Meeting:	**AUDIT COMMITTEE / EXECUTIVE / COUNCIL**	**Agenda Item:**	**4**
Portfolio Area:	Resources		
Date:	**4 FEBRUARY / 12 FEBRUARY / 27 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 2013/14 Strategy includes the revisions made to the 2012/13 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

AUDIT COMMITTEE (4 February 2013)

2.1 That Executive recommend to Council to adopt the 2013/14 Treasury Management Strategy as detailed in Appendix A.

2.2 That Executive recommend to Council to adopt the Prudential Code Indicators as detailed in Appendix A, attachment six.

2.3 That any comments on this report and/or decisions from the Audit Committee be reported to Executive and Council.

2.4 That Executive recommend to Council to adopt the modification to the use of money market funds, as detailed in paragraph 4.2.3 and Appendix A, attachment three for specified investments.

2.5 That Executive recommend to Council to adopt the modification to the limit on investments of greater than 364 days, as detailed in paragraph 4.2.3, and Appendix A attachment six, and attachment three.

2.6 That Executive recommend to Council to adopt the modification to the variable investment limit, as detailed in paragraph 4.2.3 and Appendix A, attachment six.

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'.

The collapse of the Icelandic banks in 2008, the continued turbulence in the financial markets and down-ratings of both countries and counterparties by the major credit agencies, present an ongoing requirement to ensure that Treasury Management functions are able to demonstrate that policies and practices minimise exposure to risk.

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 costs identified in the Council's General Fund and HRA Budgets for 2013/14.

3.3 Capital receipts from land and building sales are no longer a major source of funding for investment in the Council's assets. The Council is currently undertaking an asset management review which may identify assets surplus to the Council's needs, but the impact in terms of expected receipts to fund the capital programme is not yet known.

3.4 Therefore there remains an ongoing requirement to prudentially borrow to fund the Council's General Fund Capital Strategy. Although 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, a 15 year review of investment needs has identified a significant funding gap that needs to be addressed. 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 (July 2012 Exec Outturn)	**2012/13** (January 2013 Strategy)	**2013/14** (January 2013 Strategy)	**2014/15** (January 2013 Strategy)
Borrowing Requirement in Capital Strategy	£1,803,028	£2,907,040	£3,076,820	£3,416,545

3.5 The treasury management team has avoided any external borrowing for the General Fund by using its cash and investment balances (effectively internal debt). The income lost to the Council has been 0.81% on balances used, compared to the cost of around 4% to borrow externally. It is planned to continue to do this for as long as it remains favourable to do so. However, this does build up an underlying interest cost pressure to the general fund in the medium term, for when the Council needs to borrow externally. This is because it will need to take out a number of years external debt at a higher rate than the 0.81%, representing a significant cost impact in the first year of external borrowing.

3.6 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.

3.7 This Strategy's prudential indicators (Appendix A, attachment six) includes HRA debt relating to the HRA self financing regime and the planned capital programme incorporating known backlog Decent Homes funding for 2013/14 and 2014/15.

3.8 This report will be considered by the Executive. The Audit Committee is the body nominated to provide scrutiny for the Treasury Management Strategy prior to approval at Council. Any comments that Audit Committee have (4 February 2013) on the report will be reported to Executive (12 February) and to Council (27 February).

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Update on the Treasury Management Strategy

4.1.1 The Council's debt figure of £216.915M has remained unchanged throughout 2012/13. This is made up of £17.004M borrowing to fund the HRA decent homes programme and £199.911M for the HRA self financing settlement. The first repayment of self financing debt will take place on 28th March 2013. This will be for £3M.

4.1.2 At the 28 March 2013 the HRA will be £3M below its debt cap and until that date no further borrowing can be taken for new capital spend. Borrowing is anything that would affect the HRA capital financing requirement, which includes the transfer of land and properties from the General Fund.

