Report to the Audit & Governance Committee

Epping Forest District Council

Report reference: AGC-027-2013/14
Date of meeting: 6 February 2014

Portfolio: **Finance & Technology**

Subject: **Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17**

Responsible Officer: **Simon Alford (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 2014/15 to 2016/17; 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 years 2014/15 to 2016/17.

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 provide assurance to Full Council that the risks associated with Treasury Management are being appropriately managed.

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 2014/15 to 2016/17 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 programme. As mentioned in Appendix 1 it may borrow additional sums to pre or post-fund future years requirements. The capital programme is shown below in the table:

Capital Expenditure	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Non-HRA capital expenditure	4.555	8.629	1.417	1.397
HRA capital expenditure	11.130	17.823	15.490	15.187
Total Capital expenditure	**15.685**	**26.452**	**16.907**	**16.584**
Financed by:				
Government Grants	1.254	2.346	0.549	0.495
Capital receipts	3.402	7.895	2.040	1.938
Revenue	4.350	5.700	5.700	5.700
Major Repairs Allowance	6.679	10.511	8.618	8.451
Total resources Applied	**15.685**	**26.452**	**16.907**	**16.584**
Closing balance on:				
Capital Receipts	12.741	5.875	4.836	3.864
Major Repairs Reserve	9.998	6.532	5.160	4.143

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 no longer included in the Council's Corporate Risk Register, as the impact has reduced.

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 £59.943m and is fully funded. It is predicted that at the end of 2016/17 there will still be £3.864m available in usable Capital Receipts and £4.143m 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. A positive CFR would normally mean a Council would have to borrow to fund a capital programme, but this situation has only arisen as a consequence of Housing Subsidy reform. The previous table illustrates that the capital programme can be funded without any further requirement to borrow.

However, borrowing is anticipated for Land Purchase or Development and the Waste Management Contract, but these are not yet certain. This report sets an authorised limit for borrowing of £230 million.

CFR	31-Mar-14 £m	31-Mar-15 £m	31-Mar-16 £m	31-Mar-17 £m
Non-HRA	38.6	48.6	63.6	63.6
HRA	155.1	155.1	155.1	155.1
Total Capital expenditure	**193.7**	**203.7**	**218.7**	**218.7**

9. Each year the Council has to approve at Full Council its statement on the Minimum Revenue Provision (MRP). In previous years the Council has been debt free and therefore, we did not have to provide MRP in our accounts. However, the Council has taken on debt of around £185.5m and this would normally require the local authority to charge MRP to the General Fund. CLG has produced regulations intended to mitigate this impact, whereby we can ignore the borrowing incurred in relation to the Housing Self-Financing when calculating MRP and therefore (for MRP purposes only) we are classed as debt free and do not have to make provision for MRP. Additional borrowing if it were to take place for General Fund purposes in 2014/15 would create a MRP in 2015/16. The MRP statement is at Appendix E.

10. The Council had to borrow to fund The Housing Self-Financing regime. An amount of £185.456m was borrowed from PWLB on 28 March 2012. This was split into 6 separate loans, one variable rate loan of £31.8m maturing in 10 years, 4 fixed rate loans of £30m maturing between 26 and 29 years and a further fixed rate loan of £33.656m maturing in 30 years. The table below only covers the fixed rate borrowing. The upper and lower limits for next year are set to allow maximum flexibility if a re-financing opportunity arises, although this is unlikely.

Maturity structure of fixed rate borrowing	Existing level (or Benchmark level) at 31/03/13 %	Lower Limit for 2014/15 %	Upper Limit for 2014/15 %
under 12 months	0	0	100
12 months and within 24 months	0	0	100
24 months and within 5 years	0	0	100
5 years and within 10 years	0	0	100
10 years and within 20 years	0	0	100
20 years and within 30 years	100	0	100
30 years and within 40 years	0	0	100
40 years and within 50 years	0	0	100
50 years and above	0	0	100

11. The risk associated with this section relate to Refinancing – the risk that maturing borrowings, capital project or partnership refinancing cannot be refinanced on suitable terms. The borrowing portfolio is based on the Housing Revenue Account (HRA) financial plan and the borrowing maturities are linked to when the financial plan has the resources to repay the debt.

