Report to: Audit & Governance Committee

Report reference: *LDF-026-2010/11*
Date of meeting: *14 February 2011*

Epping Forest District Council

Portfolio: **Finance & Economic Development**

Subject: **Treasury Management Strategy Statement and Investment Strategy 2011/12 to 2013/14**

Responsible Officer: **Brian Moldon (01992 564455).**

Democratic Services Officer: **Gary Woodhall (01992 564470).**

Recommendations/Decisions Required:

(1) To consider how the risks associated with Treasury Management have been dealt with in the proposed Council's Treasury Management Strategy Statement and Investment Strategy 2011/12 to 2013/14; and

(2) To make any comments or suggestions that Members feel necessary to Full Council.

Executive Summary:

The annual treasury management strategy statement and investment strategy report is a requirement of the CIPFA Code of Practice on Treasury Management. It covers the treasury activity for the financial year 2011/12 to 2013/14.

The risks associated with setting these indicators are highlighted within the report along with how these risks are being managed.

Reasons for Proposed Decision:

To inform the Committee about the risks associated with Treasury Management and how the Council has sought to manage these risks.

To comply with the Committee's role and responsibilities which include:

To be responsible for the scrutiny of the Council's Treasury Management Strategy, including consideration of mid financial year and outturn reports.

Other Options for Action:

Members could ask for additional information about the CIPFA Codes or the Prudential Indicators.

Report:

Introduction

1. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming year.

2. The report attached at appendix 1 shows the Treasury Management Strategy Statement and Annual Investment Strategy 2011/12 to 2013/14 in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code.

Capital Activity in the year

3. The Council undertakes capital expenditure on long-term assets. These activities may either be financed immediately through capital receipts, grants etc; or through borrowing.

4. The Council does not plan to borrow in order to carry out its capital investment. The capital programme is shown below in the table:

Capital Expenditure	**2010/11 Revised £m**	**2011/12 Estimate £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**
Non-HRA capital expenditure	4.855	8.240	2.611	1.524
HRA capital expenditure	6.636	6.973	6.875	5.831
Total Capital expenditure	**11.491**	**15.213**	**9.486**	**7.355**
Financed by:				
Capital grants	6.181	5.531	5.171	4.084
Capital receipts	3.500	7.632	2.265	1.221
Revenue	1.810	2.050	2.050	2.050
Total resources Applied	**11.491**	**15.213**	**9.486**	**7.355**
Closing balance on:				
Capital Receipts	17.592	10.195	8.225	7.298
Major Repairs Reserve	5.791	5.867	6.120	7.510

5. The closing balance on capital receipts is after taking into account new receipts being generated from the right to buy sales and for major repairs reserve for anticipated major repairs allowance.

6. The financial risk involved within the Capital Activity is the impact on reducing the balance of usable capital receipts over the next three years. This risk is included in the Council's Corporate Risk Register (No. 17) and identifies the following potential consequences; loss of interest; loss of cover for contingencies; financial strategy becoming untenable in the long run; service reductions required; and large Council Tax increases required.

7. This prudential indicator assists the Council in controlling and monitoring the level of usable capital receipts that will be available at the end of a three-year period. Currently, the Capital Programme for the next three years totals £32.054m and is fully funded. It is predicted that at the end of 2013/14 there will still be £7.298m available in usable Capital Receipts and £7.510m in the Major Repairs Reserve. Therefore it can be concluded that

adequate resources exist for the Capital Programme in the medium term.

The impact on the Council's indebtedness for capital purposes

8. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. The Council currently does not have an overall positive CFR (HRA and Non-HRA), and so has no underlying need to borrow for capital purposes.

CFR	**31-Mar-11 £m**	**31-Mar-12 £m**	**31-Mar-13**	**31-Mar-14 £m**
Non-HRA	37.519	37.519	37.519	37.519
HRA	-38.303	-38.303	-38.303	-38.303
Total Capital expenditure	**-0.784**	**-0.784**	**-0.784**	**-0.784**

9. As the Council has no need to borrow to fund its capital programme, the Council is proposing to continue to set the Authorised Limit (this represents a limit beyond which external debt is prohibited and needs to be approved by full Council) at £5m, the Operational Boundary (the expected maximum external debt during the course of the year) at £0.5m and the Maturity Structure of Fixed Rate Borrowing (how long we can borrow for) to be restricted to under 12 months.

10. The risk for most Councils associated with this section relate to Refinancing – the risk that maturing borrowings, capital project or partnership refinancing cannot be refinanced on suitable terms. As the Council is debt free and looking to remain so in the future, there are not currently any risks relating to refinancing.

11. These prudential indicators assist the Council in controlling the level of debt the Council may need to finance over the coming years and ensures where debt is owed it is managed, whereby the Council would not be left in a situation where it finds itself having to refinance on unsuitable terms.

