AGENDA ITEM NO

Board/Committee:	**POLICY & ORGANISATION BOARD**
Date of Meeting:	**9 JULY 2015**
Title:	**MEDIUM TERM FINANCIAL STRATEGY AND CAPITAL STRATEGY**
Author:	**BOROUGH TREASURER**
Status:	**FOR DECISION**

Purpose

To consider the updated Medium Term Financial Strategy and the Capital Strategy.

Recommendation

That the Policy and Organisation Board approve the Medium Term Financial Strategy and Capital Strategy as set out in Appendix 1 and Appendix 2 respectively.

1 Background

1.1 The Council reviews and approves the Medium Term Financial Strategy each year. Following the recent completion of the budget cycle for 2015/16, it is timely to review the strategies prior to consideration of a budget strategy for 2016/17 by this Board later in the year.

1.2 At the time of writing the report there still remains a great deal of uncertainty relating to the level of Central Government Grants in 2016/17 and later years with the New Government unlikely to confirm the details for each Council until December 2015. This together with the uncertainty relating to future Business Rate income therefore results in the financial forecasting beyond 2015/16 being particularly challenging and subject to significant risk.

2 Report

2.1 Budget preparation is ongoing and will incorporate requirements resulting from Council priorities identified from the Capital Strategy, Community Strategy, Corporate Plan and the associated action plans.

2.2 The Local Government Act 2003 requires the Council to consider whether its budget is balanced with appropriate levels of reserves commensurate with perceived budget risks.

2.3 Maintaining and increasing reserve levels is seen as essential as the radical changes to the financing of Local Government including Business rate retention and the move to the new Council Tax Support

Scheme (previously Council Tax rebate) have significantly increased the risk and uncertainty borne by this and other Councils. The Strategy explains that the Collection Fund Equalisation Reserve first introduced in 2014/15 has been broadened in scope to cover the significant increase in risk and volatility arising from the introduction of the Business Rate Retention Scheme, Council Tax Support scheme and the uncertainty regarding future levels of Revenue Support Grant. In light of this the reserve has been renamed the Stability and Resilience Reserve.

2.4 Projections contained in the Medium Term Financial Strategy indicate that the Council's General Fund budget requirements will remain relatively stable over the next 4 years although the falling out of New Homes Bonus (each tranche is payable for a period of 6 years) in 2018/19 and 2019/20 do result in a larger increase in the budget requirements in these years. A prudent approach has been applied to the model in that no New Homes Bonus has been assumed for 2016/17 and later years. Should it be retained it is possible it could at least partially offset the anticipated loss of Revenue Support Grant.

2.5 The outlook regarding the level of government grant is still very uncertain and although it is widely forecast that significant reductions will occur the exact extent of these is currently not known. The strategy assumes that Revenue Support Grant will reduce by £500,000 in each of 2016/17 and 2017/18 with further reductions of £300,000 in 2018/19 and £200,000 in 2019/20. This is in addition to the £733,000 reduction in the current year. The reduction in government grant support even if confirmed at the levels assumed in the strategy will provide a significant financial challenge to this Council but it must also be recognised that there remains a very significant risk that even greater reductions will be imposed.

2.6 An area of even greater uncertainty than the level of future Revenue Support Grant is the income this Council will receive under the Business Rate Retention Scheme. The scheme is extremely complex with many of the factors that determine the business rate income the Council will receive outside the Council's control such as the level and success rate of business rate appeals (determined by the Valuation Office Agency) and any changes made by Central Government following the current review of the Scheme. The forecast within the MTFS assumes annual Business Rate Receipts of £2.9M between 2016 and 2020 however it is possible that this could fall to the safety net level (currently £2.1M). The creation of the Stability and Resilience Reserve does assist in providing some mitigation against this risk.

2.7 The strategy highlights that the Council carried out a series of service reviews with the objective of making efficiency savings whilst still maintaining service levels in order to help meet the financial challenges ahead. Further efficiency savings have been achieved (including those arising from the Environmental Health Partnership with Fareham

Borough Council) which has enabled the Council to set a net budget (before transfer to/from reserves) for 2015/16 of £110,370 (1.1%) lower than the original budget 2014/15. This together with additional income arising from increases in the Council Tax base and Business Rate Income has enabled significant additional contributions to be made to the Stability and Resilience Reserve.

2.8 A further comprehensive review of services will be undertaken in the current year with the objective of achieving a balanced budget for 2016/17 and leave the Council best placed to meet the financial challenges anticipated for 2017/18 and later years. It is possible however that any further significant reductions in support (beyond those currently forecast within the strategy) may require additional measures such as:-

(a) Reducing expenditure on 'back office' and lower priority services functions;
(b) Increase fees and charges;
(c) Raise Capital receipts to reduce the impact of capital investment;
(d) Consider local tax rises in excess of the current policy, possibly requiring a local referendum.
and,
(e) Identifying new income streams and 'invest to save opportunities'

2.9 There is also need to continue to prioritise capital projects within the Capital Programme, particularly considering affordability and impact on local tax levels. The Capital Strategy indicates the considerations that are necessary in order to achieve this.

3 Risk Assessment

3.1 As highlighted above (paragraphs 2.5 and 2.6) there is considerable risk and uncertainty relating to the new Local Government financing arrangements and the levels of future Central Government grant funding. In view of this uncertainty maintaining adequate reserve levels is seen as essential to help mitigate against these risks.

3.2 Maintaining an up to date Medium Term Financial Strategy will assist in helping to identify the financial challenges facing the Council and the actions required to meet those challenges.

3.3 Further details of the financial risks facing the Council are shown in Appendix 1 of the Council Budget Forward to the Budget Book 2015/16.

4 Conclusion

4.1 Both the Medium Term Financial Strategy and Capital Strategy are key documents affecting the financial future of the Council. The Board need to consider these and the potential impact on future council tax policy.

