Harrow COUNCIL
LONDON

Meeting:	Cabinet
Date:	12 February 2009
Subject:	Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision (MRP) Policy and Strategy 2009-10
Key Decision:	Yes
Responsible Officer:	Myfanwy Barrett: Corporate Director of Finance
Portfolio Holder:	David Ashton (Leader and Portfolio Holder for Strategy, Partnership and Finance)
Exempt:	No
Enclosures:	Appendix 1 – Prospects for Interest Rate Appendix 2 – Options under MRP Appendix 3 – MRP Policy Statement

Section 1 – Summary and Recommendations

This report sets out the Council's Treasury Management Strategy, which covers; the prudential indicators; the Annual Investment Strategy; the Borrowing Strategy and Minimum Revenue Provision (MRP) Policy and Strategy for 2009-10.

Recommendations

Cabinet is requested to recommend the Council to approve

- The Treasury Management Strategy and Prudential Indicators,
- The Minimum Revenue Provision Policy and Strategy for 2009-10 as set out in Appendix 3, and
- Implement the new MRP requirements with effect from 1 April 2007.

Reason

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

Section 2 – Report

Introduction

1. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. The Act therefore requires the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3. The Council delegates responsibility for the implementation and monitoring of its Treasury Management Policy to Cabinet and for the execution and administration of treasury management decisions to the Council's Section 151 Officer.

4. The Section 151 Officer chairs the Treasury Management Group (TMG) which consists of Deputy Section 151 Officer and Business Partner for Treasury to monitor the treasury management activity and market conditions.

5. The suggested Strategy for 2009-10 is based upon the TMG's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor (Sector). The Strategy covers:
   - Prudential Indicators;
   - the Investment Strategy;
   - the Borrowing Strategy.

6. The report also includes recommendations for the approval of a Policy Statement which provides for the introduction of the new Minimum Revenue Provision (MRP) Guidance. A full explanation is set out later in the report.

7. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -
   - increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   - any increases in running costs from new capital projects

   are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

TREASURY LIMITS FOR 2009-10 TO 2011-12

8. It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the

"Authorised Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in Section 3 of the Local Government Act 2003.

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

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

PRUDENTIAL INDICATORS FOR 2009-10 – 2011-12

11. The following Prudential Indicators are set out below.
    - Table 1 shows the position as at 31 December 2008.
    - Table 2 includes estimates of capital expenditure; ratio of financing costs to the net revenue stream; Capital Financing Requirement; the incremental impact of capital decisions; the authorised limits and operational boundary for external debt; upper limit for fixed rate interest rate exposure and total sums invested for more than 364 days.

Table 1

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	135.481		
	Market	81.800	217.281	4.694
Variable rate funding			0.000	
Other long term liabilities			0.00	
Total Debt			**217.281**	**4.694**
Total Investments			**105.275**	**5.26**

Maturity structure of fixed rate borrowing during 2009-10	**upper limit**	**lower limit**
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	10%
10 years and above	95%	30%

Table 2

PRUDENTIAL INDICATOR	2007-08	2008-09	2009-10	2010/11	2011/12
	actual	forecast outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
Non - HRA	42,425	76,586	53,946	48,293	34,122
HRA	10,957	14,963	6,997	5,966	6,160
TOTAL	**53,382**	**91,549**	**60,943**	**54,259**	**40,282**
Borrowing to Fund the Capital Programme	26,338	47,973	33,385	21,132	25,330
Ratio of financing costs to net revenue stream					
Non - HRA	7.08%	6.61%	10.14%	11.88%	12.78%
HRA	28.44%	35.64%	38.55%	38.88%	38.25%
Net borrowing requirement					
brought forward 1 April	149,333	122,083	131,568	204,748	226,343
carried forward 31 March	122,083	131,568	204,748	226,343	251,003
in year borrowing requirement	**27,250**	**9,485**	**73,180**	**21,595**	**24,660**
Capital Financing Requirement (CFR) as at 31 March					
Non – HRA	166,625	198,781	221,503	230,686	243,020
HRA	36,907	47,161	49,130	49,947	50,958
Total	**203,532**	**245,942**	**270,633**	**280,633**	**293,978**
Annual change in CFR					
Non – HRA	14,156	32,156	22,722	9,183	12,334
HRA	6,121	10,254	1,969	817	1,011
Total	**20,277**	**42,410**	**24,691**	**10,000**	**13,345**
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	20.59	57.10	36.41	20.82	20.95
Increase in average housing rent per week	18.64	19.30	18.54	18.76	18.80
Authorised Limit for external debt					
Borrowing	207	278	311	332	357
Other long term liabilities	0	0	0	0	0
Total	**207**	**278**	**311**	**332**	**357**
Operational Boundary for external debt					
Borrowing	207	255	288	309	334
Other long term liabilities	0	0	0	0	0
Total	**207**	**255**	**288**	**309**	**334**
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	207	255	288	309	334
Upper limit for variable rate exposure					
Net principal re variable rate borrowing/Investments	85	100	115	125	135
Upper limit for total principal sums invested for over 364 days	11	50	25	50	50

