long term. <p><i>ii) Characteristics</i></p> <ul style="list-style-type: none">- These certificates of deposits are not as liquid as shorter issues and fixed term deposits are not liquid at all. Yields tend to be better than bonds and credit quality is high. As with longer bonds, the value of these investments is sensitive to market conditions, but principal is protected if held to maturity. Limits are placed to contain illiquidity. <p><i>iii) Limits</i></p> <ul style="list-style-type: none">- No more than 50% of investments shall be placed in this category and no one investment shall exceed 5 years in maturity.
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ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

C	<p>Senior unsubordinated bonds and notes issued by banks and UK building societies.</p> <p><i>i) Typical usage</i></p> <ul style="list-style-type: none">- To capture additional yields that may be available from investing longer from time to time,- To secure a pick up in yields above equivalent maturity fixed term deposits, or- To benefit from short and long run rate expectations. <p><i>ii) Characteristics</i></p> <ul style="list-style-type: none">- Investments in this category are issued by the highest rated banks, but individual investments (issues) may rank lower in the credit hierarchy, but nevertheless still be of investment grade. Issues are liquid and yields are better than equivalent deposits. Principal is protected where held to maturity. These investments are managed through external managers or with assistance from consultants. Limits are placed to contain overall credit exposure. <p><i>iii) Limits</i></p> <ul style="list-style-type: none">- No more than 50% of investments shall be placed in this category and no one investment shall exceed 5 years in maturity.
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ANNUAL INVESTMENT STRATEGY 2008/09 – RECOMMENDED FOR APPROVAL

D	<p>Bond funds</p> <p><i>i) Typical usage</i></p> <ul style="list-style-type: none">- To access the wider range of investments and strategies that funds participate in,- To enhance returns over the longer term, or- To diversify investment and credit risk in overall investments. <p><i>ii) Characteristics</i></p> <ul style="list-style-type: none">- Funds typically consist of investment grade corporate and financial institution debt and structured products. Exposure to anyone counterparty is kept low and the wide range of credit rating and strategies available to funds helps raise returns over the longer term.- In addition to credit characteristics, funds may be distinguished according to volatility. The lower the average maturity of investment, the lower the volatility and the higher the short run capital preservation characteristics. However funds may require a longer time frame over which to enhance returns. Funds also have high liquidity. <p><i>iii) Limits</i></p> <ul style="list-style-type: none">- No more than 50% of investments shall be placed in this category.- Funds should have a low or low to moderately low sensitivity to interest rate and market factors.
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**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

PRUDENTIAL INDICATORS

1. Capital finance, borrowing and investment arrangements are brought together in a series of prudential indicators and limits to give a general picture of the affordability, prudence and sustainability of financing activities. There are 10 indicators grouped into three broad areas or criteria of affordability, prudence and treasury management.
2. This Appendix provides a detailed explanation of each indicator needing approval. A description of the indicators, extracted from the Prudential Code on Capital Finance for Local Authorities published by Chartered Institute of Public Finance and Accountancy, is also included.
3. The indicators needing Council Assembly approval are those for the years 2008/09 to 2010/11. (The 2006/07 indicators are shown as actuals and latest projections are given for 2007/08.)

<p>CRITERIA ONE: AFFORDABILITY AND PRUDENTIAL INDICATORS ON AFFORDABILITY</p>
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Extract from Prudential Code:

The fundamental objective in the consideration of the authority's capital plan is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits, and in particular to consider the impact on the local authority's "bottom line", Council Tax. Affordability is ultimately determined by a judgement on Council Tax levels and, in the case of the Housing Revenue Account, acceptable Rent levels.

In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it and estimated for the future, together with the totality of its capital plans, revenue income and expenditure forecasts for the forthcoming year and the following 2 years. The authority is required to consider known significant variations beyond this timeframe.

The local authority shall set and monitor against the following prudential indicators as key indicators of affordability.