Financial Services comments:	**See Report**
Legal Services comments:	**As the report sets out the Council has to set balanced budgets and to undertake its functions effectively, efficiently and economically**
Crime and Disorder	**None**
Equality and Diversity:	**None**
Service Improvement Plan implications:	**None**
Corporate Plan:	**None**
Risk Assessment:	**See Section 3.0 of this Report.**
Background papers:	**See report to Council 11/02/15 titled Council Budget 2015/16.**
Appendices	**1. Medium Term Financial Strategy 2015/16- 2019/20** **2. Capital Strategy 2015**
Report Author/Lead Officer	**Julian Bowcher**

APPENDIX 1

GOSPORT BOROUGH COUNCIL

MEDIUM TERM FINANCIAL STRATEGY

2015/16 – 2019/20

CONTENTS

GOSPORT BOROUGH COUNCIL

MEDIUM TERM FINANCIAL STRATEGY 2015/16 – 2019/20

1. 0 INTRODUCTION AND OBJECTIVES

1.1 Introduction

The Medium Term Financial Strategy (MTFS) contains details of the main challenges affecting the Council's finances over the next few years and indicates how the Council will respond to these. It provides the overall framework for the financial investment in services from 2014 to 2019. Updated and reviewed annually, the MTFS helps to ensure that the Council's financial resources are targeted to achieve the strategic priorities and values contained within the Council's Corporate Plan.
It contains sections covering:

- Revenue – the running costs of General Fund services (affecting Council Tax levels),
- Housing Revenue Account – A statutory account which is primarily financed from Council House rents,
- Capital - the Council's plans for investment in assets used to provide benefit over more than 1 year,
- Treasury Management – management of cash flows, borrowing and investing,
- Budgeting; and,
- Risk Management.

The MTFS also provides a link to other financially related strategies including the Capital Strategy, Asset Management Plan, Treasury Management Strategy and Workforce Development Strategy.

1.2 The Council's Mission

The MTFS plays a key role in helping achieve the Council's mission of 'To work with our community to improve everyone's quality of life and deliver a sustainable future for the Borough.' by providing an efficient, effective and robust financial framework which will enable the Council to focus resources on its stated priorities.

1.3 Objectives of the Strategy

The main objectives of the Medium Term Financial Strategy are:-

To help ensure that the Council's financial resources are sufficient to achieve its stated objectives within the Corporate Plan including strategic priorities and core values;

To seek to minimise net debt and maximise income in order to provide investment in economic and efficient services within Council Tax increases below the level that would result in a referendum being required;

To ensure that the Council maintains an adequate level of General Reserves to both meet unforeseen events and help reduce vulnerability to significant fluctuations in Council Tax levels;

To provide both a link and framework to other financially related strategies;

To provide a single document to communicate the financial aims and objectives to staff and stakeholders alike; and

To provide a projection of resource requirements over a 5 year period.

2.0 REVENUE

2.1 General Fund Base Budget 2015/16

2.1.1 The current year's budget is divided into the following service areas:

Gosport Borough Services	Gross Expenditure £'000	Gross Income £'000	Net Budget £'000
Environmental Health Services	1,264	97	1,167
Parks and Leisure Activities	3,059	581	2,478
Housing Services	36,097	35,271	826
Council Housing	13,584	14,631	-1,047
Refuse Collection	1,619	290	1,329
Town Planning & Development	2,126	476	1,650
Transportation	971	1,063	-92
Other Services and Expenses	6,455	4,244	2,211
Sub-Total	65,175	56,653	8,522
Net transfer to Balances	1,773		1,773
TOTAL	66,948	56,653	10,295

2.1.2 The net general fund budget (before transfer to Balances/Reserves) for 2015/16 is 1.1% lower than that for 2014/15, this together with increases in the tax base and Business Rate Income has enabled an increase in reserves whilst still maintaining the Borough's Council Tax at the same level as 2014/15, as detailed in the following table:-

Gosport-Percentage Council tax increase for 2015/16

Council's budget needs	-2.1%
Government Grant variation	-4.4%
Transfer to reserves	11.1%
Change to Council Tax base	-1.3%
Changes to Collection Fund balance	-3.3%
	0.0%

2.2 Revenue Budget Projections 2016/17 – 2019/20

2.2.1 The following table shows a forecast of the revenue budget for the next four years and takes into account any significant variations in income and expenditure that are presently known or anticipated. It must be recognised that this projection represents a central forecast and may be subject to considerable variation for a number of reasons such as changes in demand for Council services, new or amended Central Government legislation (including the Government Grant Settlement) and the external economic environment in which the Council has to operate. However, it is essential that this analysis is undertaken and updated as necessary in order that any potential budget problems or opportunities are quickly identified and the appropriate action undertaken.

2.2.2 A variation in the forecasts of only approximately £56,000 affects the Borough's Council Tax rates by 1%. Major risks to the forecasts are detailed in the Council's Budget Book and include variations in demand for statutory services (such as homelessness), reduced income from Government Grants/Business Rate Retention Scheme and reduced income from fees, charges and interest receipts. The projections are particularly susceptible to political decisions on public spending levels by the Government in response to the national economic situation. The Estimates of the Grant position for 2016/17 and later years remain very uncertain and for the purposes of this forecast it is currently estimated that there will be reductions of £500,000 in both 2016/17 and 2017/18 with further reductions of £300,000 in 2018/19 and £200,000 in 2019/20.It is believed that the greater risk to the forecast is on the downside and that the reductions in Revenue Support grant could be swifter and greater than currently predicted.

