REDDITCH BOROUGH COUNCIL

AUDIT & GOVERNANCE COMMITTEE

24th January 2011

TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY FOR 2011/12

Relevant Portfolio Holder	Councillor Michael Braley – Portfolio Holder for Corporate Management
Relevant Head of Service	Teresa Kristunas Head of Finance & Resources
Key Decision	

1. SUMMARY OF PROPOSALS

To enable members of the Audit and Governance Committee to scrutinise the Treasury Management Strategy, Prudential Indicators and the Minimum Revenue Provision prior to approval by full Council.

2. RECOMMENDATIONS

The Committee is asked to RECOMMEND that

subject to any comments, the Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision Policy for 2011/12, be approved.

3. BACKGROUND

Treasury Management Operation

3.1 Treasury Management is:-

“the management of the local authority’s cash flows, its bankings, money market and capital market transactions and loan management; the effective control of the risks associated with those activities; and the pursuit of the optimum performance consistent with those risks”.

3.2 The approved activities of the Treasury Management operation are as follows:-

a) Cash flow (daily balances and long term forecasting).
b) Investing surplus funds in Approved Investments.
c) Borrowing to finance cash deficits.
d) Funding of capital expenditure through borrowing, capital receipts, grants or leasing.
e) Management of debt (including rescheduling and monitoring)
f) Interest rate exposure management.
g) Dealing procedures with brokers, banks, building societies and the Public Works Loans Board.

3.3 On the 1st April 2004 the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code was introduced to support the new system of capital finance embodied in part 1 of the Local Government Act 2003. This introduced a number of prudential indicators that impact on treasury management activity.

3.4 The revised guidance issued in draft on the 16th November 2009 makes it clear that investment priorities should be security and liquidity, rather than yield and that authorities should not rely just on credit ratings, but consider other information on risk.

3.5 The guidance requires investment strategies to comment on the use of treasury management consultants and on the investment of money borrowed in advance of spending needs.

3.6 The investment strategy for periods commencing 1st April 2010 are to be approved by full council and published.

<u>Prudential Indicators</u>

3.7. The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable; also, that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability.

3.8 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Code does not include indicative limits or ratios, these are for the local authority to set for itself subject to the controls under [clause 4] of the Local Government Act 2003.

<u>Minimum Revenue Provision (MRP)</u>

3.9. The requirement to make a MRP is contained within the Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2008.

3.10 Following the publication of the Local Authorities (Capital Finance and Accounting) Regulations issued on the 26th February 2008 local authorities are required to prepare an annual statement of policy for making a MRP. The annual statement should be submitted to Council before the start of the financial year.

3.11 MRP is the amount of revenue which an authority sets aside for the repayment of the principal element of any borrowing undertaken to finance capital expenditure. The interest cost of borrowing continues to be a direct charge to revenue. The new regulations that came into force on the 31st March 2008 impose a duty on the Council to make an amount of MRP which it considers to be a “prudent provision”.

3.12 The broad aim of “prudent provision” is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant. This authority does not have any borrowing supported by Revenue Support Grant.

3.13 MRP is calculated in the financial year after the capital expenditure has been incurred and so the capital spend in 2010/11 informs the MRP set aside in the revenue account for 2011/12. The new regulations have added an exception to this in that if expenditure has been incurred on an asset which has not become operational then MRP does not need to be set aside until the financial year after the asset becomes operational. In effect authorities are entitled to a “MRP holiday” until the new asset becomes operational.

4. KEY ISSUES

4.1 The failing of a number of Icelandic banks and the issue with Northern Rock has highlighted the risks associated with treasury management activities.

4.2 The strategy adopted by many local authorities has been to protect capital sums with minimal returns on investments. There are now only a handful of institutions with a F1+ credit rating.

