

ROTHERHAM BOROUGH COUNCIL – REPORT TO AUDIT COMMITTEE

1.	Meeting:	Audit Committee
2.	Date:	19th October 2011
3.	Title:	Mid Year Treasury Management and Prudential Indicators Monitoring Report 2011/12
4.	Directorate:	Financial Services

5. Summary

Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs).

The report is structured to highlight the key changes to the Council's capital activity (the PIs), the economic outlook and the actual and proposed treasury management activity (borrowing and investment).

6. Recommendations

The Audit Committee is asked to:

- 1. Note the report and the treasury activity; and**
- 2. Refer the report to Cabinet to consider recommending the Council approve changes to the prudential indicators.**

7. Proposals and Details

The Strategic Director of Finance has delegated authority to carry out treasury management activities on behalf of the Council and this report is produced in order to comply with the CIPFA Code of Practice in respect of Treasury Management in Local Authorities and the “Prudential Code”.

8. Finance

Treasury Management forms an integral part of the Council’s overall financial arrangements.

The assumptions supporting the capital financing budget for 2011/12 and for future years covered by the Council’s MTFS were reviewed in light of economic and financial conditions and the future years’ capital programme.

The Treasury Management and Investment Strategy is not forecast to have any further revenue consequences other than those identified and planned for in both the Council’s 2011/12 Revenue Budget and approved MTFS.

9. Risks and Uncertainties

Regular monitoring will ensure that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

10. Policy and Performance Agenda Implications

Effective treasury management will assist in delivering the Council’s policy and performance agenda.

11. Background Papers and Consultation

CIPFA Code of Practice for Treasury Management in Local Authorities
Local Government Act 2003
CIPFA “Prudential Code”

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Mid Year Prudential Indicators and Treasury Management Monitoring Report

1. Introduction and Background to the Report

- 1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.
- 1.2 This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and PIs were previously reported to Audit Committee, Cabinet and Council in February/March 2011 respectively.
- 1.3 The Council's revised capital expenditure plans (Section 2.2 of this report) and the impact of these revised plans on its financing are set out in Section 2.3. The Council's capital spend plans provide a framework for the subsequent treasury management activity. Section 3 onwards sets out the impact of the revised plans on the Council's treasury management indicators.
- 1.4 The underlying purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the CLG Investment Guidance. These state that Members receive and adequately scrutinise the treasury management service.
- 1.5 The underlying economic and financial environment remains difficult for the Council, foremost being the improving, but still challenging, concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.
- 1.6 The Strategic Director of Finance can report that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed from that set out in the approved Treasury Management Strategy (February 2011).

2. Key Prudential Indicators

- 2.1. This part of the report is structured to update:
 - The Council's capital expenditure plans;
 - How these plans are being financed;
 - The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
 - Compliance with the limits in place for borrowing activity.

2.2 Capital Expenditure (PI)

2.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. The revised estimate reflects the capital programme approved by Cabinet at its meeting on 20 July.

Capital Expenditure by Service	2011/12 Original Estimate £m	2011/12 Revised Estimate £m
Children & Young People's Services	5.896	9.320
Environmental & Development Services	29.848	33.759
Neighbourhoods & Adult Services	23.650	22.947
Financial Services*	4.517	12.707
Total	63.911	78.733

* - includes the RCAT loan facility (£5m) and the new Mortuary and facilities (£2m)

2.3 Impact of Capital Expenditure Plans

Changes to the Financing of the Capital Programme

2.3.1 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the expected financing arrangements of this capital expenditure.

Capital Expenditure	2011/12 Original Estimate £m	2011/12 Revised Estimate £m
Total spend	63.911	78.733
Financed by:		
Capital receipts	1.431	1.660
Capital grants, capital contributions & other sources of capital funding	35.141	37.999
Borrowing Need	27.339	39.074
Total Financing	63.911	78.733
Supported Borrowing	0.463	0.719
Unsupported Borrowing	26.876	38.355
Borrowing Need	27.339	39.074

The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

- 2.3.2 As reported to Audit Committee in September actual expenditure in 2010/11 was less than anticipated and thus the increase in borrowing need for 2011/12 reflects the re-profiling of projects within the approved capital programme together with new approvals (e.g. the RCAT loan facility (£5m) and the new Mortuary and facilities (£2m).

Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)

- 2.3.3 The table below shows the CFR, which is the underlying external need to borrow for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

- 2.3.4 A key accounting change for 2009/10 was the inclusion of the Council's PFI schemes and similar arrangements on the Council's balance sheet. This has the effect of increasing the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is already included in the contract. The adjustments required were finalised during the 2009/10 accounts closedown and are now fully reflected in the indicators. The estimate for 2011/12 has been revised to incorporate the effect of the increased borrowing need.

Prudential Indicator – External Debt / the Operational Boundary

RMBC	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – Non Housing	312.079		320.922
CFR – Housing	290.460		286.782
Total CFR excluding PFI and similar arrangements	602.539		607.704
Net movement in CFR	16.467		28.429
Total CFR excluding PFI and similar arrangements	602.539		607.704
Cumulative adjustment for PFI and similar arrangements	114.146		156.393
Total CFR including PFI and similar arrangements	716.685		764.097
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	494.103	459.636	505.054
Other long term liabilities*	114.146	156.393	156.393
Total Debt 31 March	608.249	616.029	661.447

* - Includes on balance sheet PFI schemes and similar arrangements, etc.

Former SYCC	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	96.412	96.412	96.412
Other long term liabilities	0	0	0
Total Debt 31 March	96.412	96.412	96.412

3. Limits to Borrowing Activity

- 3.1 The first key control over the treasury activity is a PI to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent to do so.

RMBC	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
Gross Borrowing	494.103	459.636	505.054
Plus Other Long Term liabilities*	114.146	156.393	156.393
Less Investments	30.000	8.720	15.000
Net Borrowing	578.249	607.309	646.447
CFR* (year end position)	716.685	764.097	764.097

* - Includes on balance sheet PFI schemes and similar arrangements, etc.

- 3.2 The Strategic Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this PI.
- 3.3 A further PI controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt (RMBC + Former SYCC)	2011/12 Original Indicator £m	Current Position £m	2011/12 Revised Indicator £m
Borrowing – RMBC	615.372	459.636	627.334
Borrowing – SYCC	96.412	96.412	96.412
Other long term liabilities*	114.146	156.393	156.393
Total	825.930	712.441	880.139

* - Includes on balance sheet PFI schemes and similar arrangements, etc.

4. Treasury Strategy 2011/12 – 2013/14

4.1 Debt Activity during 2011/12

4.1.1 The expected borrowing need is set out below:

RMBC	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
CFR (year end position)	716.685	764.097	764.097
Less Other Long Term Liabilities*	114.146	156.393	156.393
Net Adjusted CFR (y/e position)	602.539	607.704	607.704
Borrowed at 30/09/11	441.176	459.636	459.636
Under borrowing at 30/09/11	161.363	148.068	148.068
Borrowed at 30/09/11	441.176		459.636
Estimated to 31/03/12	52.927		49.394
Total Borrowing	494.103		509.030
Under borrowing at 31/03/12	108.436		98.674

* - Includes on balance sheet PFI schemes and similar arrangements, etc.

4.1.2 The Council is currently under-borrowed although it is still anticipated this may be reduced by the end of the financial year. The delay in borrowing reduces the cost of carrying the borrowed monies when yields on investments are low relative to borrowing rates. There is also an interest rate risk, as longer term borrowing rates may rise, but this position is being closely monitored and the overall position carefully managed.

4.1.3 During the first half of 2011/12 the Council has borrowed the following amounts:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1m	Fixed rate	4.76%	25 years
PWLB	£1m	Fixed rate	4.24%	25 years
PWLB	£1m	Fixed rate	4.08%	25 years
PWLB	£10m	Fixed rate	3.01%	8 years
PWLB	£10m	Fixed rate	3.20%	9 years

4.1.4 The Council has repaid the first instalment (£1m) on a PWLB loan of £20m which was taken up in March 2011 on an Equal Instalment of Principal basis over 10 years at an interest rate of 3.46%. To date this part repayment has not been replaced.

4.1.5 There has been no restructuring or early repayment existing debt.

5. Investment Strategy 2011/12 – 2013/14

5.1 **Key Objectives** – The primary objective of the Council’s investment strategy is the safeguarding the repayment of the principal and interest of its investments on time – the investment return being a secondary objective. The current difficult economic and financial climate has heightened the Council’s over-riding risk consideration with regard to “Counterparty Risk”. As a result of these underlying market concerns officers continue to implement an operational investment strategy which further tightens the controls already in place in the approved investment strategy.