PROJECTED GENERAL FUND FOR THE YEARS TO 2019/20

(AT CURRENT PRICES)

		(£'000)			
		2016/17	**2017/18**	**2018/19**	**2019/20**
A	2014/15 Base Budget	10,295	10,295	10,295	10,295
B	Budget Increases				
	Crematorium (income down)	25	25	25	25
	Tax Freeze Grant (2015/16)	57	57	57	57
	Local Elections	50		50	
	Pensions ERS	39	82	128	179
	NI ERS –Cessation of contracting out (April 2016)	102	102	102	102
	Inflation (inc pay award)	120	240	360	480
	Transfer from Reserves	150	150	150	150
	New Homes Bonus Income	0	0	227	498
		543	656	1,099	1,491
C	Less Budget Decreases				
	MRP	(9)	(17)	(23)	(22)
	Transfer to Reserves	(876)	(876)	(876)	(876)
		(885)	(893)	(899)	(898)
D	PROJECTED BUDGET TOTALS (A+B+C)	9,953	10,058	10,495	10,888
E	**FUNDING**				
	Revenue Support Grant	(1,325)	(825)	(525)	(325)
	Collection fund (surplus)/Deficit- Council Tax	97	97	97	97
	Business Rates Collectable	(2,900)	(2,900)	(2,900)	(2,900)
		(4,128)	(3,628)	(3,328)	(3,128)

F	**GBC COUNCIL TAX LEVY (D-E)**	(5,825)	(6,430)	(7,167)	(7,760)
G	**COUNCIL TAX BASE**	**25,690.4**	**25,740.4**	**25,790.4**	**25,840.4**
H	**ESTIMATED COUNCIL TAX INCOME (FOR NO INCREASE)**	**(5,210)**	**(5,220)**	**(5,230)**	**(5,240)**
I	**POTENTIAL SAVINGS REQUIRED**				
	CUMULATIVE	**615**	**1,210**	**1,937**	**2,520**
	YEAR ON YEAR	**615**	**595**	**727**	**583**

2.2.3 Whilst the figures projected in paragraph 2.2.2 represent the best projection that can currently be made, there is a lot of uncertainty regarding future levels of Exchequer support, inflation and interest rates. Further information regarding levels of Exchequer Support may be provided by the budget in July 2015 although it is expected that the final position regarding the 2016/17 settlement will not be known until December 2015.

2.2.4 An area of even greater uncertainty than the level of future Revenue Support Grant is the income this Council will receive under the Business Rate Retention Scheme. The scheme is extremely complex with many of the factors that determine the business rate income the Council will receive outside the Council's control such as the level and success rate of business rate appeals (determined by the Valuation Office Agency) and any changes made by Central Government following the current review of the Scheme. The forecast assumes annual Business Rate Receipts of £2.9M between 2016 and 2020 however it is possible that this could fall to the safety net level (£2.1M in 2015/16). The creation of the Stability and Resilience Reserve does assist in providing some mitigation against this risk.

2.2.5 The Council commenced a series of service reviews with the objective of making efficiency savings whilst still maintaining service levels in order to help meet the financial challenges ahead. Further efficiency savings have been achieved (including those arising from the Environmental Health Partnership with Fareham Borough Council) which has enabled the Council to set a net budget (before transfer to/from reserves) for 2015/16 of £110,370 (1.1%) lower than the original budget 2014/15. This together with additional income arising from increases in the Council Tax base and Business Rate Income has enabled significant additional contributions to be made to the Stability and Resilience Reserve.

2.2.5 A continuing programme of service reviews is in place with the objective of achieving a balanced budget for 2016/17 and leave the Council best placed to meet the financial challenges anticipated for 2017/18 and later years. It is possible however that any further significant reductions in support (beyond those currently forecast within the strategy) may require additional measures such as:-

(a) Reducing expenditure on lower priority services functions;
(b) Increase fees and charges;
(c) Raise Capital receipts to reduce the impact of capital investment; and,
(d) Consider local tax rises in excess of the current policy, possibly requiring a local referendum.
and,
(e) Identifying new income streams and 'invest to save opportunities'.

2.3 General Fund Working Balance

2.3.1 A key objective of the Strategy is:-

'To ensure that the Council maintains an adequate level of General Reserves to both meet unforeseen events and help reduce vulnerability to significant fluctuations in Council Tax levels'

2.3.2 The Council's Working Balance minimum prudent target level of 7% of net expenditure was dropped from 2009/10 and the balance frozen at £890,000. Although still very low compared to most local authorities, £890,000 is considered to be adequate, subject to the regular review of budget risk. Gosport's working balance remains in the lowest quartile compared to other local authorities. This is considered appropriate as the Council is conscious that the balance represents local taxpayers' funds set-aside and not directly contributing to service provision.

2.3.3 It must be recognised however, that as a result of the radical changes to the financing of Local Government introduced in 2013/14 the Council is exposed to a number of new risk areas (including the collection of Business Rates, a risk previously borne by Central Government) so that the working balance should not be reduced at this time.

2.4 Revenue Financing Reserve

2.4.1 The Revenue Financing Reserve (RFR) is a provision available for general use, although it is particularly targeted at:-
- helping achieve efficiencies by providing funding for spend-to-save initiatives (seen as particularly important due to the forecast of a significant reduction in Central Government Grant);
- helping to ensure that variations in annual maintenance requirements can be adequately financed; and,
- reducing exposure to risk by helping to underwrite uninsurable risks and by saving premiums where self insurance is undertaken.

2.4.2 It is considered that maintaining a viable RFR is an essential element for improved management of the Council's finances. In order to achieve this, the approved Council policy is that the RFR is debited or credited with any General Fund budget variations and Council Tax Collection Fund surpluses/deficits (subject to the working balance first being maintained at an appropriate level).