4.3 The bank base rate has remained at 0.5% since 5th March 2009.

4.4 On 20th October 2010 HM Treasury issued an instruction to the PWLB to increase the interest rate on all new loans by an average of 1% above UK Government Gilts. The new borrowing rate for fixed loans increased by approximately 0.87% across all maturities, and variable rates by 0.90%.

4.5 The Council currently has £15 million which it invests for periods up to one year. These monies are currently invested with a number of banks and building societies at rates ranging from 0.40%and 2.00%.

Capital Resources

4.6 The Council's capital programme for 2011/12 shows a requirement for capital resources of £13.2 million. In order to fund the 2010/11 capital programme the Council will need to undertake further prudential borrowing of £8.1 million. The availability of capital receipts from asset disposals is limited because of market conditions.

4.7 The Council currently has £5.0 million of long term borrowing. The remainder of the Council's borrowing is currently undertaken on a short-term basis. Further long term borrowing will be undertaken when market conditions are favourable.

4.8 The decision on when borrowing will be taken up will depend on expenditure plans and market conditions. The Council only has the power to borrow to fund capital expenditure.

Prudential Indicators

4.9. The Council is required to publish the following indicators introduced by the Code for the next and following two financial years:

a) Actual and estimated capital expenditure.
b) Ratio of financing costs to net revenue stream.
c) Capital financing requirement.
d) Actual limit for external debt.
e) Operational boundary for external debt.
f) Council tax implications of the incremental effect of capital decisions.
g) Treasury Management indicators.

4.10 The prudential indicators for the forthcoming and following years must be set before the beginning of the financial year. They may be revised at any time, and must be reviewed, and revised if appropriate, for the current year when the prudential indicators are set for the following year.

Capital Expenditure

4.11 The estimates of capital expenditure for 2011/12 and future years included in the Council's approved capital programme are:

Approved Programme	2011/12 Estimate £'000	2012/13 Estimate £'000
HRA	6,500.4	6,220.0
General Fund	6.750.0	1,095.0
Total Approved Programme	13,250.4	7,315.0

The Council does not currently have an approved Capital Programme for 2013/14.

Ratio of Financing Costs to Net Revenue Stream

4.12 The financing costs include the amount of interest payable and receivable in respect of borrowing and investments. The Net Revenue Stream for the HRA is the amount to be met from housing subsidy and rents and for the General Fund it is the "amount to be met from government grants and local taxation". The estimates of the ratio of financing costs to net revenue stream for the current and future years are:

Ratio of financing costs to net revenue stream				
	2009/10 Actual	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
HRA	1.46%	1.37%	1.33%	1.10%
General Fund	(1.30)%	1.74%	1.44%	3.20%

4.13 The figures in the above table are shown as negatives where the interest received from temporary and long term investments is estimated to exceed the cost of temporary borrowing.

Net Revenue Streams for 2010/11 and 2011/12

4.14 The Net Revenue Stream for the HRA is calculated as follows:

	2010/11 Estimate £	2011/12 Draft estimate £
Dwelling rents	19,827,780	20,924,790
Non-dwelling rents	516,730	522,500
Charges for services and facilities	188,460	194,050
Less		
Negative subsidy	6,037,140	6,810710
Net Revenue Stream	14,495,830	14,830,630

4.15 The Net Revenue Stream for the General Fund is calculated as follows:

	2010/11 Estimate £	2011/12 Estimate £
Revenue Support Grant	818,847	1,040,000
Non-Domestic Rates	5,639,079	3,369,000
Council Tax	5,754,643	5,899,500
Collection Fund	10,200	0
Net Revenue Stream	12,222,769	10,308,500

Capital Financing Requirement

4.16 The capital financing requirement is a measure of the extent to which the Council needs to borrow to support capital expenditure. It does not necessarily relate to the actual amount of borrowing at any one point in time. The Council has an integrated treasury management strategy where there is no distinction between revenue and capital cash flows, and the day to day position of external borrowing and investments constantly changes.

