AGENDA ITEM 11

FULL COUNCIL

1 FEBRUARY 2012

REPORT OF THE HEAD OF CENTRAL SERVICES

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY

1.0 PURPOSE OF REPORT

1.1 This report outlines the Council's prudential indicators for 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

(a) The reporting of the **prudential indicators** setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice and Guidance Notes 2011 as revised.

(b) The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007);

(c) The **treasury management strategy statement** which sets out how the Council's treasury management service will support the capital decisions taken, the day to day treasury management activity and the limitations on activity through treasury prudential indicators. The key indicator is the **Authorised Limit**, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code ;

(d) The **investment strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Department of Communities and Local Government (CLG) Investment Guidance.

The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

2.0 RECOMMENDATIONS

2.1 **The Budget and Strategic Planning Working Group recommends to the Council that:**

(a) The prudential indicators and limits are adopted and approved;

(b) The Treasury Management Strategy and treasury management prudential indicators are adopted and approved;

(c) The Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP is approved;

(d) **The counterparty list as set out in Appendix B and the use of the creditworthiness service provided by the treasury consultants be adopted and approved;**

(e) **The revised limits for borrowing activity (authorised limit and operational boundary) and prudential indicators and limits on treasury activity for 2011-12 be approved (para 3.2.6 below refers).**

(f) **Following any formal decision to utilise the capital receipt monies to repay general fund debt the impact of the Prudential Indicators and Treasury Management Strategy be calculated and reported to Members along with the Mid Year Report on the Treasury Management Activities & Prudential Indicators.**

3.0 KEY ISSUES

3.1 Background

3.1.1 One of the main changes in the CLG guidance is that there is greater member scrutiny of the treasury management policies. The Budget and Strategic Planning Working Group is the responsible body for scrutinising the Treasury Management Strategy as agreed by Full Council on 3 February 2011.The Budget & Strategic Planning Working Group scrutinised the strategy on 18 January 2012 and now recommends the report to Full Council for approval.

3.1.2 To facilitate the decision making process and support capital investment decisions the Prudential Code requires the Council to agree and monitor a minimum number of prudential indicators and for housing authorities these are separated for the HRA and non-HRA capital investment. The indicators are mandatory, but can be supplemented with local indicators if this aids interpretation and many cover three years ahead.

3.1.3 The indicators cover affordability, prudence, capital expenditure, external debt and treasury management and form the basis of in year monitoring through the Members' Newsletter. For the General Fund the indicators have also been split into General and Special Expenses (Melton Mowbray).

3.1.4 The indicators are purely for internal use by the Council and are not to be used as comparators between Councils, as any comparisons will be meaningless. In addition, the indicators should not be considered individually in that the benefit from monitoring will arise from the movement in the Council’s indicators over time and the year on year changes.

3.2 Treasury Management Strategy and Prudential Indicators

3.2.1 The prudential indicators have been based on the position set out in the capital programme and revenue budget reports set out elsewhere on this agenda and the Medium Term Financial Strategy (MTFS) approved by the Policy, Finance & Administration Committee (PFA) on 25 January 2012. Along with each indicator is an explanation of what it demonstrates.

3.2.2 The Treasury Management Strategy is attached as Appendix A including the prudential indicators that relate to the treasury management function. This strategy covers the operation of the treasury function and its activities for the forthcoming year. The strategy has been informed by advice received from the Council's treasury management consultants.

3.2.3 The Council’s treasury management consultants are also advising clients to adopt a revised creditworthiness service. This replaces the current methodology which was based on the Lowest Common Denominator (LCD) approach. The advantage of this system is that it uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue reliance on just one agency's ratings.

3.2.4 The Council's latest updated list of approved counterparties for lending purposes based on the new system ("the Sector Credit List") is attached at Appendix B as at the date of this report. The list is updated on an ongoing basis as changes arise in an organisations credit rating. This includes the credit rating of each institution.