The Council's treasury position

12. The projected treasury position for the next three years is shown in the table below.

Treasury position	**31-Mar-2011 £m**	**31-Mar-12 £m**	**31-Mar-13 £m**	**31-Mar-14 £m**
Total external borrowing	**0.0**	**0.0**	**0.0**	**0.0**
Investments	50.0	47.0	43.0	37.0
Total investments	**50.0**	**47.0**	**43.0**	**37.0**
(Net Borrowing) / Net Investment Position	**50.0**	**47.0**	**43.0**	**37.0**

13. It is important that the cash flow of the Council is carefully monitored and controlled to ensure enough funds are available each day to cover its outgoings. This will become more difficult as the Council uses up capital receipts and reduces investment balances.

14. The Council is proposing to set the following indicators:

(a) The Upper Limit for Fixed Rate Exposure (100%) and Upper Limit for Variable Rate Exposure (50%) for each of the years up to 2013/14;

(b) The maximum amount of the portfolio being invested for longer than 364 days is £30m; and

(c) The maximum limit set for investment exposure per country is 30%.

15. The risks associated to this section are detailed in the following paragraphs.

- Credit and Counterparty Risk

16. The risk of failure by a third party to meet its contractual obligations to the Council, i.e. goes into liquidation. The Council's counter-party lists and limits reflect a prudent attitude towards organisations with which funds may be deposited and these are regularly updated by our treasury advisors. The previous strategy had two minimum criteria for credit rated counterparties for investments up to £5m and £10m. In the proposed new strategy there will only be one limit up to £10m. The change in credit ratings is shown in the table below (explanation of the credit ratings is at appendix 2).

Strategy	**Limit up to**	**Rating Agencies**					
		Moody's		**S & P**		**Fitch**	
		Short term	**Long term**	**Short term**	**Long term**	**Short term**	**Long term**
2010/11	£5 million	P-2	A2	A-1	A	F1	A
	£10 million	P-1	Aa3	A-1+	AA-	F1+	AA-
2011/12	£10 million	P-1	A1	A-1	A+	F1	A+

17. The consequence of this change is that a number of counterparties are removed from the approved list, for example, Close Brothers, Co-op and some building societies. In order to ensure we can invest all our money, it has been necessary to set up new accounts with highly rated foreign banks we had not used previously.

- Liquidity Risk

18. The risk that cash will not be available when it is needed, incurring additional unbudgeted costs for short-term loans. The Director of Finance & ICT has monthly treasury meetings with treasury staff, to go through the cash flow for the coming month. A number of instant access accounts are used to ensure adequate cash remains available.

- Interest Rate Risk

19. The risk of fluctuations in interest rates. The Council is proposing a maximum of 50% of its investments can be invested in variable rates, and the remainder are in fixed rate deposits. This allows the Council to receive reasonable rates, whilst at the same time, gives the Council flexibility to take advantage of any changes in interest rates. The view of the Council's treasury advisors is that interest rates are unlikely to change significantly in the short to medium term.

20. The prudential indicators within this section assist the Council to reduce the risk of:

(a) Counterparties going into liquidation by ensuring only highly rated institutions are used when investing the Council's money;

(b) the Council incurring unbudgeted short-term loans, to pay unexpected expenditure items through ensuring adequate level of money is available immediately through instant access accounts; and

(c) potentially losing out on investment income when interest rates start to increase by ensuring that deposits are kept within one year.

Housing Finance Reform

21. Currently, Councils are required to pay a proportion of the Council house rents and the majority of receipts from the sale of land and homes to central Government. Where it is then decided how best to redistribute the funds back to local authorities – known as the Housing Revenue Account subsidy system.

22. The previous Government outlined plans (through consultation) to devolve greater powers to Councils to meet the housing needs of our local communities. This would result in Councils being able to keep all the rents and sales receipts that we collect, in return for these greater freedoms, this Council would be required to take on additional housing debt (that is sustainable for the long term).

23. The current Housing Minister recently committed the new Government to changing the rules of the subsidy system. The new system will be introduced in the Localism Bill later this autumn to enable the new system to start in 2012.

24. Once details have been announced a further report will go back to Members on the implications of this, including possibly a revised treasury strategy. Financial modelling on the previous Government's proposals indicated that the Council's Housing Revenue Account had the financial capacity to repay the predicted debt allocation and accumulate substantial balances in the long term.

Resource Implications:

Continued low interest rates are likely to result in an estimated further reduction in investment interest against 2010/11 original estimate of £238,000, giving an estimated interest income for 2011/12 of £659,000.

Legal and Governance Implications:

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities; and
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007

the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

Safer, Cleaner and Greener Implications:

None.

Consultation Undertaken:

The Council's external treasury advisors provided the framework for this report and have confirmed that the content satisfies all regulatory requirements.

Background Papers:

None.

Impact Assessments:

<u>Risk Management</u>
As detailed in the report, a risk aware position is adopted to minimise the chance of any loss of the capital invested by the Council. The specific risks associated with the different aspects of the treasury management function have been outlined within the main report.

<u>Equality and Diversity:</u>

Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications?	No
Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?	N/A

What equality implications were identified through the Equality Impact Assessment process?
N/A

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
N/A