4.1.3 There are no plans to take out the approved General Fund borrowing of £4.71M (paragraph 3.4) during the remainder of 2012/13. Although there remains an underlying need to borrow, it is favourable at this time to borrow internally, using surplus cash and investment balances (see paragraph 3.5).

4.1.4 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 2013/14 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) Audit Committee members have received training updates during 2012/13 from the Assistant Director of Finance and it is intended that the Council's Treasury Management advisor's will provide training to all members during 2013/14. Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

b) The Assistant Director (Finance) and the Council's S151 officer have received relevant training in 2012/13, and the Treasury Management team have completed the CIPFA / Association of Corporate Treasurers' International Treasury Management (Public Finance) qualification.

The Strategy has been updated for (included in paragraph 4.2.3 below):

a) **Money Market Funds:** To increase the limit to £15M, with no more than £5M with any one Fund, and no more than 35% of the Council's total investments included in MMFs.
Investments exceeding 364 days: This limit has been increased to £5M from £2M to enable the Council take any opportunities to invest for longer, in only the highest rated institutions, with the approval of the Chief Finance Officer.
Variable rate limits: These have been increased to ensure that our higher balances may all be placed variable. The Council would wish to be able to place all balances variable if required, and the £40M represents the anticipated upper limit.

b) A full mid year review of Treasury Management Strategy and performance was undertaken in 2012/13. This updated the Strategy formally for the urgent decision on Money Market Funds, and the Council decision on the introduction of the Local Authority Mortgage Scheme (LAMS), and revised variable investment limits. These are summarised and updated in paragraph 4.2.3 below.

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	Annually before the end of the 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 forecast average returns for 2012/13 of 0.81%, and is budgeting for returns of 0.67% in 2013/14.

4.2 Prudential Code Indicators

4.2.1 The prudential code indicators as shown in Appendix A, attachment six have been updated for 2012/13 and subsequent years. The 2012/13 **net borrowing requirement** indicator was originally set at £214.226M. This included £218.626M for the HRA, £5.6M for General Fund and assumed investment balances of £10M. This has been revised to £215.148M

4.2.2 Although the Council’s underlying need to prudentially borrow for the General Fund (as measured by the General Fund forecast capital financing requirement (GFCFR)) has increased during the year to £16.899M, the

Council will borrow internally to fund £9,869,000 of this, by using its investment balances. A separate decision will be made on the timing of the remaining in year borrowing required. The cost to the General Fund has been negligible because investment interest rates are so low. The associated revenue cost has been included in the Council's General Fund Budget reported to be reported to the February Executive and included in the Prudential Indicators (Appendix A, attachment six). The revised cost of borrowing for the General Fund is estimated to be £6.35 and £35.73 per band D property for 2012/13 and 2013/14 respectively.

4.2.3 The changes reported to the Audit Committee as part of the 2012/13 mid year review at the December meeting, have also been incorporated into the 2013/14 Strategy, and updated as required. These were:

- Approved capital expenditure has increased by £1.5059M. This is for the Local Authority Mortgage Scheme (LAM's). £1M is funded by Hertfordshire County Council and the remainder by New Homes Bonus and property sales. The duration of the guarantee covers the entire period of the strategy therefore the eventual capital receipt will not be recognised until beyond the duration of this strategy;
- The use of Money Market Funds has relieved some of the counterparty pressures which have resulted from higher cash balances and reduced available counterparties. The limit was set at £7M
- The limit on variable investments was increased from £25M to £35M, reflecting the higher cash balances held by the Council, and the need to keep investments short in accordance with the approved Strategy.