2.5 Stability and Resilience Reserve

2.51 A Collection Fund Equalisation Reserve was first introduced in 2014/15 to help mitigate against the risks associated with the introduction of the Business Rate Retention Scheme. The scope for this reserve has been broadened to cover the significant increase in risk and volatility arising from the introduction of the Business Rate Retention Scheme, Council Tax Support scheme and the uncertainty regarding future levels of Revenue Support Grant. In light of this the reserve has been renamed the Stability and Resilience Reserve. The reserve is budgeted to increase to over £1.1 Million by 31 March 2016 which will greatly assist the Council by giving it more time to adjust to the variation in funding anticipated in the next five years particularly as there is a strong possibility this Council will receive no annual payment of Revenue Support Grant (currently £1.8M) by the end of this period

3. HOUSING REVENUE ACCOUNT

3.1 Housing Revenue Account (HRA)

3.1.1 The HRA comprises expenditure and income relating to stock of over 3,100 Council dwellings and over 290 leasehold properties. The services provided include Management, repairs and maintenance and the rental income collection service.

3.1.2 The determination of future expenditure patterns relies upon the following key elements:

- Repair and maintenance needs of the stock
- Meeting the decent homes and post decent standards
- Aspirations of the tenants
- Rent convergence
- The resources available
- Development
- Repayment of self financing loan.

3.2 HRA Self Financing

3.2.1 The HRA subsidy reform was in April 2012. For Gosport this meant buying out of a negative subsidy position. Full responsibility for managing and maintaining the stock now rests entirely with the authority. All income is now collected and managed locally and long term investment needs of the stock are now planned in consultation with the tenants.

3.2.2 The government has set a statutory debt limit for each housing authority which comprises the settlement figure for the authority plus what has previously been borrowed under the prudential code. The debt limit/cap for Gosport is £63.07m.This places a constraint on the potential for investment for this authority in the early years of self financing.

3.2.3 The cap on debt restricts the ability of Authorities to take on additional borrowing under the prudential code, even if the borrowing is affordable for the HRA. The localism Act does allow for the reopening of the settlement, but only in very limited circumstances.

3.3 HRA Business Planning

3.3.1 An HRA business plan has been developed as part of the requirement for self financing with an accompanying financial model to show that self financing is a viable option and that debt can be repaid within the timeframe. The business plan describes the Council's vision for the future of the housing stock under self financing and details how the Council intends to finance investment in the housing stock. The plan sets out the long term priorities, objectives and actions for council housing for the coming years.

3.3.2 The viability of the plan has been established through the completion of a detailed financial model. The model is calculated over thirty years and shows the baseline position for the HRA. It shows the impact of the increase in housing debt as a consequence of the required borrowing of £57m and the HRA's ability to both repay the debt and manage the stock over the next thirty years.

3.3.3 Detailed calculations are provided within the model for future rent levels, management and maintenance costs as well as capital spend, depreciation, debt repayment and working balances. This model is updated annually and rolled forward to give a continual assessment of income and expenditure over the life of the plan.

3.4 HRA Rent Income

3.4.1 Following consultation the government issued new rent guidance for social rents from April 2015 onwards. The key areas are:

- Retaining a formula rent for each property but uplifts now restricted to CPI +1%.
- Removing flexibility to increase rents by more than the formula uplift, except for relets where increases to formula or cap are expected.
- Commitment to policy for 10 years up to 2024-25

3.5 Improvement and Repairs

3.5.1 The Council has an Asset Management Strategy for the HRA that covers the period 2013-18.It has been drawn up to complement the HRA Business Plan and sets out the medium term implications of maintaining and improving the stock. It' will do this with regard to ensuring value for money, investment, procurement and partnering. The Asset Management Strategy has been informed by the Stock Condition Survey undertaken by Savills in 2012. A rolling 5 year programme of surveys will ensure that all stock information is improved and accurate.

3.5.2 The HRA Asset Management Strategy also complements the Gosport Borough Council Corporate Asset Management Plan of 2013.This document sets out corporate priorities and objectives for all council owned assets. The Council has a number of strategic objectives ,which underpin this document forming a comprehensive strategic approach to both investment (new assets or development) and re investment (maintenance of existing assets).

3.6 HRA working balance

3.6.1 The HRA working balance is a reserve of the Housing Revenue Account and is "ring fenced" for this purpose.

3.6.2 The draft HRA balance as at 31 March 2015 is in the region of £990,000. The balance is considered to be appropriate taking into account such factors as the level of stock, its condition and the additional risks borne by the Council following the move to self financing.

3.6.3 On March 31st 2015 the HRA also had £1,395,000 set aside for development or the provision of new assets. It is anticipated that this sum will continue to grow in future years and be available for use in conjunction with retained receipts from the Right –To-Buy Scheme.

4.0 CAPITAL

4.1 Capital Priorities and Selection Process

4.1.1 In order to ensure that the Council's Capital expenditure is targeted at achieving the Council's priorities capital projects must be evaluated and prioritised before they are recommended for inclusion in the Draft Capital Programme which is considered by Members as part of the budget process.

4.1.2 The projects are considered by the Council's Management Team with particular attention on their affordability (particularly critical as Government grant support has reduced) and their contribution to the priorities detailed within the Corporate Plan and associated Corporate Action Statement. The Team then make recommendations to Members on the schemes to consider and pursue as part of the Council's Capital Programme.

4.2 Prudential Framework/Impact on Revenue Account

4.2.1 The Local Government Act 2003 introduced major changes to the capital funding regime with effect from 1 April 2004.The previous system of controlling Councils capital expenditure by limiting borrowing through the use of credit approvals was replaced by a more flexible system based on affordability.

4.2.2 The prudential capital finance system (Prudential Framework) allows the Council to make its own borrowing decisions using agreed professional principles as set out in the Prudential Code to ensure that any new borrowing is affordable and prudent. It is accepted that use of the Code by the HRA will necessitate proper arrangements for debt repayment, although not currently required by statute.

4.2.3 The main advantages of the increased freedom to borrow under the Prudential Framework are:-

(i) The ability to bring forward capital schemes that would not otherwise have been possible to fund in the short to medium term under the previous capital financing regime.