INDICATOR ONE:

ESTIMATES OF RATIO OF FINANCING COSTS TO NET REVENUE STREAM

Extract from Prudential Code:

The authority will estimate for the forthcoming financial year and the following 2 years the ratio of financing costs to net revenue stream. At the year end, the ratio of financing costs to net revenue stream will be calculated directly from the local authority's consolidated revenue account.

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

Comment and Recommended Indicator

The financing ratio reflects financing costs arising from past and current capital expenditure funded from borrowing and income from cash balances. The HRA and GF ratios recommended for approval are set out below. The GF ratio has benefited from growth in working capital following expansion in balances. However, this benefit is gradually eroding as the flow of receipts slows and spend picks up. The different pattern of the HRA and GF ratios reflects the different way the two services are organised under law.

Financing Ratios	2006/07 Actual	2007/08 Previous Estimate	2007/08 Latest Projection	2008/09 Estimate	2009/10 Estimate	2010/11 Estimate
HRA	34.9%	34.0%	33.0%	32.0%	32.0%	32.0%
GF	-0.7%	0.4%	-1.0%	0.7%	1.2%	1.3%

INDICATOR TWO:

**ESTIMATES OF THE INCREMENTAL IMPACT OF CAPITAL INVESTMENT ON
THE COUNCIL TAX AND HOUSING RENTS**

Extract from Prudential Code:

A fundamental indicator of affordability for the council to consider in setting their forward plans is the impact on council tax, and in the case of the HRA housing rents, that will result. This shows the actual impact of capital investment decisions on council tax and allows the effect of the totality of the council's plans to be considered at budget setting.

Comment and Recommended Indicator

Additional budgetary requirements for the capital programme may arise from self-financed prudential borrowing, which unlike supported borrowing is entirely funded from the council's revenue budget. No self-financed prudential borrowing is expected in respect of the HRA or the General Fund. The rest of the programme is funded through capital receipts, grants, revenue contributions and supported borrowing.

Notional Rent or Council Tax Increases	2008/09	2009/10	2010/11
Weekly Housing Rent increase	Nil	Nil	Nil
Council Tax Band D increase	Nil	Nil	Nil

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

CRITERIA TWO: PRUDENCE AND PRUDENTIAL INDICATORS FOR PRUDENCE

Extract from the Code

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. Ensuring that treasury management is carried out in accordance with good professional practice is an essential feature of prudence.

INDICATOR THREE:

ESTIMATES OF CAPITAL EXPENDITURE

Extract from Prudential Code

The local authority will make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. After the year end the actual expenditure incurred during the financial year will be recorded.

Comment and Recommended Indicator

The actual capital expenditure for 2006/07 was £148m. Projections for 2007/08 reflect capital cash spend profile and include programme approvals. The 2008/09 to 2010/11 capital expenditure estimates recommended for approval are set out below.

Capital Expenditure	2006/07 Actual £m	2007/08 Previous Estimate £m	2007/08 Latest Projection £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
HRA	79	98	93	115	84	69
GF	69	83	92	91	95	103
Total	148	181	185	206	179	172

INDICATOR FOUR:

ACTUAL AND ESTIMATES OF CAPITAL FINANCING REQUIREMENTS.

Extract from Prudential Code

The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. After the year end, the actual capital financing requirement will be calculated directly from the local authority's balance sheet.

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

Comment and Recommended Indicator

Both the HRA and the GF capital financing requirements (CFR) reflect the use of borrowing to pay for past and current capital expenditure. The latest projection for March 2008 assumes capital borrowing of £25.8m (all supported: £12.5m HRA, £13.3m GF). The corresponding estimate for March 2009 is £17.5m (£12.5m HRA, £5m GF). The HRA and GF CFR recommended for approval for 2008/09 to 2011/12 are set out below.

CFR	2006/07 Actual £m	2007/08 Previous Estimate £m	2007/08 Latest Projection £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
HRA	601	614	614	626	639	651
General Fund	106	116	116	118	119	120
Total	707	730	730	744	758	771

INDICATOR FIVE:

ACTUAL DEBT- THE AUTHORISED AND OPERATIONAL LIMITS

Extract from Prudential Code

The local authority will set for the forthcoming financial year and the following two financial years an authorised limit and an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long-term liabilities.