3.2.5 To summarise, the key issues set out in the attached appendices are as follows:

Capital Expenditure – The projected capital expenditure based on the available funding set out in the Medium Term Financial Strategy is estimated as set out in the following table:

Capital Expenditure	2011/12 Revised £000's	2012/13 Estimated £000's	2013/14 Estimated £000's	2014/15 Estimated £000's
General Expenses	3,930	2,840	599	397
Special Expenses	0	36	34	33
Total Non HRA	**3,930**	**2,876**	**633**	**430**
HRA	1,591	1,572	2,383	2,037
Total	**5,521**	**4,448**	**3,016**	**2,467**

Debt Requirement and Repayment – Part of the capital expenditure programme will be financed directly (through Government grants, capital receipts etc.), leaving a residue which will increase the Council's external borrowing requirement (its Capital Financing Requirement – CFR). The General Fund CFR is reduced each year by a statutory revenue charge for the repayment of debt known as the Minimum Revenue Provision or MRP (there is no requirement for an HRA charge). However, where unsupported borrowing is undertaken for the HRA it is considered prudent to do so. For the self financing settlement the Government has stated that the repayment of borrowing is not required but the Council can opt to repay the debt rather than build up cash reserves where it considers this to be in the best interests of the Council and the Housing Service. We have yet to determine the best course of action and this will form part of the HRA business plan.

As illustrated earlier the Capital Finance and Accounting Regulations affecting MRP require the Council to formally approve a method for calculating MRP annually. For supported borrowing the existing regulatory method has been used i.e. (4% of the opening CFR for General Expenses). For new unsupported borrowing taken out in 2012/13 there are two options for calculating MRP; namely the asset life method which is currently used in terms of financial prudence and is based on the life of the particular asset or the depreciation method which ties in with the depreciation method used for the particular asset. The latter method is considered to be more complicated to calculate and also requires consideration of any residual value of the asset on disposal. It is therefore recommended that the asset life method is used for unsupported borrowing as is the case for 2011/12.

Capital Financing Requirement - The following table sets out the predicted CFR for the period 2011-2015 analysed by fund, taking into account the method of calculating MRP as recommended above.

Capital Financing Requirement	2011/12 Revised £000's	2012/13 Estimated £000's	2013/14 Estimated £000's	2014/15 Estimated £000's
General Expenses	5,683	7,859	7,544	7,250
Special Expenses	57	54	51	48
Total Non HRA	**5,740**	**7,913**	**7,595**	**7,298**
HRA	32,093	32,078	32,064	32,050
Total	**37,833**	**39,991**	**39,659**	**39,348**

The Council's anticipated net borrowing requirement (net of investments) is shown below with a comparison against the CFR. The Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

The Head of Central Services reports that the Council complied with this prudential indictor in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the assumptions set out in paragraph 3.2.1. The Council has in the past aimed to ensure borrowing is kept as closely aligned to the CFR as possible; however, due to the current interest rates on investments the scope for utilising internal borrowing will be considered which will mean borrowing will be for a short period below the CFR.

Net Borrowing	**2011/12 Revised £000's**	**2012/13 Estimated £000's**	**2013/14 Estimated £000's**	**2014/15 Estimated £000's**
Gross Borrowing	34,549	36,549	36,549	36,549
Investments	-395	-228	-61	0
Net Borrowing	**34,154**	**36,321**	**36,488**	**36,549**
CFR	**37,833**	**39,991**	**39,659**	**39,348**

Against this borrowing need (the CFR), the Council's expected maximum external debt position for each year (the Operational Boundary), and the maximum amount it could borrow (the Authorised Limit) are set out as follows:

Authorised Limit & Operational Boundary	**2011/12 Revised £000's**	**2012/13 Estimated £000's**	**2013/14 Estimated £000's**	**2014/15 Estimated £000's**
Authorised limit	47,000	49,000	49,000	49,000
Operational boundary	36,800	38,800	38,800	38,800

The net revenue impact of the new capital schemes being approved as part of this budgetary cycle on Council Tax and housing rents are expected to be:

Incremental impact of capital investment decisions on:	**2011/12 Revised £000's**	**2012/13 Estimated £000's**	**2013/14 Estimated £000's**	**2014/15 Estimated £000's**
General Expenses Band D Council Tax	-0.46	2.22	-4.27	-12.28
Special Expenses Band D Council Tax	0.00	0.00	0.00	0.00
Housing rents levels	0.00	0.00	0.00	0.00

The key impact being the implications of the move to Parkside and the Waterfield Leisure Pool Investment**.**

3.2.6 HRA Reform

A key issue facing the Council is the impact of the HRA reform. This essentially ends the impact of the redistributive housing subsidy system and sees the issue of a one-off allocation of housing debt. The legislation gained Royal Assent in November 2011 and so the Council will need to approve revised limits as noted in 3.2.7 below and within the appendix at Section 3.2 and 3.4 respectively.

3.2.7 The requirement for the HRA reform settlement to be made to the CLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £27.8m available by the 28th March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council. Whilst the debt can be drawn earlier than needed, this may incur a revenue cost, and will be considered when a review of the structure of actual prevailing borrowing and investment interest rates is undertaken nearer to the time.

Due to the timing of this borrowing revised limits for borrowing activity are required i.e. authorised limit and operational boundary and prudential indicators together with limits on treasury activity for the year 2011-12 have been revised and a recommendation is submitted for approval at 2.1 (e) above.

3.2.8 **Sale of Nottingham Road Land**

The Prudential Indicators are based on the fact that the capital receipt is still pending and no formal decision has been made as to the use of these funds. Members have indicated a desire to use a proportion of the receipt to repay all general fund debt. Such a decision would have a significant impact on the Prudential Indicators and Treasury Management Strategy. For example:

- Authorised limit
- Operational Boundary
- Capital Financing Requirements
- Gross borrowing calculations
- Ratio of financing costs to revenue streams
- Incremental Impact of capital investment decisions on Band D Council Tax
- Interest rate exposures
- Maturity Structure of fixed and variable rate borrowing

It is proposed that the detailed calculations resulting from such a decision be reported to Members as part of the Mid Year Report on Treasury Management Activities & Prudential Indicators . **see recommendation 2.1 (f) above**

4.0 POLICY AND CORPORATE IMPLICATIONS

4.1 There are no other major policy and corporate implications arising from this report.

5.0 FINANCIAL AND OTHER RESOURCE IMPLICATIONS

5.1 There are no other financial implications arising from this report.

6.0 LEGAL IMPLICATIONS/POWERS

6.1 There are no other legal implications arising from this report.

7.0 COMMUNITY SAFETY

7.1 There are no direct links to community safety arising from this report.

8.0 EQUALITIES

8.1 There are no direct equality issues arising from this report.

9.0 RISKS

9.1 The relevant risks are considered in the table below:

Probability

Very High A				
High B				
Significant C				
Low D				
Very Low E			1,2	
Almost Impossible F				
	IV Neg-ligible	III Marg-inal	II Critical	I Catast-rophic

Impact

Risk No.	Description
1	Poor Investment
2	Failure of counterparties

9.2 The relevant risks are considered to be of a very low probability, albeit of a critical nature and are mitigated as set out in the following paragraphs.

9.3 The use of a sophisticated modelling approach in selecting both counterparties and time periods utilising ratings from all three main rating agencies and supplemented with credit watches, credit outlooks CDS spreads and sovereign ratings will ensure only the most creditworthy institutions/countries are used.

9.4 A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks. These benchmarks are targets and so may be breached from time to time (the benchmarks for yield are already being assessed). Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators.

10.0 CLIMATE CHANGE

10.1 There are no climate change issues arising from this report.

11.0 CONSULTATION

11.1 The Council's treasury management consultants have been consulted on this report.

12.0 WARDS AFFECTED

12.1 All wards are affected.

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Date:	23 January 2012
Appendices:	Treasury Management Strategy Statement - Appendix A List of Approved Counterparties for Lending - Appendix B
Background Papers:	Prudential Indicators Working Papers MTFS Revenue Estimates Capital Programme
Reference:	X: C’tees, Council & Sub-C’tees/Full Council/2011-12/01-02-12/DG- Prudential Indicators and Treasury Management Strategy