(ii) Spend-to-Save Schemes where the cost of the borrowing associated with the capital expenditure on a Scheme can be wholly or partly met by revenue savings arising as a result of the project being carried out.

(iii) The ability to raise funding up to 3 years in advance when market conditions are favourable.

4.2.4 The ability to bring forward capital schemes will be limited by the ability of the Council to afford the revenue consequences of the borrowing undertaken. In any event, the anticipated low levels of supported borrowing, capital grants and other capital funding resources together with the national pooling of Housing Capital Receipts has resulted in an increase in the need to borrow to finance Capital Expenditure.

4.3 Projected Expenditure

4.3.1 Capital Programme 2015/16-2017/18

	2015/16 £,000	2016/17 £,000	2017/18 £,000
Community (Housing)	6,502	4,082	4,242
Community (Non Housing)	218	341	178
Policy & Organisation	235	175	175
Total Capital Programme	**6,955**	**4,598**	**4,595**
Revenue Contribution - HRA	3,560	3,640	3,800
St Vincent Development-HRA	2,500	-	-
Specific Capital Grants - GF	282	282	282
Capital receipts -GF	675	600	600
Capital Funding Requirement - GF	(62)	76	(87)
Total Capital Funding	**6,955**	**4,598**	**4,595**

4.3.2 A significant proportion of the planned capital expenditure relates to the Community Board, with the largest area of expenditure being that of improvements to housing stock. Partly as a result of the move to self financing (see 3.2) it has been possible to budget for higher annual expenditure levels (between £3,5M-3.75M) than had previously been the case. In addition a sum has been included in 2015/16 of £2.5M for the St Vincent Road Development where 16 new Council properties will be built.

5.0 TREASURY MANAGEMENT

5.1 Treasury Management Strategy

5.1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework, the treasury management activity covers the effective funding of these decisions. Taken together they form part of the process which ensures the Council meets the requirement of setting a balanced budget.

5.1.2 The CIPFA code of practice requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report will be produced after the year-end to report on actual activity for the year together with the mid-year position. This report includes extracts from the Treasury Management Strategy for 2015/16.

5.1.3 A key requirement of the strategy is to explain both the risks associated with the treasury service and how those risks are to be managed.
This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;

- The Council's borrowing and debt strategy
- The Council's investment strategy
- Treasury performance indicators;
- Specific limits on treasury activities;
- Any local treasury issues.

5.2 Treasury Position

5.2.1 The Council had net borrowing of almost £59M at 31 March 2015.

5.2.2 The Council's capital expenditure plans will be partially financed by external funds such as capital receipts, capital grants, external contributions and deposits. The remaining element which is not able to be immediately financed from these sources will impact on the Council's borrowing need (the Capital Financing Requirement, or CFR). This borrowing or net financing need is known as unsupported capital expenditure and must be paid for from the Council's own revenue resources.

5.2.3 A key risk of the capital funding plan is that the estimated sources of external funding are subject to confirmation and/or negotiation which may cause changes to the budgeted funding pattern. This will become increasingly important as interest rates begin to rise.

5.3 Prospects for interest rates

5.3.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60
Sep 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
Mar 2018	2.00	3.60	4.80	4.80

5.3.2 UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have remained strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

5.3.3 The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008.

5.3.4 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

• Greece: the general election on 25 January 2015 has brought a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

• As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

• Investment returns are likely to remain relatively low during 2015/16 and beyond;

• Borrowing interest rates had been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the belief that the ECB would commence quantitative easing (purchase of EZ government debt) in early 2015.as proved the case. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

• There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

5.4 Policy on borrowing in advance of need

5.4.1 The Council has some flexibility to borrow funds for up to three years in advance of when it is needed. The Borough Treasurer may do this under delegated power where, for instance, a sharp rise in interest rates is expected meaning borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Borough Treasurer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

5.4.2 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

5.5 Debt rescheduling

5.5.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

5.5.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.5.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

5.6 The Council's borrowing strategy

5.6.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

5.6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Borough Treasurer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years
- if it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

5.6.3 The Council's sources of borrowing are:-

- Long-term loans (in excess of 364 days) will be raised with the PWLB or other public bodies
- Short term loans (less than 364 days) will be raised through
  - Money market loans through the London Money Market using brokers appointed at the discretion of the Borough Treasurer
  - Directly or through brokers, at the discretion of the Borough Treasurer, with other public bodies
  - Use of the Council's overdraft limit with its bankers, National Westminster Bank, up to £250,000
  - Internal funds – the cash held in internal funds can be used short term to fund capital expenditure or the repayment of debt, thus delaying the need to borrow externally

5.7 The Council's Investment Strategy

- The key objectives of the Council's investment strategy are security, liquidity and yield in that order.
- The Council has determined that it will only use approved counterparties from the UK
- No Investments are to exceed 3 years although most will not exceed 364 days
- A £3m limit applies with any single group other than the Council's Bank or UK Regulated Qualifying Money Market Funds
- Investments will be placed with bodies that meet the Council's creditworthiness criteria
- There is a clear operational difficulty arising from the current banking situation. Ideally investments would be invested longer to secure better returns, however uncertainty over counterparty creditworthiness and interest rates suggests short dated investments may provide lower exposure to risk.

6.0 BUDGET STRATEGY AND PROCESS

6.1 The Council's current Corporate Plan details the Council's Strategic Priorities which are categorised under four main headings namely, People, Places, Prosperity and the Pursuit of Excellence.
The Corporate Action Statements (contained within the Corporate Plan) underpin the delivery of the Corporate Priorities. Any budgetary implications arising from the actions outlined in Service Improvement Plans (SIP) are included within the

Council's initial Draft Budget. Depending on the resource constraints affecting the Council these are either ultimately approved or, if this is not possible, the unit SIP is amended to reflect this.