Comment and Recommended Indicator

These two limits are the limit on debt and long term liabilities outstanding on any one day. The lower limit is the operational boundary and takes account of ordinary activity. The authorised limit is the higher limit to accommodate unexpected borrowing that may be needed for very short periods. The total authorised limit is the limit councils have to determine under the Local Government Act 2003.

The average level of borrowing in any one year is usually close to the capital financing requirement. However on any one day borrowing may be higher or lower depending on cash flow needs and timing of borrowing decisions. When rates are expected to rise it is generally more attractive to borrow ahead of capital spending. There may also, in the future, be a benefit from borrowing additional funds over a short period to restructure debt by replacing high rate loans with lower rate ones. The latest projection for 2007/08 includes funding for this and the following year's supported capital expenditure.

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

The following limits are recommended for approval for 2008/09 to 2010/11. They are based on percentages added to capital financing requirements and should:

- ◆ accommodate existing borrowing,
- ◆ permit new investment, reflecting growth in capital financing and
- ◆ take on temporary borrowing for short periods to meet cash flow requirements or complete debt refinancing as part of prudent and risk controlled framework without having the delay of a fresh re-determination (and risk compromising potential benefits in volatile markets).

Operational Boundary and Authorised Limits for External debt -	2006/07 Actual Max £m	2007/08 Previous Boundary/ Limit £m	2007/08 Latest Projection £m	2008/09 Limit £m	2009/10 Limit £m	2010/11 Limit £m
Operational Boundary for Debt						
Borrowing	717	800	730	815	830	845
Other long term liabilities	0	16	0	16	17	17
Total Operational	717	816	730	831	847	862
Authorised Limit for Debt -						
Borrowing	717	840	730	850	870	885
Other long term liabilities	0	17	0	17	17	18
Total Authorised	717	857	730	867	887	903

The council has no long term liabilities at the moment, but the limit accommodates liabilities that may be taken in place of borrowing to finance assets.

Under existing arrangements, the Finance Director is responsible for all executive, strategic and operational borrowing decisions and has discretion to allow activity to go outside the operational boundary, should it be prudent and temporary, but nevertheless remain within the overall authorised limit at all times. The Finance Director may also vary the mix between long term liabilities and debt should it to be prudent to do so.

CRITERIA THREE: TREASURY MANAGEMENT

INDICATOR SIX:

**ADOPTION OF THE CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT
IN THE PUBLIC SERVICES**

Extract from Prudential Code

That the local authority has adopted the Treasury Management Code.

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

Comment and Recommended Indicator

This indicator confirms that the council has adopted the Code of Practice for Treasury Management in the Public Sector issued by CIPFA and updated in 2002. At Southwark, the original code was adopted when it was first produced in 1992 and the latest version was adopted by the council in February 2003. The Council Assembly is asked to confirm the continued adoption of the Code through the recommendations contained in this report.

INDICATORS SEVEN, EIGHT & NINE:

**INTEREST RATE EXPOSURES – UPPER LIMITS ON FIXED RATES
INTEREST RATE EXPOSURES – UPPER LIMITS ON VARIABLE RATES
MATURITY LIMITS ON DEBT**

Extract from Prudential Code

The local authority will set for the forthcoming year and the following two financial years upper limits to its exposures to the effects of changes in interest rates. These prudential indicators will relate to both fixed and variable interest rates. The local authority will set for the forthcoming year both upper and lower limits with respect to the maturity of its borrowing.

Comment and Recommended Indicator

Council debt currently consists entirely of fixed rate loans, with very little falling for repayment over the next few years. However the proportion in fixed rates could change should financing conditions become favourable in the future. The fixed and variable rate limits reflect growth in capital financing requirement and draw on the authorised debt limit, which includes sums in temporary borrowing for cash flow and refinancing. The maturity limit reflects existing debt structure, with leeway to accommodate prudent refinancing. The three kinds of limits (fixed, variable and upper + lower maturity limits) recommended for approval are set out below.

