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**Steve Atkinson** MA(Oxon) MBA FIoD FRSA
***Chief Executive***

**Date:** **20 January 2012**

Hinckley & Bosworth
Borough Council

*A Borough to be proud of*

**To:** **Members of the Scrutiny Commission**

| | |
|---|---|
| Mr MR Lay (Chairman) | Mrs L Hodgkins |
| Mr PAS Hall (Vice-Chairman) | Mr DW Inman |
| Mr C Ladkin (Vice-Chairman) | Mr K Morrell |
| Mr PR Batty | Mr K Nichols |
| Mr Bessant | Mrs S Sprason |
| Mrs WA Hall | Miss DM Taylor |

Copy to all other Members of the Council
**Members of the Finance, Audit and Performance Committee are specifically invited to this meeting**

(other recipients for information)

Dear Councillor,

There will be a meeting of the **SCRUTINY COMMISSION** in the Council Chamber on **MONDAY, 30 JANUARY 2012** at **6.30 pm** and your attendance is required.

The agenda for the meeting is set out overleaf.

Yours sincerely

RKOwen

Rebecca Owen
Democratic Services Officer

# SCRUTINY COMMISSION - 30 JANUARY 2012

## ***A G E N D A***

1. APOLOGIES AND SUBSTITUTIONS

2. DECLARATIONS OF INTEREST

   To receive verbally from members any disclosures which they are required to make in accordance with the Council's code of conduct or in pursuance of Section 106 of the Local Government Finance Act 1992. **This is in addition to the need for such disclosure to be also given when the relevant matter is reached on the agenda.**

3. CAPITAL PROGRAMME 2011/12 TO 2014/15 (Pages 1 - 14)

   Report of the Deputy Chief Executive (Corporate Direction) attached.

4. PRUDENTIAL CODE FOR CAPITAL FINANCE - SETTING OF PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY (Pages 15 - 36)

   Report of the Deputy Chief Executive (Corporate Direction) attached.

**SCRUTINY COMMISSION – 30 JANUARY 2012**

**RE: CAPITAL PROGRAMME 2011/2012 TO 2014/15**

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## 1.0 PURPOSE OF REPORT

1.1 To consider the Capital Programme for the years 2011/12 to 2014/15.

## 2.0 RECOMMENDATIONS

- Members consider the programme that will be presented to Council for approval.

2.1 Note the financial implications contained in section 7.

## 3.0 BACKGROUND

3.1 Projects in the programme have been submitted by Project Officers and reflect outcomes from the Officers Capital Forum Group, SLB and changes after the report being presented to Executive Briefing on the 10th November 2011 and Finance and Performance Committee on the 12th December 2011. Council agreed to the depot relocation project on the 20th December 2011. This scheme has also been included.

3.2 Members will be aware of the issues surrounding future capital funding in particular the drawdown on the current capital receipts reserve as highlighted in section 4 below. The pressure on future funding of the capital programme and the depletion of reserves has previously been raised with members and were reported to Council in February 2011.

3.3 The attached programme Appendix A assumes a virtual standstill position on schemes for future years.

3.4 Projects have been reprofiled in line with the latest spending and external funding forecasts. The major change being the reprofiling of the Richmond Park Project as a result of funding approval delays with the Football Association (FA).

3.5 Within the current financial year there may be an underspend on Private Sector Housing on minor and major works of around £180,000. Due to changes in the referral system the amount of approvals have reduced. There may however be a backlog that would need to be covered by this underspend. Additionally, the Disabled Facilities Grant budget will, in the future, no longer be supported through decent homes funding. This means that the level of expenditure will need to reduce to £295,000. Because of these uncertain compensating pressures, the potential underspend of around £180,000 has not been built into the funding assumptions below.

## 4.0 Programme to 2014-15 – Funding Issues

4.1 Due to major schemes now being completed the programme will be relatively small in future years. However, due to reduced funding even a status quo programme will have an impact on the council's general fund revenue account.

The estimated cost of borrowing will be £13,323 in financial year 2012/13 rising to £100,039 by 2014/15. This assumption is based on a major use of the capital receipts reserve, estimated receipts from right to buy sales and disposal of other small plots. At the end of 2014/15 only £192,000 will be left in the capital receipts reserve. The position is summarised below:-

Table 1

| | 2011/12 | 2012/13 | 2013/14 | 2014/15 |
|---|---|---|---|---|
| Opening Bal | (1260) | (1227) | (178) | (48) |
| Receipts | (1484) | (520) | (274) | (144) |
| Funding used | 1517 | 1,569 | 404 | 0 |
| CI (Bal) | (1227) | (178) | (48) | (192) |

## 5.0 New Bids

5.1 The following new bids were received by SLB. Following a review they were not accepted.

General Fund Bids Not Supported By SLB/Executive

Recycling Receptacles - An annual uplift of £5,000 plus inflation to allow for new properties. Negotiations are currently taking place whether these additional bins can be funded either directly through voluntary contributions from developers or through the Community Infrastructure Levy (CIL). It is likely that the final CIL agreement will not be in place for another 18 months. Any shortfall in the short term could be met from the Waste Management Reserve.

