Report to the Finance and Performance Management Cabinet Committee

Report reference: FPM-016-2012/13
Date of meeting: 22 November 2012

Epping Forest District Council

Portfolio: **Finance & Technology**

Subject: **Mid-Year Report on Treasury Management and Prudential Indicators 2012/13**

Responsible Officer: **Peter Maddock (01992 564602).**

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 2012/2013.

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 the financial year 2012/13.

During the first half of the year: the Council has re-phased its capital programme with £3.4m moving out of 2012/13 and moving into future years; the Council has continued to finance all capital expenditure from within internal resources; the average net investment position has been approximately £53.6m; and there have been no breaches on any of the prudential indicators.

This report and the appendices will be considered by the Audit and Governance Committee on 29 November and an oral update will be provided on any comments from this Committee.

Reasons for Proposed Decision:

The report is presented for noting as scrutiny is provided by the Audit and Governance Committee who make recommendations to this Committee when 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 2012) is shown below in the table:

	Financial year 2012/13		
Capital Expenditure	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA capital expenditure	5.601	4.733	0.779
HRA capital expenditure	12.863	10.313	4.036
Total Capital expenditure	**18.464**	**15.046**	**4.815**
Financed by:			
Capital grants	0.728	0.909	
Capital receipts	4.910	3.899	
Revenue	12.826	10.238	
Total resources Applied	**18.464**	**15.046**	

5.. The current probable outturn for 2012/13 shows a drop in capital expenditure of £3.4m, which has been re-phased into the capital programme for future years. This will mean a reduction in the use of capital receipts in the current financial year of £1.01m, 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 £86.8m and is fully funded. It is predicted that at the end of 2016/17 there will still be £8.1m available in usable Capital Receipts and £3.2m 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 now has an overall positive CFR (HRA and Non-HRA) following the borrowing in relation to the HRA self-financing, but has no underlying need to borrow for capital purpose as highlighted in the previous section.

CFR	Financial year 2012/13		
	Estimated £m	**Revised £m**	**to month 6 £m**
Non-HRA	31.097	30.281	30.281
HRA	153.575	154.391	154.391
Total Capital expenditure	**184.672**	**184.672**	**184.672**

9. The Director of Finance & ICT confirms that there were no breaches of the Authorised Limit (£200m), the Operational Boundary (£186m) and the Maturity Structure of Fixed Rate Borrowing during the period to 30 September.

10. The risks for Councils are associated with affordability, interest rates and refinancing – the affordability risk is whether the Council can afford to service the loan, this has been evidenced through the Council producing a viable thirty-year financial plan. This plan is reviewed quarterly by officers and half yearly reports are presented to Housing Scrutiny Panel. The interest rate risk is whether a change in interest rate could have an impact on the viability of the financial plan. The Council received advice from our treasury advisors before undertaking the borrowing. Only 17% of the amount borrowed was at a variable rate, the remainder was fixed. Any upward movement in interest rates would be 'hedged' by a corresponding increase in interest earned on Council investments. The refinancing risk is that maturing borrowings, capital project or partnership financing cannot be refinanced on suitable terms. Within the financial plan it is anticipated that all borrowing will be repaid when matured and all future capital expenditure will be financed through internal resources, therefore no risk currently exist for 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 ensure where debt is owed it is managed, such that the Council would not be left in a situation where it finds itself having to refinance on unsuitable terms.

<u>The Council's overall treasury position</u>

12. During the first half of 2012/13 the average investment position for the first half of the year was £53.6m. The table below shows the treasury position as at 30 September 2012.

Treasury position	**31/03/2012 £m**	**30/09/2012 £m**
Total external borrowing	**(185.456)**	**(185.456)**
Short term investment		
Fixed investment	32.349	38.182
Variable investment	10.000	10.000
Long term investment	0.137	0.137
Total investments	**42.486**	**48.319**
(Net Borrowing) / Net Investment Position	**(142.970)**	**(137.137)**

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%) on investment during the period, with the average rates of 63.53% and 36.47% being achieved;

(b) The limit set for investment over 364 days (£30m). The Council made one investment of £5m over 364 days. The average length of investment for the period is 138 days; and

(c) The limit set for investment in non UK Country (30%). The Council made no investments to counterparties outside of the UK.

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 management advisors (Arlingclose).

(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 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 28% of its investments in variable rates, and the remainder are in fixed rate deposits on average for around 137 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 amounts 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 most deposits are kept within one year.

Heritable Bank

17. During the first half of this financial year, the Council has received further dividends of 6.64% (£166,695) from the administrators of the Heritable Bank. The latest administrators report indicates that a further dividend is due around October 2012, ultimately it is expected that total dividends will be around 90% of the value of deposits.

Resource Implications:

The continued low interest rate will result in estimated investment income to the Council reducing to around £514,000 in 2012/13 against an original budget of £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 management 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 2012/13 to 2014/15 and the Treasury Management Strategy for 2012/13 went to Council on 14 February 2012 and were amended at Council on 27 March 2012.

The report on the Council's Corporate Risk Register that went to Finance & Performance Management Cabinet Committee on 25 June 2012.

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	No

adverse equality implications?

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