LIMITS ON FIXED AND VARIABLE RATES	2006/07 Maximum Actual £m	2007/08 Previous Limit £m	2007/08 Latest Projection £m	2008/09 Limit £m	2009/10 Limit £m	2010/11 Limit £m
Upper limit for fixed interest rate exposure	717	840	730	850	870	885
Upper limit for variable rate exposure	0	210	0	215	215	220

Maturity Limits on debt	2006/07 Actual	2007/08 Upper Limit	2007/08 Lower Limit	2007/08 Latest Projection	2008/09 Upper Limit	2008/09 Lower Limit
under 12 months	0%	25%	0%	0%	0%	25%
12 months and within 24 months	0%	30%	0%	0%	0%	30%
24 months and within 5 years	21%	60%	0%	0%	0%	60%
5 years and within 10 years	39%	80%	0%	30%	0%	80%
10 years and above	40%	80%	0%	70%	0%	100%

**PRUDENTIAL INDICATORS 2008/09 – 2010/11
– RECOMMENDED FOR APPROVAL**

INDICATOR TEN:

TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS.

Extract from Prudential Code

Where a local authority invests, for periods longer than 364 days, the local authority will set an upper limit for each forward financial year period for the maturing of such investments.

Comment and Recommended Indicator

The council's cash balances averaged £306m over the course of 2006/07 and in the nine months to end of December 2007 averaged £307m. The cash is invested across a number of counterparties which can include the Government, local authorities, and large high rated banks and building societies. Exposure to investments beyond one year raises investment options and helps raise returns. However, as returns can be vulnerable to unexpected market volatility, limits are placed on such exposure. The 2008/09 upper limits on investment above one year recommended for approval are shown below, and further details about investments set out in the Annual Investment Strategy at Appendix A.

Upper limits on investments greater than 1 yr	2006/07	2007/08	2007/08	2008/09
Upper limit / Actual	Actual max exposure 1-5 years: £12m 5-10 years: £0 m	Limits Up to 50% of investments. Overall average maturity 3 years, but any one investment may be longer as referred to in the Annual Investment Strategy	Latest Positions: 16% of investments greater than 1 year Overall maximum average maturity 8 months Longest investment 8 yrs	Up to 50% of investments greater than 1 year Overall average maturity 3 years, but any one investment may be longer as referred to in the Annual Investment Strategy

**ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2008/09
– RECOMMENDED FOR APPROVAL**

Under Guidance on Minimum Revenue Provision - Issued by the Secretary of State under section 21(1(A)) of the Local Government Act, the council is required to set aside sums as minimum revenue provision (MRP) and to prepare an annual statement on it before the start of the year the provision relates to. The council's Annual Minimum Revenue Provision Statement for 2008/09, recommended for approval by the Council Assembly, is set out below.

ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2008/09

1. The council shall calculate a minimum revenue provision (MRP) on sums to be set aside from revenue to reduce borrowing and credit liabilities arising from capital expenditure and in doing so draw on advice and options cited in the Guidance on Minimum Revenue Provision - Issued by the Secretary of State under section 21(1(A)) of the Local Government Act 2003 (consultation draft issued November 2007 and attached to this report as Appendix C – Annexe 1).
2. Any changes to this statement require Council Assembly approval.

Supported Capital Expenditure or Capital Expenditure incurred before 1 April 2008.

3. In relation to capital expenditure for which support forms part of the calculation of revenue grant by the Government or any capital expenditure incurred before 1 April 2008, the MRP shall be calculated in accordance with the Local Authorities (Capital Finance and Accounting) Regulations 2003 as if they had not been revoked by the Local Authorities (Capital Finance and Accounting) Regulations 2008 issued as consultation draft in November 2007. In arriving at that calculation, the Capital Financing Requirement shall be adjusted as described in the guidance.

Self- Financed Capital Expenditure from 1 April 2008.