CCTV - SLB received a report regarding options on the delivery of CCTV in the future. This bid reflects the need to update the current technology. Although the cost is estimated at £60,000 with an estimated asset life of 10 years, there would be potential revenue savings of £13,000 per annum. This can be compared against the additional cost of borrowing of £8,700. Further options on CCTV are currently being explored. The future financial impact will be known once these options have been finalised.

HRA Bid Supported by SLB/ Executive

Orchard Upgrade - A bid has been received to upgrade the current Housing Management and Rents system. Technical support for the old system will cease in December 2012. The new system will be web based and will allow customers to check their rent accounts, report repairs etc. The estimated cost is £111,286. Based on a ten year asset life the cost of borrowing chargeable to the HRA would be £16,136.

Additionally, the Council will, under the new self financing system, need to borrow £67.2m to fund the HRA subsidy buy out. This amount has been included within the attached programme. The borrowing impact on the revenue account has been included within the future HRA budgets.

Leisure Centre

An amount of £10m (commencing in 2014/15) has been estimated for the development of a new leisure facility. A refurbishment option could potentially cost around £6.5m. It should be recognised that this option is higher risk than a new build scheme in terms of cost certainty. Furthermore, the asset life for a new centre would be c40 years and the life of a refurbishment would be c25 years. Either option would be funded from future major capital receipts, (£2.75m from the Bus Station development, £1.5m from the sale of the existing leisure centre site, £3m from the Argents Mead development and a net £0.6m receipt from the depot relocation). This would leave a balance £2.24m to fund from other sources. It is possible that an external financial contribution towards this project might be achieved. This project has currently not been built into the capital programme.

## 6.0 HRA Capital

The future year's housing repairs capital programme shows a reduction of approximately £470k. This assumes the total contract value reduction from £2.4m to £1.9m is all attributable to capital schemes. It is difficult to accurately forecast future costs as the service was recently brought in house. However savings on the current programme budget will be made. As a one off the cost of the Orchard upgrade could be met from the proposed capital underspend.

## 7.0 Financial Implications (IB)

7.1 Capital resourcing and borrowing implications arising from this report will be reflected within the Medium Term Financial Strategy and the Prudential Code (Treasury Management) report.

Based on the current economic climate there has been a significant reduction in anticipated capital receipts.

7.2 If members agree to adopt the scenario in section 4.1 above, this assumes £938k of capital receipts between 2012/13 and 2014/15. This would still mean gross borrowing of £2.671m between 2012/13 to 2014/15 with a borrowing chargeable to general fund rising by £100,039 in 2014/15 on the basis any borrowing related to the depot relocation has been paid of by March 2015. If this is not the case an additional £82,000 would be chargeable.

7.3 Future funding requirements could reduce by c£180k if savings on General Fund Housing are achieved and there were no other compensating pressures.

7.4 Members will have to decide on the option of recommending reductions on future uncommitted schemes.

New Bids

7.5 There is an additional risk with the leisure centre development. The current leisure management contract ends in April 2014. If by then development arrangements are not made there could be significant revenue costs to let a contract on a short/medium term basis.

Additionally, if future major receipts are not realised there will be a risk to the leisure centre development. It is recommended that members agree the Leisure Centre Development request to be put forward to Council for approval on the basis that the following sales are earmarked for the development.

£2.75m - Bus Station Redevelopment,
£1.5m- Future sale the Leisure Centre,
£3m - Argents Mead Development
£0.6m – Net receipt from the Depot Relocation

## 8.0 Legal Implications (AB)

8.1 None arising directly from the report.

## 9.0 Corporate Plan Implications

9.1 The report provides a refresh of the Council's rolling Capital Programme. Any item included in the programme has to contribute to the achievement of the Council's vision, as set out in the Corporate Performance Plan.

## 10.0 Consultation

10.1 Expenditure proposals contained within this report have been submitted after officer consultation. Appropriate consultation with relevant stakeholders takes place before commencement of individual projects.

## 11.0 Risk Management

11.1 It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

11.2 It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision/project have been identified, assessed and that controls are in place to manage them effectively.

| **Management of Significant (Net Red) Risks** | | |
|---|---|---|
| Risk Description | Mitigating actions | Owner |
| If the schemes were not implemented this would impact on Service Delivery. It would also mean an inability to meet corporate plan objectives and have an impact on the reputation of the Council. | Projects are to be managed through an officer capital forum group and reported to SLB on a quarterly basis. Monthly financial monitoring statements are provided to project officers and the programme will now be reviewed twice a year. | Individual Project Officers/ Capital Forum |
| The risk of external funding not being granted. This would result in additional borrowing costs in the short term if funding is delayed or long term if funding is withdrawn. | Six monthly review of capital programme would mean that it is easier to switch resources. | Project Officer / Accountancy section |
| Risk of Capital Receipts not being realised. | The Executive approve the disposal of surplus assets as recommended by the Asset Management Strategy Group | Estates and Asset Manager / Deputy Chief Executive (Corporate Direction) |

## 12.0 Knowing Your Community – Equality and Rural Implications

12.1 The programme contains schemes which will assist in equality and rural development. Equality and rural issues are considered separately for each project.

## 13.0 Corporate Implications

13.1 The Council has an agreed corporate approach to project management. This approach has been developed in collaboration with the Leicestershire and Rutland Improvement Partnership. This approach ensures that a consistent and coherent approach is applied across the Council (and across the county).