12. The calculations of the upper limit for fixed and variable rate exposures are prescribed by the CIPFA Code and in simple terms are as follows:

    - Upper Limit for fixed interest rate exposure is calculated by taking the principal sums borrowed at fixed rates less principal sums invested at fixed rates.
    - Upper Limit for variable rate exposure is calculated by taking the principal sums borrowed at variable rates less principal sums invested at variable rates.

    In order to calculate these limits over the three year periods as required it is necessary to undertake projections of possible borrowing and investment levels.

Interest Rate Outlook

13. The base rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and 0.5% in January 2009. It currently stands at 1.5% with further cuts of 1% expected during Q1 2009. Based on the Sector view it is then expected to stabilise at 0.50% until starting to rise gradually with the first increase in Q2 2010 and then to be back up to 4.00% during Q1 2012. Appendix 1 shows a range of opinions on future interest rates, including the Sector view.

14. The Council will therefore avoid locking into longer term deals while investment rates are down at historically low levels.

Borrowing Strategy

15. Sector and other views on future PWLB rates are included at Appendix 1. Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to simply taking long term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates so this may offer some opportunity for new borrowing to spread the debt maturities away from a concentration in long dated debt.

16. However, given that the next financial year is expected to be a time of historically abnormally low base rates, then the cost of new borrowing will exceed the rate at which surplus monies can be invested, resulting in a net cost to the Council. This means that the Council loses an important source of income from investments and could face higher costs in financing its net new debt requirement. This opens up an opportunity for the Council to fundamentally review the strategy of undertaking external borrowing

17. As the Council's investments (£105m at 31 December 2008) are in excess of the borrowing requirement over the next year (£33m), it would be prudent to utilise internal funds to finance the capital programme. The main advantages of the internal borrowing are:-

    - It contributes towards mitigating the loss on investment income in the short term, as long term borrowing rates are expected to be higher than rates on the investment income, and

- The running down of investments also has the benefit of reducing the exposure to interest rate and counter party risks.

18. As a result of the above strategy the Council's long term external debt is projected to decrease from £217m to £212m by the end of 31 March 2010.

19. Against this background, an increase in caution will be adopted with regard to the 2009-10 treasury operations. The Corporate Director of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet at the first available opportunity.

DEBT RESCHEDULING

20. The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans if these become available after the drying up of their supply during autumn 2008.

21. Due to short term borrowing rates being expected to be considerably cheaper than longer term rates, there are likely to be significant 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 their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a rebalancing of an authority's debt maturities towards a flattening of the maturity profile as in recent years there has been a skew towards longer dated PWLB.

22. Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action, and other financial considerations.

23. As average PWLB rates (as set out at Appendix 1) in some maturity periods are expected to be minimally higher earlier on in the financial year than later on, there should therefore be greater potential for making marginally higher interest rate savings on debt by carrying out debt restructuring earlier on in the year.

24. The reasons for any rescheduling to take place will include:
    - the generation of cash savings and / or discounted cash flow savings;
    - helping deliver the objectives of the borrowing strategy; and
    - to alter the balance of the portfolio (i.e, amend the maturity profile and/or the level of volatility).