4. Where the capital expenditure is incurred from 1 April 2008 and on an asset financed wholly or partly by self-financed borrowing or credit arrangements, the MRP is to be made in equal annual instalments over the life of the asset in accordance with the formula set out in "Option 3: Asset Life Method" of the guidance.
5. The asset life method shall also be applied to expenditure from 1 April 2008 which is treated as capital expenditure by virtue of either a direction under section 16(2) of the 2003 Act or regulation 25(1) of the 2003 Regulations.
6. Asset life will be determined in accordance with advice contained in the guidance and when borrowing to construct an asset, the asset life may be treated as commencing in the year the asset first become operational and postpone MRP until that year, subject to the approval of the Finance Director.

**ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2008/09
– RECOMMENDED FOR APPROVAL**

7. In the case of finance leases and on balance sheet Private Finance Initiative contracts, the MRP shall, in accordance with the guidance, be the sum that goes to write down the balance sheet liability.
8. The Finance Director is responsible for implementing the Annual Minimum Revenue Provision Statement and has managerial and operational discretion necessary to ensure that MRP is calculated in accordance with regulatory and financial requirements.

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1A) of the Local Government Act 2003- Consultation Draft issued November 2007

Communities and Local Government

[CONSULTATION DRAFT]

GUIDANCE ON MINIMUM REVENUE PROVISION

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

DEFINITIONS

1. In this guidance:

2003 Act means the *Local Government Act 2003*.

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

2003 Regulations means the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* [SI 2003/3146, as amended].

2007 Regulations means the *Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2007* [SI 2007/573].

2008 Regulations means the *Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2008* [SI].

Local authority has the meaning given in section 23 of the 2003 Act. (This guidance does not apply to parish councils and charter trustees).

MRP means Minimum Revenue Provision.

Prudential Code means the code of practice referred to in regulation 2 of the 2003 Regulations .

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

Non-housing CFR has the meaning given in regulation 28(11) of the 2003 Regulations before this was amended by the 2008 regulations.

Credit arrangement has the meaning given in section 7 of the 2003 Act.

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

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1(A) of the Local Government Act 2003- Consultation Draft issued November 2007

INTRODUCTION

2. Under regulation 27 of the 2003 Regulations, local authorities are required to charge to their revenue account for each financial year MRP to account for the cost of their debt in that financial year. Prior to its amendment by the 2008 Regulations, regulation 28 (read with regulation 3 of the 2007 Regulations) set out the method authorities were required to follow in calculating MRP. For the financial year 2007/08 and subsequent financial years, the detailed calculation has been replaced with a requirement that local authorities calculate an amount of minimum revenue provision which they consider to be prudent. This guidance is issued under section 21(1A) of the 2003 Act (as inserted by section 238(2) of the 2007 Act) and addresses this new requirement in regulation 28. In accordance with section 21(1B) of the 2003 Act, local authorities must have regard to this guidance.

ANNUAL MRP STATEMENT

3. 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 in paragraphs 7 to 15 below are to be followed in the financial year.

MEANING OF “PRUDENT PROVISION”

4. Regulation 28 of the 2003 Regulations (as amended by regulation 4 of the 2008 Regulations) requires a local authority to calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. The Secretary of State recommends that, for the purposes of regulation 28, the prudent amount of provision should be determined in accordance with paragraphs 5 and 6 below.

4. The broad aim of prudent provision is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits.

5. The Secretary of State considers that each of the following options in paragraphs 7 to 15 normally constitutes prudent provision, subject to the conditions in paragraphs 16 to 18.

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1(A) of the Local Government Act 2003- Consultation Draft issued November 2007

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

7. MRP is equal to the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations, as if they had not been revoked by the 2008 regulations.

Option 2: CFR Method

8. MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year. If the CFR at that date is nil or negative, no MRP is required.

Option 3: Asset Life Method

9. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset, in accordance with the following formula:

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

where-

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

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

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

10. **Commencement of provision.** Subject to paragraph 13 below, MRP should normally commence in the financial year following the one in which the expenditure was incurred.

