Report to: Finance and Performance Management Cabinet Committee

Report reference: FPM-015-2011/12
Date of meeting: 21 November 2011

Epping Forest District Council

Portfolio:	**Finance & Economic Development**
Subject:	**Mid-Year Report on Treasury Management and Prudential Indicators 2011/12**
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 2011/2012; and

(2) To note and recommend to Council the change in the strategy to reduce the minimum long term rating from A+ (or equivalent) down to A- (or equivalent) to reflect the use of our own bank (Nat West) which has fallen below the minimum credit criteria for investments.

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 2011/12.

During the first half of the year: the Council has rephased its capital programme with £1.1m moving out of 2011/12 and some moving into future years; the Council has remained debt free and no borrowing has occurred; the average net investment position has been approximately £54.6m; and there have been no breaches on any of the prudential indicators.

The Council banker's (Nat West) has fallen below the minimum credit criteria for investments during the first half of the year. It is proposed that Council gives approval to reduce the minimum long term rating criteria from A+ (or equivalent) to A- (or equivalent) to allow us to use Nat West for short term liquidity investments .

This report and the appendices were considered by the Audit and Governance Committee on 10 November and an oral update will be provided on that Committee's recommendations.

Reasons for Proposed Decision:

The report is presented for noting as scrutiny is provided by the Audit and Governance Committee who make recommendations on amending the documents, if necessary.

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.

Capital activity for the year and how it was financed

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 carry out its capital investment. The original estimate and probable outturn, along with the spend to month 6 (30 September 2011) is shown below in the table:

	Financial year 2011/12		
Capital Expenditure	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA capital expenditure	6.431	5.278	0.683
HRA capital expenditure	6.973	7.026	2.152
Total Capital expenditure	**13.404**	**12.304**	**2.835**
Financed by:			
Capital grants	0.658	1.229	
Capital receipts	5.801	4.054	
Revenue	6.945	7.021	
Total resources Applied	**13.404**	**12.304**	

5. The current probable outturn for 2011/12 shows a drop in capital expenditure of £1.1m, 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 £1.75m, but increases in the following year. This will result in a higher than anticipated level in reserves when calculating potential investment interest for the current financial year.

6. 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.

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 five-year period. Currently, the Capital Programme for the next five years totals £46.4m and is fully funded. It is predicted that at the end of 2015/16 there will still be £8.3m available in usable Capital Receipts and

£14.7m 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), and so has no underlying need to borrow for capital purpose.

	Financial year 2011/12		
CFR	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA	37.519	31.097	31.097
HRA	-38.303	-31.881	-31.881
Total Capital expenditure	**-0.784**	**-0.784**	**-0.784**

9. 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.

10. 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, there are not currently any risks relating to refinancing.

11. 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 overall treasury position

12. During the first half of 2011/12 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 £54.6m. The table below shows the treasury position as at 30 September 2011.

Treasury position	**31/03/2011 £m**	**30/09/2011 £m**
Total external borrowing	**0.0**	**0.0**
Short term investment		
▪ Fixed investment	43.803	44.545
▪ Variable investment	7.733	5.356
Long term investment	0.439	0.439
Debt from other Authorities	0.481	0.481
Total investments	**52.456**	**50.821**
(Net Borrowing) / Net Investment Position	**52.456**	**50.821**

13. 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.

14. 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 79.68% and 20.32% being achieved;

b) The limit set for investment over 364 days (£30m). We made one investment of £5m for 438 days. The average investment for the period is 160 days.

c) The limit set for investment in non UK Country (30%).

15. The risks associated to 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.

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

c) Interest Rate Risk – the risk of fluctuations in interest rates. The Council has currently around 20% of its investments in variable rates, and the remainder are in fixed rate deposits on average for around 197 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.

16. 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.

c) Potentially losing out on investment income when interest rates start to increase by ensuring that deposits are kept within one year.