25. All rescheduling will be reported to Cabinet at the meeting following its action.

ANNUAL INVESTMENT STRATEGY

Investment Policy

26. The Council approves a Treasury Management Strategy on an annual basis and has adopted the 'CIPFA code of Practice for Treasury Management in the Public Services'.

27. The Council will have regard to the ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sector Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

    (a) the security of capital; and
    (b) the liquidity of its investments.

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

    The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

    Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices.

    Specified investments are considered low risk and relate to funds invested for up to one year. Non-Specified investments sometimes offer the prospect of higher returns but carry a higher risk and have a maturity beyond one year.

    Due to the banking crisis in autumn 2008, the credit rating criteria were reviewed and revised criteria were approved by the cabinet in December 2008.

<u>Specified Investments</u>

28. All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum rating criteria where applicable. The instruments and credit criteria to be used are set out in the table below.

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA Long Term F1 Short-term 2 Support B Individual AAA Sovereign	In-house
UK Nationalised banks	F1+ Short-term 1 Support	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments

Maturities in excess of 1 year

	Minimum Credit Criteria	Use	*Max % of total investments	Max. maturity period
Term deposits – banks and building societies	AA Long Term F1 Short-term 2 Support B Individual AAA Sovereign	In-house	50%	5 yrs
Callable Deposits	F1 Short term A Long Term	In-house	20%	5 yrs

29. Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, they have assigned an F rating which means that at a historical point of time this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

30. The Council uses Fitch ratings to derive its counterparty criteria Credit Limits. Where a counter party does not have a Fitch rating, the equivalent Moodys rating will be used. All credit ratings will be monitored in-house with the help of Sector who alert the Council to changes in Fitch ratings through its creditworthiness service. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use as an investment will be withdrawn immediately.

Investment Strategy

31. The Council's funds are mainly cash flow derived and include the General Fund, Pension Fund, West London Waste Authority and Housing Revenue Account balances. It is estimated that there is a core balance of about £25m which could be available for investment over a 1 – 5 year period.

32. Officers will continue to invest funds on a risk spread basis with the security of capital being the primary consideration. Funds will be "locked in" for longer periods only if it is prudent to do so. Due to low interest rates and to reduce the exposure to counter party risk, it would be prudent to take advantage of internal borrowing to fund the capital programme for 2009-10. This will mean lower cash balances which means that a prudent estimated gross investment return would be around £0.650m for the year. The net gain after allocating out the investment return across all funds would be around £0.100m to the Council's budget.

33. At the end of the financial year the Council will report on its investment activity as part of the Annual Treasury report.

MINIMUM REVENUE PROVISION POLICY STATEMENT 2009-10

What is a Minimum Revenue Provision?

34. Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP), which was previously determined under Regulation, and will in future be determined under Guidance.

New statutory duty

35. Statutory Instrument 2008 no. 414 s4 lays down that:

> "A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146, (as amended)

There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year

The share of Housing Revenue Account CFR is not subject to an MRP charge

New Government Guidance

36. Along with the above duty, the Government issued new guidance in February 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate. The MRP policy statement which is recommended to be adopted is included at Appendix 3.

37. The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

38. (i) Although four main options are recommended in the guidance (detailed in Appendix 2), there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

    (ii) It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

39. Essentially, the Guidance may only be applied to new capital expenditure relative to the period to which the annual MRP relates. This means that debt which remains outstanding in respect of earlier capital expenditure will continue to be subject to MRP at the rate of 4% per annum (option 1). New debt up to the limit of the Council's annual supported capital expenditure amount may also continue to be charged at 4%, but apart from this expenditure to be financed from borrowing is recommended to be subject to MRP on the estimated useful life basis. This may either be assessed as equal annual instalments, or lower early year charges on an annuity basis, (categorised as option 3) or in accordance with depreciation accounting methods (option 4).

Date of implementation

40. The previous statutory MRP requirements cease to have effect after the 2006-07 financial year. However, the same basis of 4% charge may continue to be used without limit until the 2009-10 financial year, relative to expenditure incurred up to 31 March 2009.