5.2 **Current Investment Position** - The Council’s held £8.72m of investments at 30 September 2011 (excluding Icelandic Banks), and the constituent parts of the investment position are:

Sector	Country	Up to 1 year £m	1 - 2 years £m	2 – 3 years £m
Banks	UK	0.22	0	0
DMO	UK	0.00	0	0
Local Authorities	UK	8.50	0	0
Total		8.72	0	0

5.3 **Risk Benchmarking** – A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting.

The following reports the current position against the benchmarks.

5.3.1 **Security** – The Council monitors its investments against historic levels of default by continually assessing these against the minimum criteria used in the investment strategy. The Council’s approach to risk, the choice of counterparty criteria and length of investment ensures any risk of default is minimal when viewed against these historic default levels.

5.3.2 **Liquidity** – In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- A Bank overdraft facility of £10m
- Liquid short-term deposits of at least £3m available with a week's notice.

The Strategic Director of Finance can report that liquidity arrangements were adequate during the year to date.

5.3.3 **Yield** – a local measure for investment yield benchmark is internal returns above the 7 day LIBID rate

The Strategic Director of Finance can report that the return to date averages 0.37%, against a 7 day LIBID to end September 2011 of 0.47%. This is reflective of the Council's current approach to risk whereby security has been maximised by using the Debt Management Office and other Local Authorities as the principal investment counterparties.

6. Revisions to the Investment Strategy

6.1 The counterparty criteria are continually under regular review but in the light of the current market conditions no recommendations are being put to Members to revise the Investment Strategy.

7. Treasury Management Prudential Indicators

7.1 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

	2011/12 Original Indicator %	2011/12 Revised Indicator %
Non-HRA	9.90	9.62
HRA	15.78	14.40

7.2 Both revised indicators reflect the impact of borrowing at rates less than originally anticipated for 2011/12.

7.3 Prudential indicator limits based on debt net of investments

- **Upper Limits On Fixed Rate Exposure** – This indicator covers a maximum limit on fixed interest rates.
- **Upper Limits On Variable Rate Exposure** – Similar to the previous indicator this identifies a maximum limit for variable interest rates based upon the debt position net of investments.

RMBC	2011/12 Original Indicator		Current Position	2011/12 Revised Indicator	
	Lower	Upper		Lower	Upper
Prudential indicator limits based on debt net of investments					
Limits on fixed interest rates based on net debt		100%	75.38%		100%
Limits on variable interest rates based on net debt		30%	24.62%		30%

7.4 **Maturity Structures Of Borrowing** – These gross limits are set to reduce the Council’s exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

RMBC	2011/12 Original Indicator		Current Position	2011/12 Revised Indicator	
	Lower	Upper		Lower	Upper
Maturity Structure of fixed borrowing					
Under 12 months	0%	20%	3.48%	0%	20%
12 months to 2 years	0%	25%	1.52%	0%	25%
2 years to 5 years	0%	30%	13.27%	0%	30%
5 years to 10 years	0%	35%	15.23%	0%	35%
10 years to 20 years	0%	40%	3.48%	0%	40%
20 years to 30 years	0%	45%	5.72%	0%	45%
30 years to 40 years	0%	50%	1.09%	0%	50%
40 years to 50 years	10%	60%	18.78%	10%	60%
50 years and above	15%	100%	37.43%	15%	100%

The former SYCC account is due to be wound up by the end of 2020/21 and the maturity structure is now largely fixed as the need and indeed opportunities to re-finance within the remaining 10 years will be limited. As a result future limits are currently set in line with the on-going maturity profile.

Former SYCC	2011/12 Original Indicator		Current Position	2011/12 Revised Indicator	
	Lower	Upper		Lower	Upper
Maturity Structure of fixed borrowing					
Under 12 months	0%	50%	0%	0%	50%
12 months to 2 years	0%	70%	0%	0%	70%
2 years to 5 years	0%	100%	9.76%	0%	100%
5 years to 10 years	0%	100%	90.24%	0%	100%

- 7.5 **Total Principal Funds Invested** – These limits are set to reduce the need for the early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end.

The Council currently has no sums invested for periods exceeding 364 days due to market conditions. To allow for any changes in those conditions the indicator has been left unchanged. The above also excludes any Icelandic investments that are due to be recovered after more than 364 days.

RMBC	2011/12 Original Indicator £m	Current Position £m	2011/12 Revised Indicator £m
Maximum principal sums invested > 364 days	10	0	10
Comprising			
Cash deposits	10	0	10