13.2 By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Human Resources implications
- Planning Implications
- Voluntary Sector

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**Background Papers:** Capital Estimates 11/12 – 14/15

**Contact Officer:** Ilyas Bham ext. 5924

**Portfolio Holder:** Cllr K. Lynch

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# CAPITAL ESTIMATES 2011-2012 to 2013-2014 SUMMARY

Appendix A

| | TOTAL COST | ESTIMATE 2011-12 | ESTIMATE 2012-13 | ESTIMATE 2013-14 | ESTIMATE 2014-15 |
|---|---|---|---|---|---|
| | £ | £ | £ | £ | £ |
| SECTION 1 (Leisure and Environment) | 2,050,574 | 1,368,330 | 322,244 | 180,000 | 180,000 |
| SECTION 2 (Planning) | 1,878,070 | 255,820 | 1,535,000 | 48,250 | 39,000 |
| SECTION 3 (Central Services) | 1,393,304 | 441,104 | 892,200 | 30,000 | 30,000 |
| Housing (General Fund) | 2,005,910 | 618,860 | 462,350 | 462,350 | 462,350 |
| Sub-Total General Fund | 7,327,858 | 2,684,114 | 3,211,794 | 720,600 | 711,350 |
| Housing Revenue Account | 9,265,440 | 2,896,296 | 2,123,048 | 2,123,048 | 2,123,048 |
| H R A Borrowing | 67,993,000 | 67,993,000 | - | - | - |
| | **84,586,298** | **73,573,410** | **5,334,842** | **2,843,648** | **2,834,398** |
| Resources : HRA Major Repairs Allowance | 2,052,266 | 2,052,266 | 0 | 0 | 0 |
| Resources : Capital Receipts | 3,489,867 | 1,517,309 | 1,568,756 | 403,802 | 0 |
| Supported Borrowing GF | 426,400 | 106,600 | 106,600 | 106,600 | 106,600 |
| Unsupported Borrowing GF | 3,311,178 | 959,792 | 1,536,438 | 210,198 | 604,750 |
| Unsupported Borrowing HRA | 1,056,376 | 844,030 | 70,782 | 70,782 | 70,782 |
| HRA Major Repairs Reserve Adj | 6,156,798 | 0 | 2,052,266 | 2,052,266 | 2,052,266 |
| HRA Subsidy Buy Out Borrowing | 67,993,000 | 67,993,000 | 0 | 0 | 0 |
| Contribution from reserves GF | 95,413 | 95,413 | 0 | 0 | 0 |
| Contribution from reserves HRA | 0 | 0 | 0 | 0 | 0 |
| | 84,581,298 | 73,568,410 | 5,334,842 | 2,843,648 | 2,834,398 |

**SECTION 1**

| | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013-2014 | ESTIMATE 2014-2015 |
|---|---|---|---|---|---|
| **Parish & Community Initiatives Grants** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **430,710** | **130,710** | **100,000** | **100,000** | **100,000** |
| **Parks Major works** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **141,090** | **40,350** | **40,740** | **30,000** | **30,000** |
| **Richmond Park Play Area** | | | | | |
| Total Annual Expenditure | 237,120 | 18,560 | 218,560 | | |
| External Funding (FA) | (100,000) | 0 | (100,000) | | |
| Total Annual Expenditure(ALL HBBC) | **137,120** | **18,560** | **118,560** | **0** | **0** |
| **Hollycroft Park** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **670** | **670** | **0** | **0** | **0** |
| **Burbage Common** | | | | | |
| Total Annual Expenditure | 264,300 | 264,300 | | | |
| Less 6c's grant | (72,300) | (72,300) | | | |
| HBBC Element | **192,000** | **192,000** | **0** | **0** | **0** |
| **Memorial Safety Programme** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **5,770** | **5,770** | **0** | **0** | **0** |
| **Waste Management Receptacles** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **224,654** | **61,710** | **62,944** | **50,000** | 50,000 |
| **Blue Bin Recycling** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **892,000** | **892,000** | 0 | 0 | 0 |
| **Churchyard Repairs** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **2,370** | **2,370** | **0** | **0** | **0** |
| **Queens Park** | | | | | |
| Total Annual Expenditure | 6,610 | 6,610 | | | |
| HBBC Element | **6,610** | **6,610** | **0** | **0** | **0** |
| **Grounds Maintenance Machinery** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **2,580** | **2,580** | **0** | **0** | **0** |
| **Sport in Desford** | | | | | |
| Total Annual Expenditure | 205,000 | 205,000 | | | |
| Less contributions | (200,000) | (200,000) | | | |
| HBBC ELEMENT | **5,000** | **5,000** | **0** | **0** | **0** |
| **Brodick Road Woodlands Scheme** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **10,000** | **10,000** | **0** | **0** | **0** |
| **Billa Barra Improvements** | | | | | |
| Total Annual Expenditure | 10,980 | **10,980** | | | |
| Less contributions | (10,980) | **(10,980)** | | | |
| HBBC ELEMENT | **0** | **0** | **0** | **0** | **0** |
| **TOTAL GROSS EXPENDITURE** | 2,433,854 | 1,651,610 | 422,244 | 180,000 | 180,000 |
| **LESS TOTAL CONTRIBUTIONS** | (383,280) | (283,280) | (100,000) | 0 | 0 |
| **TOTAL HBBC ELEMENT** | **2,050,574** | **1,368,330** | **322,244** | **180,000** | **180,000** |

| | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013-2014 | ESTIMATE 2014-2015 |
|---|---|---|---|---|---|
| **Borough Improvements** | | | | | |
| Total Annual Expenditure | 214,040 | 64,040 | 50,000 | 50,000 | 50,000 |
| Less Private contribution | (64,235) | (19,235) | (15,000) | (15,000) | (15,000) |
| HBBC Element | **149,805** | **44,805** | **35,000** | **35,000** | **35,000** |
| **Car Park Resurfacing** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **28,805** | **11,555** | **0** | **13,250** | **4,000** |
| **Goddard Building Conversion** | | | | | |
| HBBC ELEMENT | **31,460** | **31,460** | **0** | **0** | **0** |
| **Barwell Shop Front Improvements** | | | | | |
| Total Annual Expenditure | 30,085 | 30,085 | 0 | 0 | 0 |
| Less Private contribution | (30,085) | (30,085) | 0 | 0 | 0 |
| HBBC Element | **0** | **0** | **0** | **0** | **0** |
| **Depot Relocation** | | | | | |
| Total Annual Expenditure | 1,668,000 | 168,000 | 1,500,000 | 0 | 0 |
| HBBC Element | **1,668,000** | **168,000** | **1,500,000** | **0** | **0** |
| **Barwell Wall Improvements** | | | | | |
| Total Annual Expenditure | 9,300 | 9,300 | 0 | 0 | 0 |
| Less Private contribution | (9,300) | (9,300) | 0 | 0 | 0 |
| HBBC Element | **0** | **0** | **0** | **0** | **0** |
| **TOTAL GROSS EXPENDITURE** | 1,951,605 | 284,355 | 1,550,000 | 63,250 | 54,000 |
| **LESS TOTAL CONTRIBUTIONS** | (73,535) | (28,535) | (15,000) | (15,000) | (15,000) |
| **TOTAL HBBC ELEMENT** | **1,878,070** | **255,820** | **1,535,000** | **48,250** | **39,000** |

## SECTION 3

| | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013/14 | ESTIMATE 2014/15 |
|---|---|---|---|---|---|
| **Asset Management Enhancements** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **100,000** | **50,000** | **50,000** | **0** | **0** |
| **General Renewals** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **69,100** | **35,100** | **14,000** | **10,000** | **10,000** |
| **Rolling Server Review** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **113,230** | **43,230** | **30,000** | **20,000** | **20,000** |
| **Financial System** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **15,730** | **15,730** | **0** | **0** | **0** |
| **Customer Services Project** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **17,190** | **17,190** | **0** | **0** | **0** |
| **Members IT** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **39,370** | **39,370** | **0** | **0** | **0** |
| **Flexible Working Project** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **5,000** | **5,000** | **0** | **0** | **0** |
| **Council Office Relocation** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **498,000** | **49,800** | **448,200** | **0** | **0** |
| **GIS Upgrade** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **6,520** | **6,520** | **0** | **0** | **0** |
| **HR/Payroll** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **2,880** | **2,880** | **0** | **0** | **0** |
| **Greenfields Development** | | | | | |
| Total Annual Expenditure | 2,830 | 2,830 | | | |
| Less LSEP contribution | 0 | 0 | | | |
| HBBC Element | **2,830** | **2,830** | **0** | **0** | **0** |
| **Electronic Meter Reading** | | | | | |
| Total Annual Expenditure(ALL HBBC) | 20,000 | **20,000** | **0** | **0** | **0** |

## SECTION 3

| | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013/14 | ESTIMATE 2014/15 |
|---|---|---|---|---|---|
| **Demolition of Argents Mead Offices** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **350,000** | **0** | **350,000** | **0** | **0** |
| **Transformation** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **49,041** | **49,041** | **0** | **0** | **0** |
| **Atkins partisionng** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **50,000** | **50,000** | **0** | **0** | **0** |
| **Planning Plotter** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **6,143** | **6,143** | **0** | **0** | **0** |
| **Modern E Gov** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **20,000** | **20,000** | **0** | **0** | **0** |
| **Corporate Scanner** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **10,270** | **10,270** | **0** | **0** | **0** |
| **Atkins partisionng Phase 2** | | | | | |
| Total Annual Expenditure(ALL HBBC) | **18,000** | **18,000** | **0** | **0** | **0** |
| **Revenues and Benefits Shared Services** | | | | | |
| Total Annual Expenditure | 369,280 | 369,280 | | | |
| Less RIEP Funding | (369,280) | (369,280) | | | |
| HBBC Element | **0** | **0** | **0** | **0** | **0** |
| | | | | | |
| **TOTAL GROSS EXPENDITURE** | 1,762,584 | 810,384 | 892,200 | 30,000 | 30,000 |
| **LESS TOTAL CONTRIBUTIONS** | (369,280) | (369,280) | 0 | 0 | 0 |
| **TOTAL HBBC ELEMENT** | **1,393,304** | **441,104** | **892,200** | **30,000** | **30,000** |