41. It is recommended that the Council implements the new guidance in 2007-08 which will result in a reduction in charge to revenue of approximately £766k in 2007-08. This is mainly due to the concept of charging revenue only once the asset becomes operational and the cost is spread over the useful life of the asset. The detailed MRP policy is set out at appendix 3.

Financial Implications

42. Financial matters are integral to the report.

Performance Issues

43. Treasury Management is scored as part of one of the Key Line of Enquiry on Financial Standing. Council meets the requirement of CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for Treasury Management function, contributing to the overall score on Use of Resources.

Environmental Impact

44. There is no environmental impact.

Risk Management Implications

45. Risk is included on Directorate risk register.

Section 3 - Statutory Officer Clearance

Name: Myfanwy Barrett Date: 30 January 2009		Chief Financial Officer
Name: Helen White Date: 3 February 2009		on behalf of Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Tom Whiting Date: 2 February 2009		On behalf of Divisional Director of Strategy and Improvement

Section 5 – Environmental Impact Officer Clearance

Name: John Edwards Date: 30 January 2009		Divisional Director (Environmental Services)

Section 6 - Contact Details and Background Papers

Contact: Jennifer Hydari (Divisional Director of Finance and Procurement)

Background Papers: Report to February 2008 Cabinet : Approval of 2008-09 Treasury Management Strategy and Prudential Code.

Appendix 1

PROSPECTS FOR INTEREST RATES

The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates.

Bank Base Rate Forecast

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
	%	%	%	%	%	%	%	%	%	%	%	%	%
Sector	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.75	2.50	3.25	3.75	4.00
Capital Economics	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**Forecast not available**				
UBS	0.50	0.50	0.50	0.75	**Forecast not available**								

PWLB New Borrowing Rate Forecast

Sector forecast

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
	%	%	%	%	%	%	%	%	%	%	%	%	%
5yr	2.50	2.25	2.15	2.15	2.15	2.45	2.80	3.15	3.65	3.95	4.20	4.45	4.60
10yr	3.10	2.75	2.55	2.55	2.55	2.85	3.25	3.65	4.15	4.40	4.70	4.75	4.85
25yr	4.00	3.95	3.95	3.95	4.00	4.15	4.35	4.45	4.60	4.85	1.95	5.00	5.05
50yr	3.85	3.80	3.80	3.80	3.85	3.90	4.00	4.25	4.40	4.70	4.80	4.95	5.00

Capital Economics forecast

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010
	%	%	%	%	%	%	%	%
5yr	1.65	1.45	1.45	1.45	1.45	1.45	1.45	1.45
10yr	2.65	2.15	2.15	2.15	2.15	2.15	2.15	2.15
25yr	4.15	4.00	3.80	3.65	3.65	3.65	3.65	3.65
50yr	4.05	3.95	3.85	3.75	3.75	3.75	3.75	3.75

UBS forecasts

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
	%	%	%	%
5yr	**Forecast not available**			
10yr	3.75	4.15	4.35	4.65
25yr	4.25	4.55	4.85	5.05
50yr	4.30	4.65	5.00	5.25

ECONOMIC BACKGROUND

The sub prime crisis of early 2008 was superseded by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50bp took place on 8 October 2008. Forecasts in the UK were for further sharp cuts in interest rates as the recession bites.

International

- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The ECB was very concerned about rising inflation and less about the state of the economy.
- The second quarter of 2008-09 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions that had invested in these issues.
- In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the IMF for support.
- Eventually even the Asian 'Tiger' economies were affected, including India and China, and it became clear that the crisis had become a global one and no country was insulated from it.
- The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the Fed, ECB and MPC all cutting rates by 50bp on 8 October. The Fed subsequently cut rates again by 50bp to 1% on 29 October and again on 16 December to a band of 0.0% to 0.25% in an attempt to stave off the oncoming recession.
- The ECB reduced rates again on 6 November by 50bp and by its biggest ever cut of 75bp on 4 December and a further cut in January to reach 2%.

