Part I – Release to Press

Meeting:	**EXECUTIVE / AUDIT COMMITTEE / COUNCIL**	**Agenda Item:**	**3**
Portfolio Area:	Resources		
Date:	**7 FEBRUARY / 13 FEBRUARY / 29 FEBRUARY 2012**		

PRUDENTIAL CODE INDICATORS AND TREASURY MANAGEMENT STRATEGY

KEY DECISION

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1. PURPOSE

1.1 To recommend to Council, the approval of the revised Treasury Management Strategy including its Annual Investment Strategy and the Prudential Indicators.

1.2 The 2012/13 Strategy includes the revisions made to the 2011/12 Strategy reported as part of the mid year review to Audit Committee in November and Council in December. The Strategy is also aligned to the Housing Revenue Account Business Plan, the Council's General Fund Medium Term Financial Strategy and Capital Strategy. The ongoing review of the Strategy is undertaken with regard to the CIPFA code of practice and guidance from the Treasury.

2. RECOMMENDATIONS

EXECUTIVE (7 February 2012) / AUDIT COMMITTEE (13 February 2012)

2.1 That Council be recommended to adopt the 2012/13 Treasury Management Strategy as detailed in Appendix A.

2.1.1 That Council be recommended to adopt the Prudential Code Indicators as detailed in Appendix A, attachment six.

2.1.2 That any comments on this report and/or decisions (to be reported at the meeting) be reported to Council.

2.1.3 That Council adopt the modification to investment criteria, as detailed in paragraph 4.2.3 and Appendix A, attachment 3 for instant access call accounts.

COUNCIL (29 February 2012)

2.2 The recommendations to Council from the Executive and the Audit Committee will be circulated following those meetings.

3. BACKGROUND

3.1 It is a requirement of the Local Government Act 2003 that from April 2004 Councils must 'have regard to the Prudential Code and set Prudential Indicators to ensure that capital investment plans are affordable, prudent and sustainable'.

Following the collapse of the Icelandic banks in 2008, questions were asked about how robust Treasury Management arrangements were in local authorities, particularly the exposure of district councils. The continued turbulence in the financial markets, down-ratings of both countries and counterparties by the major credit agencies, shows that this remains relevant.

As a consequence, The Chartered Institute of Public Finance Accountants (CIPFA) updated the Treasury Management in Public Services Code of Practice (the Code) and the requirements for the Treasury Management Policy Statement. It is a requirement of the code of practice that the Code is formally adopted by the Council. This was mandatory from 1 April 2010.

3.2 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 (The Act), for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that arise as a result of capital financing decisions. This therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue are limited to a level which is affordable within the projected income of the Council for the foreseeable future. The costs included in the Treasury Management Prudential Indicators reflect the costing included in the Council's General Fund and HRA Budgets for 2012/13.

3.3 Capital receipts from land and building sales can no longer be relied on to be the major source of funding for investment in the Council's assets. There is now an ongoing requirement to prudentially borrow to fund the Council's General Fund Capital Strategy. The Council continues to take decisive action to bring about a Capital Strategy that is affordable, through its prioritisation framework and by deferring and deleting schemes. The Capital Strategy has included a requirement to borrow for the past two years, and includes a requirement to borrow for the next two years thus:

	2011/12 (November 2011 Strategy)	**2012/13** (January 2012 Strategy)	**2013/14** (January 2012 Strategy)
Borrowing Requirement in Capital Strategy	£2,800,000	£2,800,000	£2,000,000

The Council has avoided borrowing for the General Fund by carefully managing down its cash and investment balances (effectively internal debt). It is however anticipated that external borrowing to fund capital expenditure will be required for the foreseeable future.

3.4 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.5 This Strategy's prudential indicators (Appendix A) includes provision for HRA debt relating to the HRA self financing regime (as outlined in the Localism Act 2011) and the planned capital programme incorporating known backlog Decent Homes funding for 2012/13 and provisional figures for 2013/14 and 2014/15.