| | PROJECT | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013-2014 | ESTIMATE 2014-2015 |
|---|---|---|---|---|---|---|
| H1 | **Major Works Assistance** | | | | | |
| | Total Annual Expenditure | 760,000 | 190,000 | 190,000 | 190,000 | 190,000 |
| | Less Government Grant | 0 | 0 | 0 | 0 | 0 |
| | HBBC ELEMENT | **760,000** | **190,000** | **190,000** | **190,000** | **190,000** |
| H2 | **Minor Works Assistance** | | | | | |
| | Total Annual Expenditure | 360,000 | 90,000 | 90,000 | 90,000 | 90,000 |
| | Less Government Grant | 0 | 0 | 0 | 0 | 0 |
| | HBBC ELEMENT | **360,000** | **90,000** | **90,000** | **90,000** | **90,000** |
| H3 | **Care & Repair Improvement Agency** | | | | | |
| | Total Annual Expenditure(ALL HBBC) | **149,400** | **37,350** | **37,350** | **37,350** | **37,350** |
| H4 | **Disabled Facilities Grants** | | | | | |
| | Total Annual Expenditure | 1,540,450 | 581,450 | 295,000 | 295,000 | 295,000 |
| | less decent homes | 0 | 0 | 0 | 0 | 0 |
| | Less Government Grant | (729,940) | (279,940) | (150,000) | (150,000) | (150,000) |
| | HBBC ELEMENT | **810,510** | **301,510** | **145,000** | **145,000** | **145,000** |
| H5 | **Decent Homes Projects** | | | | | |
| | Total Annual Expenditure | 23,340 | 23,340 | 0 | 0 | 0 |
| | Less Contributions | (23,340) | (23,340) | 0 | 0 | 0 |
| | Total Annual Expenditure(ALL HBBC) | **0** | **0** | **0** | **0** | **0** |
| | **TOTAL GROSS EXPENDITURE** | 2,759,190 | 922,140 | 612,350 | 612,350 | 612,350 |
| | **LESS TOTAL CONTRIBUTIONS** | (753,280) | (303,280) | (150,000) | (150,000) | (150,000) |
| | **TOTAL HBBC ELEMENT** | **2,005,910** | **618,860** | **462,350** | **462,350** | **462,350** |

## HOUSING REVENUE ACCOUNT (CAPITAL PROJECTS)

| PROJECT | TOTAL COST | ESTIMATE 2011-2012 | ESTIMATE 2012-2013 | ESTIMATE 2013-2014 | ESTIMATE 2014-2015 |
|---|---|---|---|---|---|
| HRA PROJECTS | | | | | |
| Communal Furniture | 0 | 0 | 0 | 0 | 0 |
| Tenant Led Community Projects | 20,000 | 20000 | 0 | 0 | 0 |
| Adaptations for Disabled People | 1,500,594 | 429,150 | 357,148 | 357,148 | 357,148 |
| Upgrade Lifts | 50,000 | 50,000 | 0 | 0 | 0 |
| Kitchen Improvements | 1,170,249 | 290,610 | 293,213 | 293,213 | 293,213 |
| Central Heating Replacement | 1,130,488 | 282,622 | 282,622 | 282,622 | 282,622 |
| Low Maintenance Doors | 114,657 | 21,180 | 31,159 | 31,159 | 31,159 |
| Electrical Testing / Upgrading | 461,425 | 134,110 | 109,105 | 109,105 | 109,105 |
| Major Void Enhancements | 3,155,152 | 922,690 | 744,154 | 744,154 | 744,154 |
| Programmed Enhancements | 1,273,026 | 514,827 | 252,733 | 252,733 | 252,733 |
| Single to Double Glazing | 122,123 | 62,123 | 20,000 | 20,000 | 20,000 |
| Re-roofing | 131,656 | 32,914 | 32,914 | 32,914 | 32,914 |
| Housing Repairs Software system | 22,000 | 22,000 | 0 | 0 | 0 |
| | 9,151,370 | 2,782,226 | 2,123,048 | 2,123,048 | 2,123,048 |
| Council Houses - New build | 232,070 | 232,070 | 0 | 0 | 0 |
| Less Contributions | (118,000) | (118,000) | 0 | 0 | 0 |
| Total Annual Expenditure(ALL HBBC) | 114,070 | 114,070 | 0 | 0 | 0 |
| **TOTAL GROSS EXPENDITURE** | 9,383,440 | 3,014,296 | 2,123,048 | 2,123,048 | 2,123,048 |
| **LESS TOTAL CONTRIBUTIONS** | (118,000) | (118,000) | 0 | 0 | 0 |
| **TOTAL HBBC ELEMENT** | **9,265,440** | **2,896,296** | **2,123,048** | **2,123,048** | **2,123,048** |

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**SCRUTINY COMMISSION – 30 JANUARY 2012**

**REPORT OF THE DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)**

**THE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES – SETTING OF PRUDENTIAL INDICATORS 2011/12 – 2014/15 AND TREASURY MANAGEMENT STRATEGY 2012/13-14/15**

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## 1. Purpose of Report

This report outlines the Council's prudential indicators for 2011/12 - 2013/14 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

- 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 - Section A). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

- 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 – Also Section A);

- The **treasury management strategy statement** which sets out how the Council's treasury service will support the capital decisions taken above, the day to day treasury management 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 and shown at Section B;

- 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 CLG Investment Guidance. And also shown in Section B.