	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
HRA	17,576	20,576	22,876
General Fund	17,125	18,326	18,823
Total	34,701	38,902	41,699

4.17 Calculation of Capital Financing Requirement from the Council's Balance Sheet

Extracts from Balance Sheet	2009/10 £'000
Fixed Assets	338,076
Less	
Capital Adjustment Account	266,763
Government Grant Deferred Account	1,011
Revaluation Reserve	44,681
Capital Financing Requirement	**25,621**

4.18 CIPFA's Prudential Code for Capital Finance includes the following key indicator of prudence:

4.19 "In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financial Requirement for the current and next two years."

4.20 As at the 31st March 2010 the Council's borrowing exceeded its investments by £17.3 million.

External Debt

4.21 In respect of any external debt, it is recommended that the Council approves the following Authorised Limits for its total external debt gross of investments for the next three financial years. The Authorised Limit for external debt for the forthcoming year is the statutory limit determined under section 3 (1) of the Local Government Act 2003: "A local authority shall determine and keep under review how much money it can afford to borrow."

4.22 The Authorised Limits are consistent with the current capital programme and the proposals for capital expenditure included in the Medium Term Financial Plan and the Council's Capital Strategy. The limits are based on the most likely financial circumstances but with an allowance made for unusual cash movements. It is not anticipated that any borrowing will be undertaken except temporarily until further revenues are received.

Authorised Limit for External Debt				
	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Borrowing	38,000	44,500	49,000	52,000
Other long term liabilities	0	0	0	0
Total	38,000	44,500	49,000	52,000

4.23 The Council is asked to approve the following Operational Limit for external debt for the same period. The Operational Limit is based on the same estimates as for the Authorised Limit but differs in that it does not take into account the allowance for unusual cash movements.

	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Borrowing	35,000	41,500	46,000	49,000
Other long term liabilities	0	0	0	0
Total	35,000	41,500	46,000	49,000

4.24 The Council's actual external debt at the 31st March 2010 was £32,903 million (£27,807 million in short term borrowing and £5.1 million long term borrowing). It should be noted that the actual external debt is not directly comparable to the authorised limit and the operational boundary, since the actual external debt reflects the position at one point in time.

Treasury Management

4.25 The Council has previously adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Interest rate risk management is a priority and therefore the Code identifies two indicators that will provide the Operational Boundaries to the exposure to interest rate risk.

a) Upper limits for variable rate exposure and
b) Upper limits to fixed rate exposure.

4.26 It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2011/12, 2012/13 and 2013/14 of 100% and on its variable interest rate exposures on 50%. This limit on variable rates is consistent with the current approved limit.

4.27 The medium term strategy is to undertake borrowing for capital expenditure. The timing of any longer term borrowing will depend on the profile of capital spend.

4.28 The Council's investments are held in a relatively flexible form and therefore fixed interest rate exposure is not considered to be a significant risk.

Maturity Structure of any Fixed Rate Borrowing (as a percentage of total projected borrowing that is fixed rate)		
	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

4.29 The Council has recalled its externalised investments of £15 million, which originated in relation to the Council's reserved capital receipts. This sum is invested by the in-house team. The Code requires that authorities set out the total principal of sums invested for periods longer than 364 days and set an upper limit for each forward financial year for the maturity of these investments. The purpose of the indicator is to manage the investment portfolio within good treasury management practice guidelines and ensure there is a spread of investment maturities to reduce risks inherent in interest rate volatility. The following limits are recommended.

Total principal sums invested for periods longer than 364 days	
	£ million
31st March 2011	0.0
31st March 2012	0.0
31st March 2013	0.0

Minimum Revenue Provision Policy

4.30 For all unsupported (prudential) borrowing the Minimum Revenue Provision (MRP) will be based on the estimated life of the assets financed by borrowing in accordance with the MRP guidance.

5. FINANCIAL IMPLICATIONS

The financial implications are contained throughout the report.