3.6 This report will be considered by the Executive on 7 February and the Audit Committee as the body nominated to provide scrutiny for the Treasury Management Strategy prior to approval at Council. The recommendations from the Executive and the Audit Committee will be reported to Council.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Update on the Treasury Management Strategy

4.1.1 The Treasury Management Code has been revised to incorporate the new HRA Self Financing regime which replaces the current subsidy system. The Council projects that it will take on £200.85M of debt on 28 March 2012, the amended requirements have been incorporated in this revised Strategy. They are expanded upon in Section 4.3. The provisions comply fully with the Treasury Management Code 2011 and Guidance on Self Financing. The Council also complies fully with the investment guidance issued by Communities and Local Government (CLG). As part of the 2012/13 Strategy review and update the following points have been considered and included in the Council's Treasury Management Strategy: -

Areas kept under review are:

a) Member training requirements have been kept under review. Training was provided to all Members in 2009/10 from the Council's Treasury

Management advisor's, targeted training has been provided to other Members. Further training was provided to the Audit Committee on 17 February 2011, including an update on treasury management and the Council's investments. Further training will be provided as required.

b) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training. Both the Head of Finance and s151 officer received relevant training in 2011/12, and the Treasury Management team have either completed or are in the process of completing the CIPFA / Association of Corporate Treasurers' International Treasury Management (Public Finance) qualification.

c) The Council's appetite for risk must be clearly identified within the Strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out. See Appendix A paragraph 2.1-2.6.

The Strategy has been updated for:

a) Credit ratings. These continue to be only a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the level of such support. The Council has continued to keep under review its counterparty list, and responds to any daily updates sent through by its Treasury Advisors, Sector. Following the downrating of UK banks in October 2011, ratings acceptable to the Council were reviewed and the counterparty list amended and prioritised accordingly.

b) A full mid year review of Treasury Management Strategy and performance was undertaken in 2011/12. This updated the Strategy formally for the areas addressed under an urgent decision, which set out the order of priority for investing in high quality counterparties. These are summarised in paragraph 4.2.3 below.

c) Each Council must delegate the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council, the Audit Committee will consider the Strategy on 13 February, before referring on to Council for formal approval on the 29 February 2012.

d) It has been agreed that the monitoring of fixed rate investments and fixed rate borrowing should be performed separately, rather than combined. The aggregated balance will be under review, but does not represent a target maximum or minimum, but instead shows the hedged position.

4.1.2 This Council has adopted the following reporting arrangements in accordance with the requirements of the revised Code: -

Area of Responsibility	Council Committee Officer	Frequency
Treasury Management Policy Statement (revised)	Council	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy / Minimum Revenue Provision (MRP) policy	Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Council	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Council	As required.
Annual Treasury Outturn Report	Council	Annually by 30 November after the end of the year
Scrutiny of Treasury Management Strategy	Audit Committee	Annually before the start of the year
Scrutiny of Treasury Management performance	Audit Committee	Quarterly (General Fund monitoring report)

The Council has average returns for 2011/12 of 0.87%, and is budgeting for returns of 0.80% in 2012/13.

4.2 Prudential Code Indicators

4.2.1 The prudential code indicators as shown in Appendix A, have been updated for 2011/12 and for 2012/13 to include HRA Self Financing. The 2011/12 **net borrowing requirement** indicator was originally set at £10.89M. This included £8.65M for the HRA Decent Homes programme. As described in section 4.3 the Council needs to take on £200.85M debt in the transfer to Self Financing. This will be paid over to CLG as the final HRA settlement.

4.2.2 Although the Council’s underlying need to prudentially borrow for the General Fund (as measured by the General Fund capital financing requirement (GFCFR)) has increased during the year, the Council has managed to borrow internally to fund this, by managing down its investment balances. This has had a negligible cost to the General Fund because investment interest rates are so low. The associated revenue cost has been included in the Council’s General Fund Budget reported to this Committee and included in the Prudential Indicators (Appendix A, attachment six). The revised cost of borrowing for the General Fund is estimated to be £0.00 and £8.42 per band D property for 2011/12 and 2012/13 respectively. This is because we have not borrowed in 2011/12.

4.2.3 The changes reported to the Audit Committee as part of the 2011/12 half year review at the December meeting, have also been incorporated into the 2012/13 Strategy. These changes are a result of the down rating by Standard and Poor of a number of part nationalised institutions, resulting from an assessment of the perceived level of government support for these institutions. These are:

- The counterparty minimum criteria be amended from exclusively investing in F1+ institutions to resolve the problem of having insufficient counterparties on occasions, subject to the following order:
  Invest in F1+ approved institutions first, then F1 part nationalised institutions, then other F1 institutions.