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

## 2. Recommendations

Members note the key elements of these reports:

1. The Prudential Indicators and Limits for 2011/12 to 2014/15 contained within Section 3 Part A of the report, including the Authorised Limit Prudential Indicator.

2. The Minimum Revenue Provision (MRP) Statement contained within Section 3 Part A which sets out the Council's policy on MRP.

3. The Treasury Management Strategy 2011/12 to 2014/15, and the treasury Prudential Indicators contained within Section 3 Part B.

4. The Investment Strategy contained in the treasury management strategy Part 3 Section B and the detailed strategy in Appendix 1.

## 3. Background

## A) The Capital Prudential Indicators 2011/12 - 2014/15

Introduction

1. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, reflecting the outcome of the Council's underlying capital appraisal systems.

   The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

2. Within this overall prudential framework there is an impact on the Council's treasury management activity – as it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2012/13 to 2014/15 is included as Appendix B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

   A key issue facing the Council is the impact of planned HRA reform. This would essentially end the impact of the housing subsidy system and will see the HRA as a stand alone business. The Council will need to approve revised limits in advance of the reform being put into operation.

   The Council currently pays into the HRA housing subsidy system, and in order to stop future payments from 1 April 2012 the Council is required to pay the CLG £67.993m. This payment is effectively HRA debt, so the prudential indicators have been adjusted to reflect this change. The actual payment will be made on the 28 March 2012 and so the indicators will take immediate effect from the approval of these limits by Council. The change is expected to be beneficial to the Council.

**The Capital Expenditure Plans**

3. The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

   - Service objectives (e.g. strategic planning);
   - Stewardship of assets (e.g. asset management planning);
   - Value for money (e.g. option appraisal);
   - Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
   - Affordability (e.g. implications for the council tax and rents);
   - Practicality (e.g. the achievability of the forward plan).

4. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

5. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

6. The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to the poor condition of the property market.

7. The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

Table 1

| Capital Expenditure £'000 | Actual 2010/11 | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|---|
| Non-HRA | 9,786 | 3,668 | 3,4,77 | 886 | 876 |
| HRA | 2,711 | 3,014 | 2,123 | 2,123 | 2,123 |
| HRA Settlement | | 67,993 | | | |
| Total | 12,497 | 74,675 | 5,600 | 3,009 | 2,999 |
| **Financed by:** | | | | | |
| Capital receipts | 2,733 | 1,517 | 1,569 | 404 | 0 |
| Capital grants | 3,005 | 913 | 265 | 165 | 165 |
| Capital reserves | 243 | 95 | 0 | 0 | 0 |
| Revenue | 2,052 | 2,052 | 2,052 | 2,052 | 2,052 |
| **Net financing need for the year** | **4,464** | **70,098** | **1,714** | **388** | **782** |

**The Council's Borrowing Need (the Capital Financing Requirement)**

8. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.

9. The Council is asked to approve the CFR projections below:

Table 2

| £'000 | Actual 2010/11 | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| CFR - Non Housing | 14,547 | 15,123 | 16,071 | 15,686 | 15,663 |
| CFR - Housing | 2,004 | 70,841 | 68,672 | 65,503 | 64,334 |
| **Total CFR** | **16,551** | **85,964** | **84,743** | **82,189** | **79,997** |
| **Movement in CFR** | **3,787** | **69,413** | **-1,221** | **-2,554** | **-2,192** |

| | | | | | |
|---|---|---|---|---|---|
| **Movement in CFR represented by** | | | | | |
| Net financing need for the year (above) | 4,464 | 70,098 | 1,714 | 388 | 782 |
| Less MRP/ VRP and other financing movements | 677 | 685 | -2,935 | -2,942 | -2,974 |
| **Movement in CFR** | **3,787** | **69,413** | **-1,221** | **-2,554** | **-2,192** |

10. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP). No revenue charge is required for the HRA.

11. CLG Regulations have been issued which require full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement.

12. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

    - **Existing practice** - MRP will follow the existing practice outlined in former CLG Regulations (Option 1);

    These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

13. From 1 April 2008 for all unsupported borrowing (including PFI and Finance Leases) the MRP policy will be

    - **Asset Life Method –** MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

    These options provide for a reduction in the borrowing need over approximately the asset's life.

**The Use of the Council's Resources and the Investment Position**

14. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 3

| £'000 | Actual 2010/11 | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|---|
| Fund balances | 3,968 | 4,004 | 3,961 | 3,781 | 3,510 |
| Capital receipts | 1,260 | 1,227 | 178 | 49 | 193 |
| Earmarked reserves | 3,382 | 4,296 | 4,371 | 3,695 | 3,125 |
| Provisions | 505 | 440 | 376 | 312 | 248 |
| Contributions unapplied | 867 | 200 | 0 | 0 | 0 |
| **Total Core Funds** | **9,982** | **10,167** | **8,886** | **7,837** | **7,076** |
| Working Capital* | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Under borrowing | 6,751 | 11,164 | 10,443 | 7,289 | 4,297 |
| **Expected Investments** | **0** | **0** | **0** | **0** | **0** |

