Report to the Audit & Governance Committee

Report reference: AGC-003-2011/12
Date of meeting: 23 June 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:

(1) To consider how the risks associated with Treasury Management have been dealt with in the amended 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 Council is required to approve the Treasury Management Strategy and Prudential Indicators and a statement on the Minimum Revenue Provision (MRP) before the start of each financial year. This was achieved for 2011/12 when Members approved this in February 2011. However, following the Government announcement to proceed with Housing Self Financing through the Localism Bill, the Council needs to be ready to borrow around £200m. The amended strategy enables the Council to borrow up to £200m and gives delegated powers to the Director of Finance & ICT to undertake this borrowing, in consultation with the Leader and the Finance and Economic Development Portfolio Holder.

The risks associated with the changes to the strategies are highlighted within the report along with how these risks are being managed.

A further report on how the borrowing will be structured will follow in due course.

Reasons for Proposed Decision:

The changes to the strategies fundamentally alter the Council's position on Treasury Management. The Council has been debt free for a number of years and has previously expressed the desire to remain so. However, Government policy means this position is not sustainable and the Council must now put itself in a position where it can borrow approximately £200m.

As the changes fundamentally alter the strategies previously considered by this committee it is appropriate for the committee to consider the changes and comment on them.

Other Options for Action:

Members could recommend different values for 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 Council approved the Treasury Management Strategy and Investment Strategy for 2011/12 and the Prudential Indicators for 2011/12 to 2013/14 in February 2011 as part of the budget process.

3. The report attached at appendix 1 shows the amended 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.

Reason for the Change to the Original Strategy

4. The layout between the strategy approved in February 2011 and the proposed strategy being suggested for approval have not changed, nor have any of the strategy and prudential indicators relating to the investment activities. The only changes relate to borrowing activities.

5. The Council has been debt free since 2004 and the original strategy (approved February 2011) advised that the Council had no intention to borrow in order to finance our capital programme. However, Members will be aware that the previous Government announced the proposal to review the current Housing Subsidy System with a view to dismantle this and to offer Councils the possibility to buy themselves out of the Subsidy system. The current Government has pushed forward with this and as part of the Localism Bill from April 2012 the subsidy system will be dismantled and a self financing regime will start. This will result in the Council needing to pay the Government around £200m to buy itself out of the subsidy system.

6. The Council have had initial discussions with Arlingclose (our treasury advisors) who have advised that our treasury strategy needs to be updated as soon as possible to allow the Council the powers to borrow the amount required, during this financial year.

Changes from the Original Strategy

7. The main changes from the original strategy reflect the need for the Council to borrow around £200m. This has resulted in the need to amend a number of the Prudential Indicators as shown below.

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's estimated total CFR will change from March 2012 onwards to reflect the need to pay the Government around £200m. This increase in CFR will result in the Council needing to borrow to finance this payment.

	31/02/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m
Total CFR				
Original Strategy	-0.784	-0.784	-0.784	-0.784
Amended Strategy	-0.784	179.216	179.216	179.216
Cumulative Net Borrowing Requirement / (Investments)				
Original Strategy	-50.784	-47.784	-43.784	-37.784
Amended Strategy	-50.784	132.216	136.216	142.216

9. As the Council will now need to borrow to fund the payment to the Government, the Council is proposing to change its Authorised Limit (this represents a limit beyond which external debt is prohibited and needs to be approved by full Council) from £5m to £200m, the Operational Boundary (the expected maximum external debt during the course of the year) from £0.5m to £181m and the Maturity Structure of Fixed Rate Borrowing (how long we can borrow for) from under 12 months, to an upper limit of 100% on each of the duration periods, as we are still to determine the exact composition of the debt.

10. 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 risk associated with this section are:

(a) Level of borrowing set too low – The risk here relates to the possibility that once the final settlement figures are known (around January 2012), our Operational Boundary and or our Authorised Limit Prudential Indicators are below the revised debt figure. The likelihood of this is small, as there is £19m headroom between the Operational and Authorised limit and any changes from the estimated debt figure of £181m and the final figure will only be due to changes to housing stock numbers. There is also the possibility that Members may consider part funding the loan from using internal resources and therefore reducing the initial loan required.

(b) Being unable to finance level of debt – This relates to the Council being unable to finance and repay the debt. The Council has appointed Consult CIH to work closely with the Council to produce an indicative HRA business plan to identify the viability of the plan. The result shows that the HRA business plan is viable, with the Council being able to repay the debt back within 17 years whilst still being able to fund the capital programme.

(c) Timing and changes to interest rates – The risk relates to the Council missing the opportunity to borrow in advance if Arlingclose suggest interest rates were likely to increase. This could then leave the Council paying higher interest charges on the borrowing over the entire life of the loans. By ensuring the Council has the power to borrow, it should reduce the chance of the Council missing out on the opportunity to borrow at a competitive rate. Any evaluations here will have to weigh the interest charge from borrowing earlier than necessary against the interest charges from borrowing later at a higher rate (cost of carrying).

11. As the Council is currently debt free and is now looking to borrow, the risk to the Council will be to determine how best the debt portfolio is created, in relation to interest rates, duration and type of borrowing. This work will be undertaken working closely with our treasury advisors (Arlingclose) and further reports will be made to this Committee and Cabinet before any decisions are made.

Resource Implications:

Within the Government proposal it states 'These reforms only have implications for each stock-retaining local authority's ring-fenced Housing Revenue Account, and will not impact on their general finances'.

The Council is a debt free authority with a negative overall Capital Financing Requirement (CFR), however, we do have a positive general fund CFR of around £38m. The impact on the General Fund could result in a substantial increase in the cost to the general fund through Minimum Revenue Provision (MRP) payments of £1.5m and an increase in interest payments of £1.6m.

However, there are indications that mitigation will be put in place so that where an authority has no current requirement to make MRP on its General Fund it will not be required to make MRP as a consequence of self financing.

Currently, the interest payment for the borrowing between HRA and General Fund is based on the average rate of return on investment. However, it is generally agreed that the average rate of borrowing will be higher than the average rate on investment, resulting in potential increase in interest charges to the general fund. Recent discussions with Government officials indicate they are aware of this issue and considering alternative ways of providing some form of mitigation.

The Council currently pays the Government subsidy payments each year. For 2011/12 this amounts to £11.312m which in future years would not be paid. Within the latest HRA Business Plan 2011-12 it estimates that the debt could be paid off within 17 years, whilst the capital programme is fully funded and substantial balances accumulate after repayment.

Legal and Governance Implications:

The Council's treasury management activities are regulated by a variety of professional codes and 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 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.

The power to dismantle and to force Council's to buy themselves out of the Housing Subsidy System is included within the Localism Bill that is currently going through Parliament.

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:

The original treasury management strategy for 2011/12 and prudential indicators for 2011/12 to 2013/14 went to Council on 22 February 2011.

Finance and Performance Management Cabinet Committee on 18 May 2010 – Response to CLG offer on the reform of the HRA subsidy system. CLG prospectus on Council housing: a real future published March 2010.

HRA Business Plan 2011-2012.

Impact Assessments:

<u>Risk Management</u>
As detailed in paragraph 10 in changing the strategies the Council needs to ensure that:
(a) the borrowing limit is not too restrictive;
(b) the level of debt is sustainable; and
(c) sufficient flexibility exists to borrow in advance of need if this will reduce overall life time costs of the borrowing.

<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