In order to allow flexibility to place instant access investments while reflecting the availability with counterparties on any given day a minor modification in respect of Instant Access Call Accounts is recommended, (Note this does not apply to notice period call accounts):

- The counterparty minimum criteria for instant access call accounts be amended to F1, reflecting the lower risk from instant access.

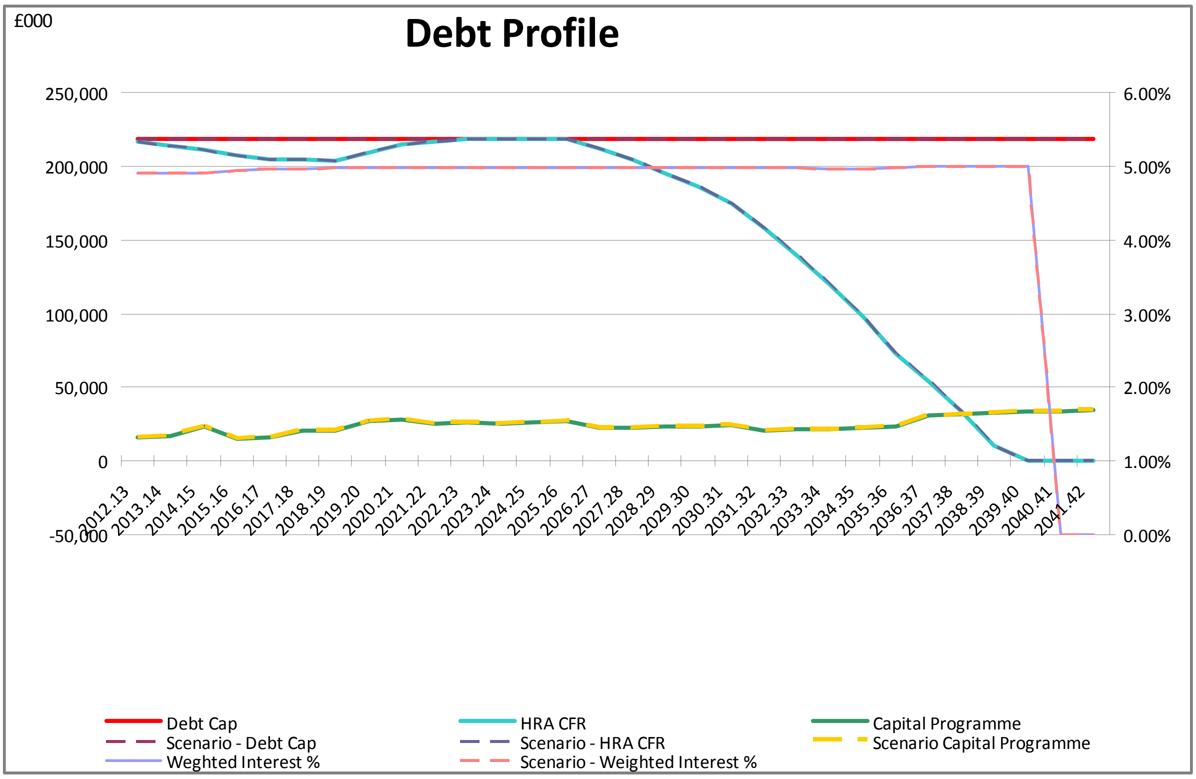
4.3.1 **Treasury Management Strategy - Self Financing**

4.3.2 The provisional debt settlement as a result of self financing has been agreed at £218,626,000. This figure represents the debt cap on the HRA, and is therefore the maximum borrowing shown in the Prudential Indicators (Appendix A) for the HRA. It is also the HRA Capital Financing Requirement (HRACFR), which represents the underlying need to borrow on the HRA. The £218,626,000 includes debt undertaken and planned to be undertaken at 31 March 2012 of £17,773,463. The net new debt on settlement therefore £200,852,537. This will be paid over on 28 March 2012.

4.3.3 The Council aims to ensure that the profile of debt maturity minimises both the cost and the risk to the Council. The debt profile generated from planned capital works in the HRA Business Plan (shown in the chart below) identifies that there will not be any significant ongoing reductions to the debt required until after 15 years. Although there will be short term reductions and then increases below the debt curve during that time.

