Report to the Finance & Performance Management Cabinet Committee

Report reference: FPM-nnn-2010/11
Date of meeting: 22 November 2010

Epping Forest District Council

Portfolio: **Finance & Economic Development**

Subject: **Mid-Year Report on Treasury Management and Prudential Indicators 2010/11**

Responsible Officer: **Brian Moldon (01992 564455).**

Democratic Services Officer: **Gary Woodhall (01992 564470).**

Recommendations/Decisions Required:

(1) To note how the risks associated with Treasury Management have been dealt with in the first half of 2010/2011.

Executive Summary:

The mid-year treasury report is a requirement of the CIPFA Code of Practice on Treasury Management. It covers the treasury activity for the first half of year in 2010/11.

During the first half of the year: the Council changed its treasury advisors from Butlers to Arlingclose (1 May 2010); has rephased its capital programme whereby £3.533m has been moved out of 2010/11 and some moved into future years; the Council has remained debt free and no borrowing has occurred; the average net investment position has been approximately £50.9m; and there have been no breaches on any of its prudential indicators.

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.

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 current year. The updated code in November 2009 also recommended that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

2. The report attached at appendix 1 shows the mid-year position of the treasury function in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code.

Treasury Advisors

3. The Council treasury advisors at the beginning of the year were Butlers who have provided the Council with treasury management services since 1992. This contract expired on 30 April 2010 and a tender for the provision of Treasury Management services was undertaken, involving a joint Member and officer panel.

4. The successful treasury advisors were Arlingclose who were appointed for three years starting 1 May 2010.

Capital Activity In The Year

5. The Council undertakes capital expenditure on long-term assets. These activities may either be financed immediately through capital receipts, grants etc; or through borrowing.

6. The Council does not plan to borrow in order to carryout its capital investment. The original estimate and probable outturn, along with the spend to month 6 (30 September 2010) is shown below in the table:

	Financial year 2010/11		
Capital Expenditure	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA capital expenditure	8.511	5.298	1.047
HRA capital expenditure	6.956	6.636	2.688
Total Capital expenditure	**15.467**	**11.934**	**3.735**
Financed by:			
Capital grants	0.841	1.658	
Capital receipts	7.720	3.730	
Revenue	6.906	6.546	
Total resources Applied	**15.467**	**11.934**	

7. The current probable outturn for 2010/11 shows a drop in capital expenditure of £3.533m, which has been partly re-phased into future years capital programme. This will mean a reduction in the use of capital receipts in the current financial year of £3.99m, but increases in later years. This will result in a higher than anticipated level in reserves when calculating potential investment interest for the current financial year.

8. There is a financial risk involved in reducing the balance of usable capital receipts over the next five 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.

9. 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 five-year period. Currently, the Capital Programme for the next five years totals £50.7m and is fully funded. It is predicted that at the end of 2014/15 there will still be £6.9m available in usable Capital Receipts and £9.9m 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

10. 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), and so has no underlying need to borrow for capital purposes.

	Financial year 2010/11		
CFR	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA	22.019	22.019	22.019
HRA	-22.803	-22.803	-22.803
Total Capital expenditure	**-0.784**	**-0.784**	**-0.784**

11. The Director of Finance & ICT confirms that there were no breaches of the Authorised Limit (£5m), the Operational Boundary (£0.5m) and the Maturity Structure of Fixed Rate Borrowing during the period to 30 September, with no borrowing undertaken within this period.

12. The risk for most Councils associated with this section relate to Refinancing – the risk that maturing borrowings, capital project or partnership refinancing cannot be refinanced on suitable terms. As the Council is debt free and looking to remain so in the future, there are not currently any risks relating to refinancing.

13. 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

14. During the first half of 2010/11 the treasury function managed the debt position to remain debt-free, in accordance with Council policy. The average investment position for the first half of the year was £50.9m. The table below shows the treasury position as at 30 September 2010.

Treasury position	**31/03/2010 £m**	**30/09/2010 £m**
Total external borrowing	**0.0**	**0.0**
Short term investment ▪ Fixed investment ▪ Variable investment	 33.622 10.396	 36.464 12.877
Long term investment	0.0	0.0
Debt from other Authorities	0.508	0.508
Total investments	**44.526**	**49.849**
(Net Borrowing) / Net Investment Position	**44.526**	**49.849**

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 Director of Finance & ICT confirms that there have been no breaches of:

(a) The Upper Limit for Fixed Rate Exposure (100%) and Upper Limit for Variable Rate Exposure (50%) during the period, with the average rates of 74.07% and 25.93% being achieved;

(b) Investment being made longer than 364 days, the average being 97.25 and the longest being 364 days;

(c) The limit set for investment over 364 days (£30m); and

(d) The limit set for investment in non UK Country (10%).

17. The risks associated to this section are as follows:

(i) 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.

(ii) 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 instant access accounts are used to ensure adequate cash remains available.

(iii) Interest Rate Risk – the risk of fluctuations in interest rates. The Council has currently around 25% of its investments in variable rates, and the remainder are in fixed rate deposits on average for around 97 days. 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 are 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.

Heritable Bank

19. During the first half of this financial year, the Council has received a further dividend of 6.27% (£157,511.03) from the administrators of the Heritable Bank. The latest administrators report indicates that a further dividend is due around October 2010, ultimately it is expected that total dividends will be at least 85% of the value of deposits.

Housing Finance Reform

20. 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.

21. The previous Government outlined plans (through consultation) to devolve greater powers to Councils to meet the housing needs of our local communities. This would result in Councils being able to keep all the rents and sales receipts that we collect, in return for these greater freedoms, this Council would be required to take on additional housing debt (that is sustainable for the long term).

22. The current Housing Minister recently committed the new Government to changing the rules of the subsidy system. The new system will be introduced in the Localism Bill later this autumn to enable the new system to start in 2012.

23. Once details have been announced a further report will go back to Members on the implication of this. Financial modelling on the previous Government's proposals indicated that the Council's Housing Revenue Account had the financial capacity to repay the predicted debt allocation and accumulate substantial balances in the long term.

Resource Implications:

The continued low interest rate will result in a reduction in the estimated investment income to the Council in 2010/11 of around £373,000.

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; and
- 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.

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 report on the Council's Prudential Indicators for 2010/11 to 2012/13 and the Treasury Management Strategy for 2010/11 went to Council on 16 February 2010; and
- The report on the Council's Corporate Risk Register that went to Finance & Performance Management Cabinet Committee on 27 September 2010.

Impact Assessments:

<u>Risk Management</u>
As detailed in the report, a risk averse 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.