6.2 Budget preparation incorporates requirements resulting from Council priorities identified from Capital Strategies, Community Strategy, Corporate Plan and departmental action plans, culminating in recommendations to Boards and Council the following January/February.

6.3 Budget preparation is "zero-based" where appropriate and new bids are minimised. Maintenance proposals are provided for according to the latest Asset Management Plan requirements.

6.4 Prudent inflation parameters are used in the build up of the initial budgets.

6.5 In the interest of sustainability, the Council will not generally budget to use one-off or short-term income (including grants) on expenditure that is properly part of its base budget requirements.

6.6 Capital projects bids are considered for inclusion within the Capital Programme in terms of affordability, including impact on local tax levels as part of the Budget Process.

6.7 Once the Council's budget is set and the precepting authorities' requirements known, the Council sets Council Tax levels for the forthcoming year (this has to be done by 11 March).

7.0 RISK MANAGEMENT AND INSURANCE

7.1 Risk Management

7.1.1 The Council recognises the importance of an effective risk management process covering all aspects of the significant business risks that the authority faces. Although much has been achieved, ongoing development of the risk management process remains a key priority of the Council and dedicated resource has been earmarked for this purpose. In particular Risk Working groups have been formed to review areas considered to be of greater risk i.e. housing, motor, property and combined liability in order to improve the Council's overall risk performance.

7.1.2 The Council has an agreed Risk Management Strategy in place. Major capital schemes must be risk assessed as part of the approval process. In addition risk registers for both operational and strategic risks are in operation which assesses the financial risks as part of its overall framework. Finally, an established corporate risk management group meets to discuss key risk issues that influence the Council's day-to-day business and to further develop and critically review the risk management process.

7.1.3 The Budget report to Council and the Budget Book highlight the principal areas of risk to the budget with an assessment of likelihood and impact.

7.2 Insurance

7.2.1 In collaboration with the other 10 Hampshire District Councils this Council successfully tendered for insurance services on a long term agreement basis commencing on 1 April 2015. The contract will run for 3 years until 2018 with an option to extend for a further 2 years.

Our new insurers are as follows: -

Property – Allianz Insurance PLC,
Casualty & Motor – QBE Insurance via Risk Management Partners Ltd,
Fidelity, Engineering, PA & Travel – Zurich Municipal PLC
Terrorism – Catlin Ltd.

7.2.2 The new contracts will ensure that the Council continues to have a robust range of insurance policies in place to help safeguard against many of the higher financial risk, in particular the areas of property, employers and public liability insurance.

Appendix 2

Gosport Borough Council

Capital Strategy

2015

CAPITAL STRATEGY

1.0 INTRODUCTION

1.1 The main purpose of the Capital Strategy is to outline how the Council decides what Capital Projects are supported and the process that is undertaken to make sure that these are in line with the Council's priorities and objectives.

1.2 The funding options and constraints relating to the funding of the programme are explored for the Capital Programme 2014-18.

2.0 FINANCIAL AND ASSET INFORMATION

Revenue Budget

The Council's gross revenue budget 2015/16 totals £66.948 Million, which after deducting gross income of £56.653 Million results in a net revenue budget of £10.295 Million.

Assets

The Council's asset base is dominated by its housing stock, which numbered 3,157 properties on 31 March 2015 with an estimated value of over £113 Million representing 72.6% of the total fixed asset value of over £156 Million.