It is further recommended in this strategy:

- that the £7M limit approved in November 2012 be increased to £15M reflecting the continuing need to use the DMO and the expectation of high cash balances relating to the Housing Revenue Account over the next year. This is subject to maximum of £5M with any one Fund, and a maximum of 35% of the total investment portfolio. This is to enable the Council access to more high quality counterparties (currently offering rates between 0.44% and 0.51%), as an alternative to investing in the Government's Debt Management Office at 0.25%. This will mean opening a further money market fund and increasing the limit form £2M to £5M with one of the existing funds.
- that the variable investment limit approved in November 2012 be raised from £35M to £40M. This is required to ensure that all investments may be kept variable as may required by market conditions. The increased limit is to reflect our increased cash balances.
- that the £2M limit on placing investments greater than 364 days be increased to £5m. This would apply only to F1+ approved institutions as defined in Appendix A, Attachment three, and with the authorisation of the Chief Finance Officer. This would enable the Council to maximise returns by investing its higher balances for longer whilst minimising exposure to risk.

4.3.1 **Treasury Management Strategy**

Housing Revenue Account

4.3.2 The net debt settlement as a result of self financing was agreed at £199.911M. This combined with the £17,773,463 decent homes limit represents the debt cap on the HRA (£217,684,463). The HRA has borrowed £216,915,000 against this debt cap, and will repay £3M on 28 March 2013 and £2M on 28 March 2014.

4.3.3 The maximum borrowing shown in the Prudential Indicators (Appendix A) for the HRA is the debt cap. The debt cap exceeds the HRA Capital Financing Requirement (HRACFR), which represents the underlying need to borrow on the HRA. All planned capital expenditure on the HRA is funded from resources available either from the Housing Revenue Account or from grant funding to meet decent homes standards. The HRA CFR has therefore reduced in year by the value of the principal repayment.

4.3.4 It should be noted that interest rates have continued at their historic low level, with the UK still maintaining safe-haven status. In addition the Treasury announced the introduction of a Certainty Rate for borrowing, enabling Council's which have signed up to this to take out PWLB loans at 20 basis points below the standard PWLB rate.

4.3.5 The Council has adopted a two debt-pool model, where debt structure and cost is managed separately for the HRA and the General Fund. Where new HRA loans are required but a 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).

4.3.6 It is not the intention of the Council to borrow in advance of need. However, should this happen as part of optimising the treasury management position of the Council and minimising risk, the transaction will be accounted for in accordance with proper practices, e.g.the HRA will be reimbursed interest on balances.

4.3.7 The settlement figure of £217,685,000 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. 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. It also presents constraints in terms of transferring assets from the General Fund, which impact directly on the CFR of the HRA even if there would otherwise be headroom within the capital programme to finance it.

General Fund

4.3.8 The General Fund has an underlying need to borrow to meet both its share of apportioned HRA debt as a result of the self financing settlement on 28 March 2012, and to finance its capital programme from 2011/12 onwards.

4.3.9 The Council's CFR on 31 March 2012 was £6,962,000, with an estimated additional requirement of £9,937,000 for 2012/13 and £2,728,000 for 2013/14.

4.3.10 It is not planned to undertake the borrowing for the prior year CFR or for £2,907,040 of the in year CFR at this stage. This is because the Council's cash balances remain buoyant, and it is favourable to use investment balances and forego interest (at 0.81%) at this time rather than incur the much higher interest cost of borrowing (around 4%). It is possible that shorter term borrowing may be taken for £7,135,000 this year depending on treasury management conditions.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 The report is of a financial nature and outlines the Prudential Code Indicators and the principles under which the Treasury Management functions are managed. The Chief Financial Officers (CFO) view on the level of on-going prudential borrowing required to resource the General Fund capital programme is not financially sustainable. This will be16% of net expenditure by 2016/17 and requires alternative means of resourcing capital spend e.g. through the review of the Council's assets.

5.2 Risk implications

5.2.1 The current policy of not borrowing externally only remains financially beneficial while prevailing differentials between investment income rates and borrowing rates remain, and balances remain buoyant. When this changes, the Council may need to borrow several years borrowing at a higher rate. Leading to a significant additional cost in the one year.

5.3 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.

6. BACKGROUND DOCUMENTS

- Sector reports
- Strategy report

7. 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