4.3.4 It should be noted that interest rates are at a historic low level. In addition gilt rates have been deflated reflecting the turbulent times in the Eurozone, and that the Treasury have announced that as a one off transaction, that financing can be secured from PWLB at 0.15% on average above the prevailing gilt rate. The normal PWLB rate is 1% above the gilt rate. The HRA Business Plan provides for a 5% interest rate on this transaction. It is however expected that the transaction can be secured more cheaply depending upon prevailing PWLB rates on 28 March and the debt structure opted for.

4.3.5 One option open to the council is to match our debt maturity dates to the debt profiling schedule. This would have the benefit of enabling us to take out cheaper (1.30-2.00%) short term borrowing covering the reductions in required debt (over 1-5 years in the schedule below), and then refinancing short term (at the prevailing short term rates as the debt profile curve (below) starts to rise). Although the rates on offer make this look slightly more attractive, it does carry both an interest rate risk on refinancing, and no access to the special one off reduction in the PWLB rate. The Council are currently working closely with our treasury advisors, recognising that every 0.25% on the interest rate represents a £500k cost to the HRA.



4.3.6 It is a requirement of the Treasury Management Code and the Self Financing regime that the existing debt be split equitably between the General Fund and the Housing Revenue Account. All borrowing undertaken to date has been for the Decent Homes programme. However, the calculations underpinning the Subsidy system attributed some of the cost the General Fund, as the General Fund used capital resources which would otherwise have been available to fund the Decent Homes programme.

4.3.7 The basis of the split should be equitable and at no detriment to the General Fund. The council have therefore apportioned the projected debt based on the proportion of the interest cost charged to the two accounts. The HRA will have £17.77M of PWLB loans relating to Decent homes debt by the end of the March 2012, which has been adjusted for in the provisional debt settlement. The amount planned to be spent on Decent Homes which is not funded from borrowing, will be financed from internal borrowing through the use of investment balances. The HRA Capital Financing Requirements (CFR) has been amended to include the £17.77M, as shown in Appendix A.

Amount to be funded from investment balances	£ 5,159,845
HRA	£17,773,463
	£22,933,308

4.3.8 In accordance with Treasury Management Guidance Notes, where the HRA has an unfunded element of CFR (i.e. where it has not borrowed up to its limit, choosing instead to fund from internal balances), it would need to pay interest to the General Fund in compensation in line with the policy on interest and balances. It is therefore equitable practice to assume all unfunded CFR belongs to the General Fund. All borrowing taken out to date is therefore attributable to the Housing Revenue Account.

4.3.9 The Council will adopt a two debt-pool model, where debt structure and cost is managed separately. Where a HRA loan matures, it will need to be replaced by a new HRA loan, dependent on the borrowing and treasury management position at the time. Where a new loan is not taken out, this will result in an unfunded HRA CFR with the cash overdrawn position being dealt with through the interest on balances calculation. Where it is mutually beneficial the Council may move existing loans from the General Fund portfolio to the HRA portfolio and vice versa, recognising an internal premium or discount. This will avoid physically repaying and reborrowing, which would incur significant loss on the repayment spread (particularly in the PWLB).

4.3.10 It is not the intention of the Council to borrow in advance of need. However, should this happen as part of optimising the debt maturity profile and minimising risk, the HRA will be reimbursed interest on balances in the normal way.

4.3.11 The settlement figure of £218,626,000 is the “Debt Cap”. The HRA is not allowed to borrow above this amount. Any capital cashflows will need to be managed within this limit. As can be seen from the profile graph, the Council will be operating at or around the limit for the first 15 years of the 30 year HRA Business Plan. This presents a risk in terms of careful management of the capital programme.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 The report is of a financial nature and outlines the Prudential Code Indicators and the principals under which the Treasury Management functions are managed.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Policy Implications

5.3.1 The proposed limits are in line with current policy.

5.4 Equalities and Diversity Implications

5.4.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

BACKGROUND DOCUMENTS

- Sector reports
- Strategy report

APPENDICES

- Appendix A – Treasury Management Strategy
- Appendix A attachment one – Treasury Management Statement
- Appendix A attachment two – Minimum Revenue Provision
- Appendix A attachment three – Specified and Non Specified Investments
- Appendix A attachment four – Approved Countries for Investment
- Appendix A attachment five – Treasury Management Scheme of Delegation and role of s151 officer
- Appendix A attachment six – Prudential Indicators