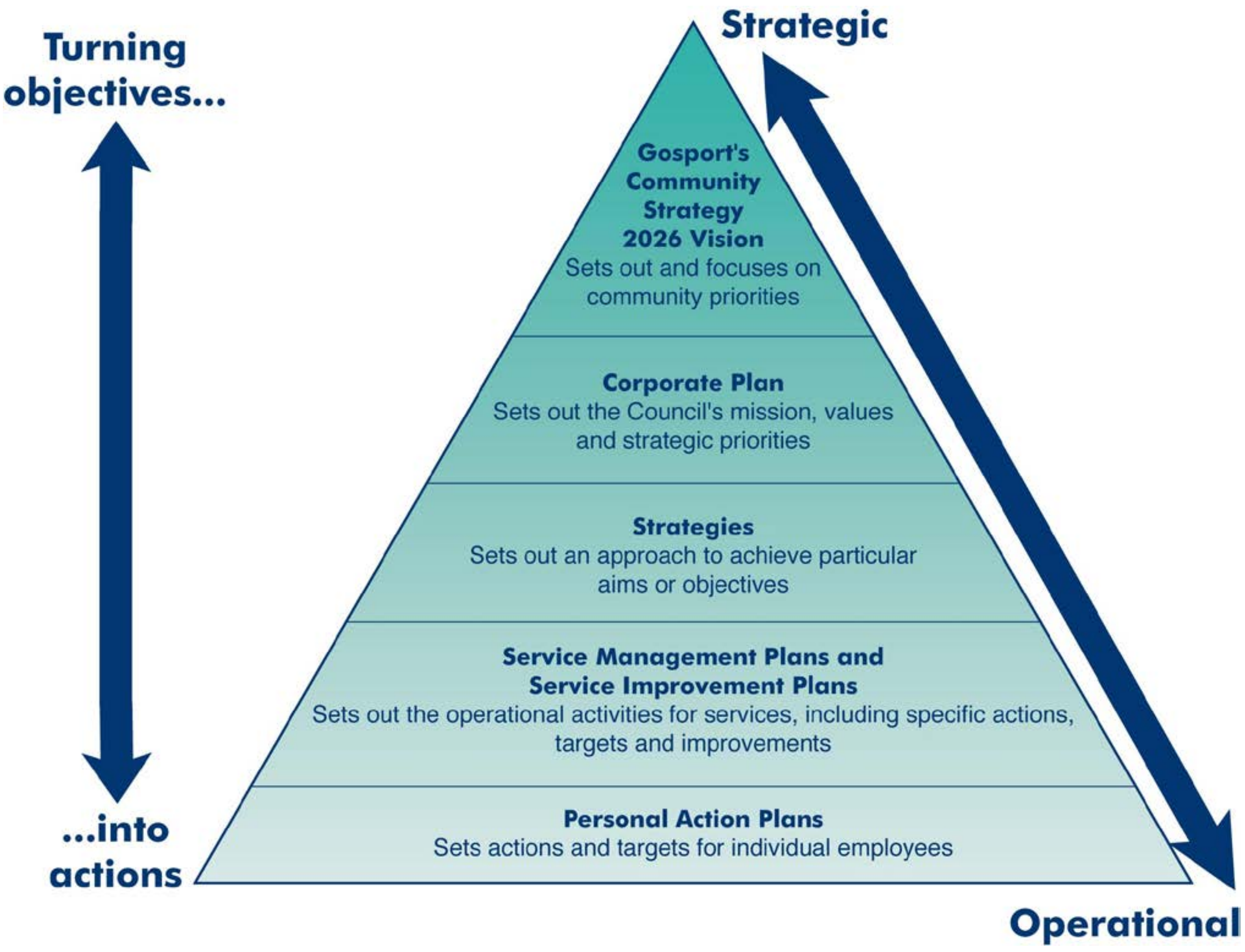
Council Assets 2014/15

	2014/15 £'000
Council Dwellings	113,437
Land & Buildings	21,521
Vehicles, Plant & Equipment	848
Infrastructure	8,375
Community Assets	3,839
Surplus Assets	68
Assets Under Construction	132
Heritage Assets	316
Investment Property	7,088
Intangible Assets	601
	156,225

2.1 The relatively high proportion of Infrastructure Assets (£8.3M) is primarily due to the coastal nature of the Borough and includes sea defence features such as sea walls and pontoons. The Community Assets (£3.8M) include land set aside for recreation and leisure purposes (including the 27 designated parks within the Borough).

3.0 THE COUNCIL'S OBJECTIVES

3.1 The diagram below shows how the Council's objectives are identified and incorporated within the strategies and plans of the Council to ensure that the limited resources available are targeted to the areas considered most important.



3.2 The Corporate Plan which is reviewed annually and is the key document for setting out the Council's objectives detailing the Councils Mission, values and strategic priorities many arising from the Community Strategy/2026 Vision.

The Council's mission is:

'To work with our community to improve everyone's quality of life and deliver a sustainable future for the Borough'.

A number of Core Values are also identified under the headings of Participation, Performance, Partnership, People and Political Processes to help the Council to meet its aspiration to be recognised as an open and responsive organisation, regarded as excellent and at the centre of the community.

The Corporate Plan also lists the Councils Strategic Priorities under the four main headings of:
People
Places
Prosperity
Pursuit of Efficiency & Effectiveness

People, Places and Prosperity are the cornerstones of Gosport's 2026 Vision whilst Pursuit of Excellence embraces the core values.

The Council's Strategic Priorities are a combination of the priorities of local people, national priorities set by Central Government and the challenges arising from Gosport's changing social, economic and environmental context.

3.3 As shown in the diagram the principal purpose of the various Strategies of the Council are to help set out a framework to assist the achievement of the objectives and strategic priorities of the Council. The Capital Strategy seeks to ensure that the Council's limited Capital Resources are best used to achieve this objective.

4.0 THE SELECTION AND PRIORITISATION OF CAPITAL PROJECTS

4.1 In order to ensure that the Council's Capital expenditure is targeted at achieving the Council's Priorities capital projects must be evaluated and prioritised before they are recommended for inclusion in the Draft Capital Programme which is considered by Members as part of the budget process.

4.2 The projects are considered by the Council's Management Team with particular attention on their affordability (particularly critical as Government grant support has reduced) and their contribution to the priorities detailed within the Corporate Plan including strategic priorities and core values. The Team then make recommendations to Members on the schemes to consider and pursue as part of the Council's Capital Programme.

5.0 FINANCING THE CAPITAL PROGRAMME

5.1 The Local Government Act 2003 introduced major changes to the capital funding regime with effect from 1 April 2004.The previous system of controlling Councils capital expenditure by limiting borrowing through the use of credit approvals was replaced by a more flexible system based on affordability.

5.2 The prudential capital finance system (Prudential Framework) allows the Council to make its own borrowing decisions using agreed professional principles (as set out in the Prudential Code which has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA)) to ensure that any new borrowing is affordable and prudent.

5.3 The main advantages of the increased freedom to borrow under the Prudential Framework are: -

(i) The ability to bring forward capital schemes that would not otherwise have been possible to fund in the short to medium term under the previous capital financing regime.

(ii) Spend-to-Save Schemes where the cost of the borrowing associated with the capital expenditure on a Scheme can be wholly or partly met by revenue savings arising as a result of the project being carried out.

(iii) The ability to raise funding up to 3 years in advance when market conditions are favourable.

5.4 The capital expenditure possible through the prudential framework will be limited by the ability of the Council to afford the revenue consequences of the borrowing undertaken placing an increasing reliance on other sources of Capital Funding. These include:

Internal Funding:-

Usable Capital Receipts-Receipts arising from the disposal of Council Land, buildings and other assets.

Whilst 100% of the receipts arising from the disposal of General Fund Assets can usually be used to fund capital projects the rules regarding the disposal of HRA assets are more complex. Non Right To Buy (RTB) receipts are no longer subject to pooling. In April 2012 this authority signed an agreement with the DCLG regarding RTB receipts under which the Council is able to retain a greater proportion of receipts on the understanding that they are applied to investment in affordable housing up to a maximum of 30% of the funding for each scheme.

