

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY FOR 2012/13

Relevant Portfolio Holder	Councillor Michael Braley, Portfolio Holder for Corporate Management
Portfolio Holder Consulted	
Relevant Head of Service	Teresa Kristunas, Head of Finance and Resources
Wards Affected	All Wards
Ward Councillor Consulted	
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

- 2.1 **That subject to any comments, the Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision Policy for 2012/13, be approved.**

3. KEY ISSUES

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.

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

- 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 of 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 2009 made 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.

Prudential Indicators

- 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.

Minimum Revenue Provision (MRP)

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

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

- 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 2011/12 informs the MRP set aside in the revenue account for 2012/13. 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.
- 3.14 The turmoil within financial markets, in particular the failing of a number of Icelandic banks and the issue with Northern Rock has highlighted the risks associated with treasury management activities.
- 3.15 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.
- 3.16 The bank base rate has remained at 0.5% since 5th March 2009.
- 3.17 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 borrowing rate for new fixed loans increased by approximately 0.87% and by 0.90% across variable rates. In September 2011 HM Treasury announced that these increases would be removed for authorities required to make payments to the

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

Department for Communities and Local Government (CLG) as part of the Housing Revenue Account reforms.

- 3.18 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 0.95% and 2.0%. It is proposed that these monies are lent by the General Fund to the Housing Revenue Account as a contribution to the £99,512,000 that is due to be paid to the CLG on the 28th March 2012. In return the General Fund would receive interest based on the rate charged by the Public Works Loans Board on the monies borrowed from that source in respect of self-financing. This is estimated to amount to £540,000.

Capital Resources

- 3.19 The Council's capital programme for 2012/13 shows a requirement for capital resources of £9.4 million. In order to fund the 2012/13 capital programme the Council will need to undertake further prudential borrowing of £2.1 million. The availability of capital receipts from asset disposals is limited because of market conditions.
- 3.20 The Council currently has £5.0 million of long term borrowing relating to housing capital expenditure. Further long term borrowing will be undertaken on or before the 28th March 2012 in order to make the payment of £99,512,000 to the CLG and to replace most of the housing short 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.
- 3.21 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. From 1st April 2012 the Council will have a limit (Debt Cap) on borrowing for housing purposes currently estimated at £118,040,000.

Prudential Indicators

- 3.22 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,

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

- e) Operational boundary for external debt,
- f) Council tax implications of the incremental effect of capital decisions,
- g) Treasury Management indicators.

3.23 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

3.24 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	2013/14 Estimate £'000	2014/15 Estimate £'000
HRA	7,115.0	7,050.0	7,950.0	7,260.0
General Fund	12,613.0	2,348.7	2,046.0	962.0
Total Approved Programme	19,728.0	9,398.7	9,996.0	8,222

Ratio of Financing Costs to Net Revenue Stream

3.25 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 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				
	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
HRA	1.6	21.2	20.2	19.2
General Fund	(0.5)	(3.6)	(3.5)	(3.4)

3.26 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. The significant

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

changes in 2012/13 are due to the borrowing the HRA self-financing and the use by the HRA of the monies previously invested externally.

Net Revenue Streams for 2011/12 and 2012/13

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

	2011/12 Estimate £	2012/13 Initial £
Dwelling rents	19,827,780	22,682,180
Non-dwelling rents	516,730	484,000
Charges for services and facilities	188,460	190,280
Less		
Negative subsidy	6,037,140	0
Net Revenue Stream	14,495,830	23,356,460

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

	2011/12 Estimate £	2012/13 Estimate £
Revenue Support Grant	1,108,936	80,099
Non-Domestic Rates	3,587,596	4,132,050
Council Tax	5,774,800	5,784,189
Council Tax Grant	144,173	144,397
Collection Fund	19,956	0
Net Revenue Stream	10,635,461	10,140,735

Capital Financing Requirement

3.29 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. The closing Capital Financing Requirement for 2010/11 was £31.066 million.

**AUDIT & GOVERNANCE
COMMITTEE**

23rd January 2012

Capital Financing Requirement				
	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000
HRA	118,040	118,040	118,040	118,040
General Fund	18,500	20,600	21,600	22,600
Total	136,540	138,640	139,640	140,640

Prudential Indicators

- 3.30 CIPFA's Prudential Code for Capital Finance includes the following key indicator of prudence:
- 3.31 "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."
- 3.32 As at the 31st March 2011 the Council's borrowing exceeded its investments by £23.3 million.

External Debt

- 3.33 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."
- 3.34 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.

**AUDIT & GOVERNANCE
COMMITTEE**

23rd January 2012

Authorised Limit for External Debt				
	2011/12 Revised Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000
Borrowing	137,000	140,000	145,000	150,000
Other long term liabilities	0	0	0	0
Total	137,000	140,000	145,000	150,000

3.35 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.

Operational Limit for External Debt				
	2011/12 Revised Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000
Borrowing	141,000	145,000	150,000	155,000
Other long term liabilities	0	0	0	0
Total	141,000	145,000	150,000	155,000

3.36 The Council's actual external debt at the 31st March 2011 was £33.825 million (£28.561 million in short term borrowing and £5.3 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. The figures above reflect the £99.512 million to be paid to the CLG on or before the 28th March 2012.

Treasury Management

3.37 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.

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

- 3.38 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.
- 3.39 The medium term strategy is to undertake borrowing for capital expenditure. The timing of any longer term borrowing will depend on interest rates and the profile of capital spend.
- 3.40 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%

- 3.41 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. It is proposed that these monies are utilised by the HRA to reduce the amount to be borrowed from the PWLB and at the same time generate an interest receipt for the General Fund. 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
31 March 2011	0.0
31 March 2012	0.0
31 March 2013	0.0

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

Minimum Revenue Provision Policy

- 3.42 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.

Self-financing for housing

- 3.43 The underlying principle of introducing self-financing for the Housing Revenue Account is that it should be at no detriment to the General Fund. In order to achieve it is proposed that the current long term loan of £5 million continues to be allocated to the HRA and that the current short term borrowing in respect of HRA capital expenditure is replaced with long term borrowing from the PWLB at the proposed preferential rates. There will then be two separate loans/borrowing funds one for the HRA and one for the General Fund. All other cash flow related transactions will be pooled and the costs allocated as at present.

Financial Implications

- 3.44 The financial implications are contained throughout the report.

Legal Implications

- 3.45 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.
- 3.46 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.
- 3.47 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.
- 3.48 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.
- 3.49 In order to comply with the requirement of the Local Government Act 2003 the Council needs to approve a range of prudential indicators as

AUDIT & GOVERNANCE COMMITTEE

23rd January 2012

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.

Service/Operational Implications

- 3.50 The Council's policy regarding borrowing and investments is contained in its Treasury Management Strategy.
- 3.51 This report will determine the Council's policy on making a MRP for 2012/13.
- 3.52 The performance management implications are detailed in the report.

Customer / Equalities and Diversity Implications

- 3.53 There are no implications identified.

4. RISK MANAGEMENT

- 4.1 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.
- 4.2 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.

5. APPENDICES

Appendix 1 – Treasury Management Strategy 2012/13

6. BACKGROUND PAPERS

CIPA – Treasury Management Implications of HRA Reform

AUTHOR OF REPORT

Name: Teresa Kristunas, Head of Finance and Resources
E Mail: teresa.kristunas@bromsgroveandredditch.gov.uk
Tel: (01527) 64252 ext 3295