

Report to the Audit & Governance Committee



Report reference: AGC-018-2016/17
Date of meeting: 6 February 2017

**Epping Forest
District Council**

Portfolio: Finance

Subject: Treasury Management Strategy Statement 2017/18

Responsible Officer: Bob Palmer (01992 564279).

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 2017/18; and

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

Executive Summary:

The annual Treasury Management Strategy Statement report is a requirement of the CIPFA Code of Practice on Treasury Management. It covers the treasury activity for the financial year 2017/18.

The risks associated with treasury management are highlighted within the report along with how these risks are being managed. The most significant change from the previous strategy is an increase in the minimum credit rating for counterparties from BBB to BBB+.

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 2017/18 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 will need to borrow in order to carry out its capital programme. This may be done by borrowing additional sums to pre or post-fund future year's requirements. The capital programme is shown below in the table:

Capital Expenditure	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Non-HRA capital expenditure	21.445	10.551	2.096	1.464
HRA capital expenditure	20.567	28.164	14.989	11.668
Total Capital expenditure	42.012	38.715	17.085	13.132
Financed by:				
Government Grants	1.575	0.870	0.870	0.870
Capital receipts	3.890	10.032	1.595	0.664
Revenue	16.182	24.122	14.620	11.598
Borrowing	20.365	3.691	0	0
Total resources Applied	42.012	38.715	17.085	13.132
Closing balance on:				
Capital Receipts	5.169	0.198	0.299	1.368
Major Repairs Reserve	9.143	2.149	0	0

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

6. The financial risk involved with the capital programme is the impact of reducing the balance on usable capital receipts. This will reduce earnings from interest on balances and will mean additional borrowing is needed in the future. 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 to the end of 2018/19 totals £98m and is funded but requires borrowing of £24m. It is predicted that at the end of 2019/20 there will be £1.368m available in usable Capital Receipts and nothing in the Major Repairs Reserve.

7. However, it should be remembered that the Council currently has no external borrowing for the General Fund and as at 31 March 2016 the balance sheet included more than £150m of General Fund fixed assets and investment properties. So the Council is not currently over borrowed and, as future borrowing will only be used on revenue generating schemes, completion of the capital programme will ultimately strengthen both the balance sheet and revenue position of the Council. Therefore it can be concluded that adequate resources, including borrowing, are available to fund 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 will require some additional borrowing. This report sets an authorised limit for borrowing of £240 million rising to £260m. Given current borrowing of £185m and borrowing of £24m to fund the capital programme, the authorised limit allows a further £30m of headroom to exploit any investment or development opportunities that arise. Taking forward any such opportunities would require approval from both Cabinet and Council.

CFR	31-Mar-16 £m	31-Mar-17 £m	31-Mar-18 £m	31-Mar-19 £m
Non-HRA	29.6	50.3	53.1	52.1
HRA	155.1	155.1	155.1	155.1
Total Capital expenditure	184.7	205.4	208.2	207.2

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 2017/18 would create a MRP in 2018/19. The MRP statement is at Appendix F.

10. The Council had to borrow to fund Housing Self-Financing and so £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 at 31/03/16 %	Lower Limit for 2017/18 %	Upper Limit for 2017/18 %
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, so that the Council is not left in a situation where it finds itself having to refinance on unsuitable terms. Borrowing is readily available either through the PWLB or from other local authorities and interest rates are predicted to remain low over the medium term. Therefore, no difficulty is currently anticipated with either the availability or cost of finance for either refinancing or new borrowing.

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) Maturity limits of between 35 days and 13 months are now applicable;
- (ii) A maturity limit of 13 months applies to Bank of Scotland, Lloyds TSB and HSBC Bank plc;
- (iii) A maturity limit of 6 months applies to Santander UK, Nationwide Building Society, Coventry Building Society and Close Brothers;
- (iv) A maturity limit of 100 days applies to Barclays plc and most building societies;
- (v) A maturity limit of 35 days applies to RBS and NatWest.

(b) European Banks:

- (i) A maturity limit of 100 days applies to Credit Suisse, Danske Bank and ING Bank;
- (ii) A maturity limit of 6 months applies to Op Corporate Bank and Landesbank Hessen-Thuringen;
- (iii) A maturity limit of 13 months applies to no Nordea, Rabobank, and Handelsbanken.

(c) Non European Banks:

A maturity limit of 6 months applies to Australian, 13 months to Canadian and US banks that are on our Counterparty list.

(d) Money Market Funds:

An exposure limit of £5m per MMF.

14. As at 31 December the Council had an investment portfolio of £48.5m, 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	46.5
Euro Zone	0.0
Australia/Canada/USA	0.0
Ireland	0.0
Sweden	2.0
Total	48.5

Current Maturity profile of investments	£m
Overnight (Call / Money Market Fund)	15.5
Up to 7 days	1.0
7 days to 1 month	18.0
1 month to 3 months	14.0
3 months to 6 months	0.0
6 months to 9 months	0.0
9 months to 1 year	0.0
> 1 year	0.0
Total	48.5

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 2019/20; and

(b) the maximum amount of the portfolio being invested for longer than 364 days is £15m.

17. The risks and related prudential indicators 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. This position has been strengthened for 2017/18 with the removal of counterparties with a BBB rating that had been included in the 2016/17 counterparty list, the minimum required rating is now BBB+.

(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 Resources 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 medium term.

Housing Finance Reform

18. 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 0.48%. The actual annual interest payments will be £5.6m which continues to represent a considerable saving against both what had been anticipated and what the payments used to be under the previous subsidy system.

Inter-Fund Balances

19. 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 regulations issued by CIPFA, it is required 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.

Policy Statement

20. 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 2016/17 Treasury Strategy. The Policy is attached at Appendix G for the Committee to consider, no changes are currently proposed.

Resource Implications:

Continued low interest rates, the use of limited counterparties and the short durations of investments have lowered the estimated interest income for 2016/17. Interest earnings for 2017/18 will reduce further as balances are invested in capital projects rather than short term deposits. No significant change in interest rates is anticipated over the medium term.

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.

Risk Management:

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.