The Council's Banker

17. On 7 October, the Council received notification from Arlingclose that following the conclusion of the Moody's review of UK Financial Institutions, Nationwide Building Society, Nat West Bank and Royal Bank of Scotland Bank Plc no longer met our

minimum criteria and therefore we currently can not undertake any new investments with them.

18. As Nat West is the Council's banker, although it does not meet the minimum credit criteria of A+ (or equivalent) long term, it stills meet the minimum short term credit criteria of F1 (or equivalent). The table below shows our minimum criteria for short and long term as agreed in the Council Treasury Management Strategy and the latest credit rating score for National Westminster Bank PLC.

	Treasury Strategy Criteria	Nat West Bank
Long Term Rating		
Fitch	A+	A
Moody's	A1	A2
Standard & Poor's	A+	A+
Short Term Rating		
Fitch	F1	F1
Moody's	P-1	P-1
Standard & Poor's	A-1	A-1

19. It is proposed that Council gives approval that the Treasury Strategy is changed to reduce the minimum criteria for Long Term Rating of A+ (or equivalent) to A- (or equivalent) in line from advice given by our Treasury Advisors on 11 November. This will bring the counterparties mentioned in paragraph 17 back onto our counterparty list, but it should be noted that these will have a reduced maximum duration compared to a counterparty with a higher credit rating. This will allow the Council to continue to have adequate cash available to cover our outgoings each day. .

20. It is not proposed to change the short term rating criteria within the Treasury Strategy. All three credit agencies have maintained the short term rating at levels that do not breach our strategy for the above named counterparties and no long term transactions will be entered into. The position is being monitored closely by accountancy staff and our treasury advisors, any changes to the current situation will be reviewed and the position reassessed to identify the best course of action.

Heritable Bank

21. During the first half of this financial year, the Council has received further dividends of 10.37% (£258,793) from the administrators of the Heritable Bank. The latest administrators report indicates that a further dividend is due around October 2011, ultimately it is expected that total dividends will be around 90% of the value of deposits.

Housing Finance Reform

22. The PWLB has historically been the cheapest source of borrowing for local authorities. However, the Chancellor of the Exchequer increased the margin charged by the PWLB in October 2010 and it appeared that cheaper sources of finance may have existed. Indicative pricing for ten year loans showed a PWLB interest rate of 4.4% compared to a ten year bond at 4% and a private placement between 4 and 4.25%.

23. To give the Council the best chance of securing the necessary borrowing at the most favourable rate Cabinet decided on 18 July 2011 to obtain a credit rating. This decision followed informal discussions with several merchant banks and advice from the

Council's treasury management advisers, Arlingclose. Following from this decision a Member panel interviewed Moody's and Standard & Poor's and decided to appoint Moody's to provide a credit rating.

24. On 19 September 2011 it was announced, without any prior indication, that for self financing transactions PWLB rates would revert to their pre-October 2010 rates. This reduces the rates by approximately 0.85% to leave the margin over gilts at approximately 0.15%. The largest saving against post-October 2010 PWLB rates that any of the alternative providers of finance had suggested as being possible was approximately 0.4%. This means that the new PWLB rates will undercut private financing opportunities by around 0.5%. Therefore, PWLB clearly offers the cheapest financing and as PWLB offers the same rates regardless of credit ratings there is little to be gained from proceeding with the rating process. Therefore, on 24 October Cabinet will be re-considering the decision to obtain a credit rating.

Resource Implications:
The continued low interest rate will result in estimated investment income to the Council to continue around £670,000 in 2011/12.

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 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 2011/12 to 2013/14 and the Treasury Management Strategy for 2011/12 went to Council on 22 February 2011 and amended at Council on 26 July 2011.
The report on the Council's Corporate Risk Register that went to Finance & Performance Management Cabinet Committee on 20 June 2011.

Impact Assessments:

Risk Management
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.

There is little risk associated with the continued use of Nat West for overnight deposits. The bank remains in state ownership and has not had its short term ratings reduced by any of the rating agencies.

Equality and Diversity:

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