UK

- GDP: growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in the autumn the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.
- Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.
- Notwithstanding the pressures on household finances, consumer spending still continued at a reasonable pace although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.
- The Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer interbank lending.
- The Government took action in September to either supply finance itself to recapitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was

so that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.

- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The MPC had been very concerned about CPI inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 50bp on October 8 in concert with the Federal Reserve, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 150bps on 6 November, 100bps on 4 December and 50 bps on 8 January 2009.
- The LIBOR spread over Bank Rate has also been a feature, and a concern, of 2008-09. Because of the credit fears and the reluctance of lenders to place cash for long periods, 3 month LIBOR (this is the London Inter Bank Offer Rate – the rate at which banks will lend to one another) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 150 bps Bank Rate cut in November on some borrowing rates.
- The Government has abandoned its 'golden rule'. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short term designed to help stimulate economic growth to counter the recession.

Options under new MRP regulations

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the Supported Capital Expenditure (SCE) annual allocation..

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

a. equal instalment method – equal annual instalments
b. annuity method – annual payments gradually increase during the life of the asset

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

MRP Policy Statement

The Council will implement the new MRP Guidance in 2007-08, and assess their Minimum Revenue Provision for 2007-08 in accordance with the main recommendations contained within the Guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. In particular, the Council are satisfied that the guidelines for their annual amount of MRP set out within this Policy Statement will result in their making the requisite prudent provision that is required by statute.

The major proportion of the MRP for 2007-08 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the recommendations and intent of Option 1 of the Guidance. For 2007-08, the base amount of debt liability to be subjected to an MRP charge on this basis, after adjusting for schemes to be deferred for MRP purposes, or otherwise subjected to MRP under the Option 3 recommendations, will be £133.312m. This represents a reduction from the amount of debt liability that would have applied under previous statutory requirements of £19.157m, and complies with one of the central recommendations contained within the new Guidance. The reasons for the reduction are explained below.

In subsequent financial years, further amounts of new capital expenditure may continue to be charged at the rate of 4%, and added to the above mentioned base amount, up to an amount equivalent to the Council's annual SCER allocation.

Certain expenditures reflected within the debt liability at 31 March 2007 will under delegated powers be subject to MRP under Option 3. In cases where schemes/capital expenditures were not fully completed/incurred as at 31 March 2007, these will be deferred from any MRP charge in 2007-08, but reconsidered for MRP in 2008-09, or such later year as they may be completed, in the light of the overall mix of new capital expenditures to be subjected to MRP at that time. The aggregate amount of expenditure for these in 2006-07 is estimated to be £15.101m. Further expenditure of £4.056m incurred in 2006-07 will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual installment method.

When adopting this aspect of the recommendations contained within option 3, the Council will, where applicable, treat any new capital expenditures/schemes which are both commenced and finalised within the financial year as having been financed from any associated grants, S.106 monies, or similarly earmarked funds. However, the amount of resources available and used for financing in accounting terms within each financial year will be fully allocated within that year, which means that in cases where expenditure is incurred on only part of a scheme which is not completed by the year end, any grant or similar financing resources will be allocated to other new expenditures under delegated powers.

Estimated life periods will be determined under delegated powers. For example, new buildings or similar structures will have an estimated life period ranging from 20 to 80 years. In this latter case, it is considered that the recommended life period of 25 years for land contained within the Guidance does not adequately reflect its realistic life period. The Guidance recommends only that the life period

should bear some relation to that over which the asset is estimated to provide a service.

In the case of new capital expenditures which serve to add to the value of an existing capital asset, these will be estimated to have the remaining useful life as the asset whose value is enhanced.

To the extent that expenditures are not on the creation of an asset, and are of a type that are subject to estimated life periods that are referred to in the Guidance, these periods will generally be adopted by the Council. However, in the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no Minimum Revenue Provision made. The Council are satisfied that a prudent provision will be achieved after exclusion of these capital expenditures from the MRP requirements.

In view of the variety of different types of capital expenditure incurred by the Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure, and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The determination as to which schemes shall be deemed to be financed from available resources, and those which will remain as an outstanding debt liability to be financed by borrowing or other means, will be assessed under delegated powers.