Revenue Contributions to Capital-

Revenue funding of capital projects represents another funding option although, due to revenue budget pressures, it has generally not been possible to fund such contributions from the General Fund. The current expectation of further reductions in Central Government Grant in the next three years makes it unlikely that this position will change in the near future.
Such contributions from the Housing Revenue Account (ring fenced for Housing Capital Expenditure) have historically played an important funding role in supporting the Housing Stock Improvement Programme. As a result of the introduction of self financing and the discontinuation of the Major Repairs Allowance this has become an even more significant source of funding for HRA capital expenditure.

External Funding:-

Some of the principle sources of external funding are:-

Specified Capital Grants

Government grants given towards certain capital expenditure items such as Disabled Facilities Grants.

Other Grants and Partnership Contributions

All other external grants and contributions from other sources.

6.0 THE CAPITAL PROGRAMME 2014/15-2016/17

6.1 A summary of the Council's Capital Programme and proposed funding for the next 3 years is set out in the table below. More detailed breakdowns of the programme is available in the Council's Budget Book 2015/16.

	2015/16 £,000	2016/17 £,000	2017/18 £,000
Community (Housing)	6,502	4,082	4,242
Community (Non Housing)	218	341	178
Policy & Organisation	235	175	175
Total Capital Programme	**6,955**	**4,598**	**4,595**
Revenue Contribution - HRA	3,560	3,640	3,800
St Vincent Development-HRA	2,500	-	-
Specific Capital Grants -GF	282	282	282
Capital receipts -GF	675	600	600
Capital Funding Requirement - GF	(62)	76	(87)
Total Capital Funding	**6,955**	**4,598**	**4,595**

6.2 A significant proportion of the planned capital expenditure relates to the Community Board, with the largest area of expenditure being that of improvements to housing stock. Partly as a result of the move to self financing it has been possible to budget for higher annual expenditure levels (between £3,5M-3.75M) than had previously been the case. In addition a sum has been included in 2015/16 of £2.5M for the St Vincent Road Development where 16 new Council properties will be built.

7.0 CAPITAL PROGRAMME AND PROJECT MONITORING

7.1 Once approved it is important the Capital Programme is delivered and a robust monitoring process is in operation. The Capital Programme is closely monitored and any variation is included in the Budget Monitor which is either distributed to Policy and Organisation Board Members or where required (such as when a virement or supplementary estimate is needed) is taken to the Board for decision. In addition the programme is revisited as part of the annual budget process with scheme progress being monitored and scheduled projects re-phased or deleted as necessary.

7.2 In addition to the above process a specific project group for larger projects is established when required to progress and monitor the progress of the scheme. The project team would also report back regularly to Council Management Team and if issues arise requiring political decision to the appropriate Council Board.

8.0 POST IMPLEMENTATION REVIEW

8.1 The lead officer for major (over £100,000) Capital Projects will notify the Head of Accountancy when the project is completed and a Post Implementation Review form is to be supplied. The feedback on these forms will then be considered by Council Management Team.

8.2 The form provides details on how successfully the project has been delivered specifically in relation to the following:-

(1) Timing-was the project started/completed by the anticipated dates?
(2) Cost-was the Scheme completed in accordance with the allocated budget?
(3) Objectives-did the scheme achieve the anticipated outputs/outcomes?

9.0 PARTNERSHIP WORKING

9.1 Working in partnership with other organisations from both the private and public sector is an important way of ensuring the limited Capital Resources available are used efficiently to help maximise their contribution towards achieving the Corporate Objectives and Priorities. Partnership working may range from key overarching Partnerships such as those arising from the Local Strategic Partnership, preferred partners in specific Service areas such as the Key Housing Association Partners or 'one off' schemes where the organisation's and the Council's priorities coincide.

9.2 The Capital Scheme Proposal Form specifically requests information on how the scheme will Develop partnership working, financial and non financial input from other partners and asks how the scheme will contribute to the partners' strategies and priorities.

10.0 MEDIUM TERM FINANCIAL STRATEGY

10.1 The Medium Term Financial Strategy provides an overall framework for the financial investment in services for a five year period. It therefore is closely linked with the Capital Strategy and shows the effect on the overall revenue budget and associated Council Tax levels of the financing charges arising from the Capital Programme.

10.2 It is important, therefore, that any significant alterations in the Capital Strategy are promptly used to update the Medium Term Financial Strategy to help fully understand the impact of such changes on the Council's Finances as a whole.

11.0 ASSET MANAGEMENT PLAN

11.1 The Council's Asset Management Plan and HRA Asset Management Plan help develop a process to achieve efficient effective and economical management of its assets. The linkages to the Capital Strategy and Programme are strong with capital expenditure on Council Assets being a significant element of the Programme particularly relating to the Council's Housing Stock.

11.2 It is important that the Council's property assets are maintained as they play a vital role in the delivery of the Councils Statutory Services and the delivery of its Corporate Priorities. The Asset Management Plan informs the Council on the improvement and maintenance requirement of the Council Assets with the larger schemes being included in the Capital Programme.

12.0 HOUSING BUSINESS PLAN

12.1 The Housing Business Plan is a long term plan for managing the authority's housing Assets and financing the necessary investments. It is a key element in ensuring the effective long term management and maintenance of the Council Housing Stock. The importance of the plan has further increased following the introduction of self financing of the HRA with a greater responsibility and risk being borne by the Council.

12.2 The Plan should be consistent with the Authorities wider corporate objectives and Housing Strategy and will inform on the level of Capital Expenditure required on the Housing stock necessary to achieve the Decent Homes and energy efficiency targets.

13.0 REVIEW OF THE CAPITAL STRATEGY

13.1 The Capital Strategy is reviewed annually to take account of any changes in legislation, capital expenditure requirements, funding position or process improvements. Any significant changes are considered by Council Management Team and consequent amendments to the strategy are submitted to Policy and Organisation Board for consideration and approval.