12. 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

13. The Council's investments are all denominated in UK sterling and regular information is received from our treasury advisors on the latest position on the use of Counterparties. The latest information supplied is as follows:

(a) UK Banks and building societies:

(i) A maximum maturity limit of 12 months applies to HSBC, Standard Chartered, Barclays Bank and Nationwide Building Society;

(ii) A maximum maturity limit of 6 month to Lloyds TSB, Bank of Scotland;

(iii) A maximum maturity limit of 100 days applies to Santander UK plc; and

(iv) A maximum maturity limit of Overnight applies to RBS and NatWest.

(b) European Banks:

(i) A maximum maturity limit of 100 days applies to Credit Suisse , ING Bank and Landesbank Hesses-Thuringen;

(ii) A maximum maturity limit of 6 months applies to Pohjola Bank; and

(iii) A maximum maturity limit of 12 months applies to Svenska Handelsbanken, Rabobank, Bank Nederlande Gemeenten, Deutsche Bank, Nordea Bank.

(c) Non European Banks:

A maximum maturity limit of 12 months applies to Australian, Canadian and US banks that are on our Counterparty list.

(d) Money Market Funds:

A maximum exposure limit of 10% of our total investments per MMF.

14. The Council currently has an investment portfolio of £61m, this will vary from day to day, depending on the cash flow of the authority. A breakdown of this portfolio by Country and length of time remaining on investments are shown in the two tables below.

Country of Counterparty	**£m**
United Kingdom	51.0
Euro Zone	0.0
Australia/Canada/USA	0.0
Ireland**	2.0
Sweden	8.0
Total	**61.0**

** Please note that the investments shown under Ireland relates to Money Market Funds that are AAA rated and approved to be used by Arlingclose (Council's treasury advisors), however, they are domiciled in Ireland for tax purposes only.

Maturity profile of investment as at 31 December 2013	**£m**
Overnight (Call / Money Market Fund)	16.0
Up to 7 days	5.5
7 days to 1 month	5.0
1 month to 3 months	16.2
3 months to 6 months	5.0
6 months to 9 months	2.0
9 months to 1 year	1.3
> 1 year	10.0
Total	**61.0**

15. 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.

16. 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 (75%) for each of the years up to 2016/17;

(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%.

17. The risks associated with this section are as follows:

(a) Credit and Counterparty Risk – 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. It can be seen from the table above and from advice given by Arlingclose that the Council is keeping deposits fairly liquid and the number of Counterparties is restricted.

(b) Liquidity Risk – 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 meetings with treasury staff, to go through the cash flow for the coming month. A number of Money Market Funds are used to ensure adequate cash remains available.

(c) Interest Rate Risk – the risk of fluctuations in interest rates. The Council is proposing a maximum of 75% 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.

18. 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 an 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 the investment portfolio has a balanced but relatively short maturity profile.

<u>Housing Finance Reform</u>

19. In setting the original HRA budget for 2012/13 it was estimated that the borrowing would all be fixed rate at 4.24% and that this would result in annual interest payments of £6.3m. The actual debt portfolio comprises £154m of fixed rate borrowing at rates between 3.45% and 3.5% and variable rate borrowing of £32m which is currently at 0.62%. The actual annual interest payments will be £5.5m which continues to represent a considerable saving.

<u>Inter-Fund Balances</u>

20. The Council has inter-fund borrowed for many years between the General Fund and Housing Revenue Account and the interest charge made between the funds has been based on the average interest earned on investment for the year. Under draft regulations issued by CIPFA, it is now proposed that the interest rate applicable to any inter-fund borrowing should be approved by Full Council before the start of the financial year. As the Council has been undertaking inter-fund borrowing for many years, it is proposed to continue to use the average interest earned for the year on investments as the rate for any inter-fund borrowing.

<u>Policy Statement</u>

21. The Treasury Management Policy Statement is a high level statement setting out how the Council Treasury function will be undertaken. The Policy Statement was last updated as part of the 2013/14 Treasury Strategy. The Policy is attached at Appendix 2 for the Committee to consider, no changes are currently proposed.

Resource Implications:

The continued low interest rates, the use of limited counterparties and the short durations of investments have reduced estimated interest income for 2014/15 to £399,000.

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.
- Under section 21(1) AB 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