11. **Asset life.** The estimated life of the asset should be determined in the year that MRP commences and not subsequently be revised.

12. **Freehold land.** If no life can reasonably be attributed to an asset, such as freehold land, the life should be taken to be a maximum of 50 years. However, in the case of freehold land on which a building or other structure is constructed, the life of the land may be treated as equal to that of the structure, where this would exceed 50 years.

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1(A) of the Local Government Act 2003- Consultation Draft issued November 2007

13. **Construction period.** When borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make MRP until that year. “Operational” here has its standard accounting definition. Investment properties should be regarded as becoming operational when they begin to generate revenues.

Option 4: Depreciation Method

14. MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements.

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

(a) MRP should continue to be made annually until the cumulative amount of such provision is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority may cease to make MRP.

(b) On disposal of the asset, the amount of the capital receipt should not be taken to the revenue account and the authority must comply with the normal requirements of the 2003 Act on the use of capital receipts.

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

CONDITIONS FOR USING THE OPTIONS

16. Options 1 and 2 should only be used In relation to:

- (a) capital expenditure incurred before 1 April 2008; and
- (b) capital expenditure incurred on or after that date which the authority is satisfied forms part of its Supported Capital Expenditure.

17. Options 3 and 4 should be used in relation to all capital expenditure incurred on or after 1 April 2008 which is to be financed by borrowing or credit arrangements and which does not form part of the authority’s Supported Capital Expenditure.

18. Option 3 should be used for all capitalised expenditure (see paragraph 22).

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1(A) of the Local Government Act 2003- Consultation Draft issued November 2007

CFR ADJUSTMENT

19. Where the authority has used Options 3 or 4, the CFR for the purposes of Options 1 and 2 should be treated as not being increased by the amount of the expenditure on the asset. In addition, the CFR should not be treated as being decreased by the amount of the MRP made under Options 3 and 4. However, for the purposes of determining the affordability of borrowing in accordance with the Prudential Code, the CFR should continue to be calculated as specified in that document.

FINANCE LEASES AND PFI

20. In the case of finance leases and on balance-sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability. Thus, Option 3 will apply in a modified form.

TRANSFERRED DEBT

21. Where debt is transferred between authorities, the authority relinquishing the debt should cease to make MRP in respect of it and the authority taking it over should begin to make MRP as if it were undertaking new borrowing.

GUIDANCE ON MINIMUM REVENUE PROVISION - Issued by the Secretary of State under section 21(1)(A) of the Local Government Act 2003- Consultation Draft issued November 2007

CAPITALISED EXPENDITURE

22. Where on or after 1 April 2008 an authority incurs expenditure which is:
 (a) financed by borrowing or credit arrangements; and
 (b) treated as capital expenditure by virtue of either a direction under section 16(2)(b) of the 2003 Act or regulation 25(1) of the 2003 Regulations
 the authority should make MRP in accordance with Option 3.

23. For the purpose of the formula in paragraph 9 above, in the initial year of making MRP the variable “C” should be given the following maximum values:

<u>Expenditure type</u>	<u>Maximum value of “C” in initial year</u>
Expenditure capitalised by virtue of a direction under s16(2)(b)	“C” equals 20 years
Regulation 25(1)(a) Expenditure on computer programs	“C” equals the value it would have for computer hardware
Regulation 25(1)(b) Loans and grants towards capital expenditure by third parties	“C” equals the estimated life of the assets in relation to which the third party expenditure is incurred
Regulation 25(1)(c) Repayment of grants and loans for capital expenditure	“C” equals 25 years
Regulation 25(1)(d) Acquisition of share or loan capital	“C” equals 20 years
Regulation 25(1)(e) Expenditure on works to assets not owned by the authority	“C” equals the estimated life of the assets
Regulation 25(1)(ea) Expenditure on assets for use by others	“C” equals the estimated life of the assets
Regulation 25(1)(f) Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings	“C” equals 25 years