Report to the Audit & Governance Committee

Epping Forest District Council

Report reference: ***AGC-021-2011/12***
Date of meeting: ***9 February 2012***

Portfolio: **Finance & Economic Development**

Subject: **Council's Treasury Management Strategy Statement and Investment Strategy 2012/13 to 2014/15**

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 2012/13 to 2014/15; 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 2012/13 to 2014/15.

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 2012/13 to 2014/15 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 carryout its capital investment. However, the Council will be borrowing to finance the Housing Self-financing. The capital programme is shown below in the table:

Capital Expenditure	**2011/12 Revised £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Non-HRA capital expenditure	5.278	5.635	1.193	1.176
HRA capital expenditure	193.225	12.863	15.067	14.859
Total Capital expenditure	**198.503**	**18.498**	**16.260**	**16.035**
Financed by:				
Capital grants	5.935	8.393	9.470	8.562
Capital receipts	4.254	4.892	0.890	0.873
Revenue	2.115	5.213	5.900	6.600
Borrowing	186.199	0.000	0.000	0.000
Total resources Applied	**198.503**	**18.498**	**16.260**	**16.035**
Closing balance on:				
Capital Receipts	14.595	9.877	9.221	8.642
Major Repairs Reserve	6.612	5.931	3.738	2.443

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 £50.793m and is fully funded. It is predicted that at the end of 2014/15 there will still be £8.642m available in usable Capital

Receipts and £2.443m 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), but following the payment to Government for Housing Self-financing, the Council will have a positive CFR.

CFR	**31-Mar-12 £m**	**31-Mar-13 £m**	**31-Mar-14**	**31-Mar-15 £m**
Non-HRA	31.097	31.097	31.097	31.097
HRA **	154.318	154.318	154.318	154.318
Total Capital expenditure	**185.415**	**185.415**	**185.415**	**185.415**

** this figure includes the potential increase for Housing Self-financing of £186.199m

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 is taking on debt of around £186m and this would normally require the local authority to charge MRP to the General Fund. CLG has produced draft 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.

10. The Council has no need to borrow to fund its capital programme, however, it is required to borrow in relation to Housing Self-financing, therefore the Authorised Limit (this represents a limit beyond which external debt is prohibited and needs to be approved by full Council) will be increased to £200m, and the Operational Boundary (the expected maximum external debt during the course of the year) increased to £187m. In relation to Maturity Structure of Fixed Rate Borrowing (how long we can borrow for), our treasury advisors are still in the process of considering the best possible borrowing portfolio for the Council, based on the 30 year financial plan and once this has been received, an updated treasury strategy will be issued with completed tables under the Gross and Net Debt, Interest Rate Exposures and Maturity Structure of Fixed Rate borrowing indicators.

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 will be based on the HRA financial plan and the borrowing maturities will be 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 3 months applies to HSBC and Standard Chartered;

(ii) a maximum maturity limit of 1 month to Barclays Bank, Lloyds TSB, Bank of Scotland, Royal Bank of Scotland, National Westminster, and Nationwide Building Society; and

(iii) a maximum maturity limit of overnight applies to Santander UK plc;

(b) **European Banks:**

(i) all temporarily suspended for new investments;

(c) **Non European Banks:**

(i) a maximum maturity limit of 3 months applies to Australian, Canadian and US banks that are on our Counterparty list; and

(d) **Money Market Funds:**

(i) a maximum exposure limit of 10% of your total investment per MMF.

14. The Council currently has an investment portfolio of £55m, 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	34.6
France	4.0
Australia	5.0
Ireland**	11.4
Total	**55.0**

** 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 domicile in Ireland for tax purposes only.

Maturity profile of investment as at 18 January 2012	**£m**
Overnight (Call / Money Market Fund)	23.0
Up to 7 days	7.0
8 days to 1 month	5.0
1 month to 3 months	15.0
3 months to 6 months	0.0
6 months to 9 months	5.0
Total	**55.0**

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 2014/15;

(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 very liquid (with a current maximum maturity of 3 months) and the number of Counterparties is greatly 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 treasury 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 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

19. 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.

20. The reforms involve a removal of the housing subsidy system by offering a one-off reallocation of debt. The settlement of the reallocation is expected to take place on 28 March 2012 and will result in the Authority having to take debt on to fund the settlement of £186.2m. The specific borrowing amount and terms will be determined by the Authority in conjunction

with its treasury advisors.

Inter-fund Balances

21. 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.

Policy Statement

22. The Treasury Management Policy Statement is a high level mission statement for how the Council Treasury function will be undertaken. The Policy Statement was last updated as part of the 2010/11 Treasury Strategy following the changes made to the Code in November 2009. CIPFA has now updated this Policy to include a high level statement for borrowing and investments. This amended Policy is attached at appendix 2 for Council to approve.

Resource Implications:

The continued low interest rates, the use of fewer counterparties and the shorter durations of investments have reduced estimated interest income for 2012/13 to £561,000.

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