6. LEGAL IMPLICATIONS

6.1 Section 151 of the Local Government Act 1972, the authority has to make arrangements for the proper administration of its financial affairs. The Council has previously resolved to comply with the CIPFA Code of Practice on Treasury Management. Under the Code of Practice the Council is required to approve the Treasury Management Strategy and Annual Investment Strategy before the start of the financial year.

6.2. Guidance issued under Section 15 (1) (a) of the Local Government Act 2003 requires the Council to approve an Annual Investment Strategy before the start of the financial year.

6.3. The treasury management code of practice requires all organisations covered by it to have a treasury management strategy stating the policies and objectives of its treasury management function.

6.4. On the 16th November 2009 the Department for Communities and Local Government issued a consultation paper on various changes to the prudential Capital Finance system introduced by the Local Government Act 2003. The revised guidance impacted on an authority's investment strategy.

6.5 In order to comply with the requirement of the Local Government Act 2003 the Council needs to approve a range of prudential indicators as detailed in the body of this report before the start of the forthcoming financial year. At the same time the Council also needs to approve a Minimum Revenue Provision Policy.

7. POLICY IMPLICATIONS

7.1 The Council's policy regarding borrowing and investments is contained in its Treasury Management Strategy.

7.2. This report will determine the Council's policy on making a MRP for 2011/12.

8. COUNCIL OBJECTIVES

8.1 The Council's Treasury Management activities support the achievement of the Council's objectives.

9. RISK MANAGEMENT INCLUDING HEALTH & SAFETY CONSIDERATIONS

9.1 The Council needs to ensure that the risks associated with the treasury function have been properly identified and evaluated. The risks include interest rate exposure, counterparty or credit risk, liquidity (insufficient cash to meet liabilities) risk, funding (inability to repay or replace loans) risk, and the failure of internal controls.

9.2. The Council would be failing in its legal obligations under the Local Government Act 2003 if it failed to agree a set of Prudential Indicators for the forthcoming financial year and in its legal obligations under the Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2008 if it failed to prepare an annual statement of policy on making a MRP

10. CUSTOMER IMPLICATIONS

No direct implications.

11. EQUALITIES AND DIVERSITY IMPLICATIONS

No direct implications.

12. VALUE FOR MONEY IMPLICATIONS, PROCUREMENT AND ASSET MANAGEMENT

No direct implications.

13. CLIMATE CHANGE, CARBON IMPLICATIONS AND BIODIVERSITY

There are no climate change, carbon implications or biodiversity implications.

14. HUMAN RESOURCES IMPLICATIONS

There are no human resource implications.

15. GOVERNANCE/PERFORMANCE MANAGEMENT IMPLICATIONS

The performance management implications are detailed in the report.

16. COMMUNITY SAFETY IMPLICATIONS INCLUDING SECTION 17 OF CRIME AND DISORDER ACT 1998

There are no community safety implications.

17. HEALTH INEQUALITIES IMPLICATIONS

There are no direct health inequality implications.

18. LESSONS LEARNT

None.

19. COMMUNITY AND STAKEHOLDER ENGAGEMENT

There has been no community or stakeholder engagement in the preparation of this report.

20. OTHERS CONSULTED ON THE REPORT

Portfolio Holder	No
Chief Executive	No
Executive Director (S151 Officer)	Yes
Deputy Chief Executive/Executive Director – Leisure, Environment and Community Services	No
Executive Director – Planning & Regeneration, Regulatory and Housing Services	No
Director of Policy, Performance and Partnerships	No
Head of Service	No
Head of Resources	Author
Head of Legal, Equalities & Democratic Services	No
Corporate Procurement Team	No

21. WARDS AFFECTED

All Wards.

22. APPENDICES

Appendix A - Treasury Management Strategy 2011/12.

23. BACKGROUND PAPERS

Working papers held by Financial Services Team.
CIPFA's Prudential Code – Fully revised 2nd edition.
Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008.

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