*Working capital balances shown are estimated year end; these may be higher mid year

**Affordability Prudential Indicators**

15. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

16. **Actual and Estimates of the ratio of financing costs to net revenue stream –** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 4

| % | Actual 2010/11 | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|---|
| Non-HRA | 6.9 | 7.4 | 7.9 | 7.6 | 7.0 |
| HRA | 40.3 | 40.5 | 40.3 | 40.1 | 40.0 |

17. The estimates of financing costs include current commitments and the proposals in this budget report.

18. **Estimates of the incremental impact of capital investment decisions on the Council Tax –** This indicator identifies the revenue costs associated with ***proposed changes*** to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

19. **Incremental impact of capital investment decisions on the Band D Council Tax**

Table 5

| £ | Actual 2010/11 | Proposed Budget 2011/12 | Forward Projection 2012/13 | Forward Projection 2013/14 | Forward Projection 2014/15 |
|---|---|---|---|---|---|
| **Council Tax - Band D** | 1.83 | 0.94 | -1.53 | 0.72 | 1.71 |

20. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels –** Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

21. **Incremental impact of capital investment decisions Housing Rent levels.**

Table 6

| £ | Actual 2010/11 | Proposed Budget 2011/12 | Forward Projection 2012/13 | Forward Projection 2013/14 | Forward Projection 2014/15 |
|---|---|---|---|---|---|
| **Weekly Housing Rent levels** | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

22. This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

## B) Treasury Management Strategy 2011/12 - 2012/13

1. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

2. 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). This Council adopted the Code of Practice on Treasury Management on 30 June 2003.

3. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (30 June 2003). This adoption is the requirements of one of the prudential indicators.

4. The Constitution require an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

5. This strategy covers:

    - The Council's debt and investment projections;
    - The Council's estimates and limits on future debt levels;
    - The expected movement in interest rates;
    - The Council's borrowing and investment strategies;
    - Treasury performance indicators;
    - Specific limits on treasury activities;

**Debt and Investment Projections 2011/12 - 2014/15**

6. The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. The expected maximum debt position during each year represents the Operational Boundary prudential indicator, and so may be different from the year end position. The table also highlights the expected change in investment balances.

Table 7

| £'000 | 2011/12 Revised | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|
| **External Debt** | | | | |
| Debt at 1 April | 16,551 | 85,964 | 84,743 | 82,189 |
| Expected change in debt | 69,413 | -1,221 | -2,554 | -2,192 |
| Debt at 31 March | 85,964 | 84,743 | 82,189 | 79,997 |
| **Operational Boundary** | 85,964 | 84,743 | 82,189 | 79,997 |
| **Investments** | | | | |
| Total Investments at 31 March | **0** | **0** | **0** | **0** |
| Investment change | **0** | **0** | **0** | **0** |

7. The related impact of the above movements on the revenue budget are:

Table 8

| £'000 | 2011/12 Revised | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|
| **Revenue Budgets** | | | | |
| Interest on Borrowing | **2,226** | **-31** | **-85** | **-70** |
| Related HRA Charge | 2,203 | -69 | -69 | -69 |
| Net General Fund Borrowing Cost | 23 | 38 | -15 | -1 |
| Investment income | **0** | **0** | **0** | **0** |

**Limits to Borrowing Activity**

8. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

9. For the first of these 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 2011/12 and the following two financial years (the relevant comparative figures are highlighted). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Table 9

| £'000 | 2011/12 Revised | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|
| Gross Borrowing | 85,964 | 84,742 | 82,189 | 79,997 |
| Less Investments | 0 | 0 | 0 | 0 |
| Net Borrowing | 85,964 | 84,743 | 82,189 | 79,997 |
| CFR* | 85,964 | 84,743 | 82,189 | 79,997 |

* - Under the Prudential Code revision any falls in the CFR are ignored.

10. The Deputy Chief Executive (Corporate Direction) reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

11. The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit

beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

12. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

13. The Council is asked to approve the following Authorised Limits:

Table 10

| Authorised limit £'000 | 2011/12 Revised | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|
| Borrowing | 86,364 | 85,197 | 82,589 | 80,397 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 86,364 | 85,197 | 82,589 | 80,397 |

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

| HRA Debt Limit £m | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate |
|---|---|---|---|---|
| Total | 72.0 | 72.0 | 72.0 | 72.0 |

14. Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Deputy Chief Executive (Corporate Direction) may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Deputy Chief Executive (Corporate Direction) will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 20% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 12 months in advance of need.

15. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

**Expected Movement in Interest Rates**

Table 11

**Medium-Term Rate Estimates (averages)**

| Annual Average % | Bank Rate | Money Rates | | PWLB Rates* | | |
|---|---|---|---|---|---|---|
| | | 3 month | 1 year | 5 year | 25 year | 50 year |
| 2010/11 | 0.5 | 0.7 | 1.5 | 3.6 | 5.3 | 5.25 |
| 2011/12 | 0.5 | 0.7 | 1.5 | 2.3 | 4.2 | 4.3 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 2012/13 | 0.5 | 0.8 | 1.7 | 2.5 | 4.4 | 4.5 |
| 2013/14 | 1.3 | 1.4 | 2.4 | 2.9 | 4.8 | 4.9 |
| 2014/15 | 2.5 | 2.6 | 3.3 | 3.7 | 5.2 | 5.3 |
| 2015/16 | 3.5 | 3.7 | 4.0 | 4.8 | 5.7 | 5.8 |

- Borrowing Rates

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

**Borrowing Strategy 2012/13 - 2014/15**

16. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high and will be maintained for the borrowing excluding the HRA reform settlement.

    Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Deputy Chief Executive (Corporate Direction) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

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 £69.993m 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 curently 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.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

**Borrowing In Advance**

17. The Council will not borrow more, than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the current reporting mechanism.

**Debt Restructuring**

18. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

**Investment Strategy 2012/13 – 2014/15**

19. **Key Objectives -** The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, the current investment climate has one over-riding risk, counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

20. **Risk Benchmarking –** A development in the revised Codes and the CLG Investment Guidance 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, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex B2.

21. These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

22. Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

    - 0.24% historic risk of default when compared to the whole portfolio.

23. Liquidity – In respect of this area the Council seeks to maintain:

    - Bank overdraft - £0.6m
    - Liquid short term deposits of at least £1m available with a week's notice.
    - Weighted Average Life benchmark is expected to be 0.75 years, with a maximum of 1 year.

24. Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate and in addition that the security benchmark for each individual year is:

<u>Table 12</u>

| | 1 year | 2 years | 3 years | 4 years | 5 years |
|---|---|---|---|---|---|
| Maximum | 0.24% | 0.78% | 1.48% | 2.24% | 3.11% |

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

25. **Investment Counterparty Selection Criteria -** The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

26. The Deputy Chief Executive (Corporate Direction) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

27. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

28. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

29. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks 1 - Good Credit Quality –** the Council will only use banks which:

  i) Are UK banks; and/or
  ii) Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AAA

  And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

  i) **Short Term –** F1
  ii) **Long Term –** A
  iii) **Individual / Financial Strength –** C (Fitch / Moody's only)
  iv) **Support –** 3 (Fitch only)

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support –** In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and

- (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- **Banks 3 - Eligible Institutions** - the organisation was considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions were subject to suitability checks before inclusion.

- **Banks 4** - The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- **Bank Subsidiary and Treasury Operations –** the Council will use these where the parent bank has the necessary ratings outlined above.

- **Building Societies –** the Council will use all Societies which:

  i) meet the ratings for banks outlined above
  Or are both:
  ii) Eligible Institutions; and
  iii) Have assets in excess of £500m.

- **Money Market Funds** - AAA
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

A limit of 100% will be applied to the use of Non-Specified investments.

30. **Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than 5% will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

31. **Use of additional information other than credit ratings –** Additional requirements under the Code of Practice require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

32. **Time and Monetary Limits applying to Investments** - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

Table 13

| | Fitch (or equivalent) | Money Limit | Time Limit |
|---|---|---|---|
| Limit 1 Category | AAA | £5m | 3yrs |
| Limit 2 Category | AA | £5m | 3yrs |
| Limit 3 Category | A | £3m | 2yrs |
| Other Institution Limits | - | £2m | 1yr |
| Guaranteed Organisations | - | £2m | 6mths |

33. The proposed criteria for Specified and Non-Specified investments are shown in Annex B1 for approval.

34. In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

35. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

36. **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid/late-2013. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

37. **The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Deputy Chief Executive (Corporate Direction) may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.**

38. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

**Sensitivity to Interest Rate Movements**

39. Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table 14

| £m | 2012/13 Estimated + 1% | 2012/13 Estimated - 1% |
|---|---|---|
| **Revenue Budgets** | | |
| Interest on Borrowing | 0 | 0 |
| Net General Fund Borrowing Cost | 0 | 0 |
| Investment income | 0 | 0 |

**Treasury Management Limits on Activity**

40. There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments.
- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- Total principal funds invested for greater than 364 days - these limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

41. The Council is asked to approve the limits:

Table 15

| £m | 2011/12 | 2012/13 | 2013/14 |
|---|---|---|---|
| **Interest rate Exposures** | | | |
| | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates based on net debt** | 16 | 16 | 16 |
| **Limits on variable interest rates based on net debt** | 4 | 4 | 4 |
| **Maturity Structure of fixed interest rate borrowing 2011/12** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 100% |
| 12 months to 2 years | | 0% | 100% |
| 2 years to 5 years | | 0% | 100% |
| 5 years to 10 years | | 0% | 100% |
| 10 years and above | | 0% | 100% |
| **Maximum principal sums invested > 364 days** | | | |
| Principal sums invested > 364 days | £5m | £5m | £5m |

**Performance Indicators**

42. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:
    - Debt - Borrowing - Average rate of borrowing for the year compared to average available
    - Debt - Average rate movement year on year
    - Investments - Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report.

**Treasury Management Advisers**

43. The Council uses Sector as its treasury management consultants. The company provides a range of services which include:

    - Technical support on treasury matters, capital finance issues and the drafting of Member reports;
    - Economic and interest rate analysis;
    - Debt services which includes advice on the timing of borrowing;
    - Debt rescheduling advice surrounding the existing portfolio;
    - Generic investment advice on interest rates, timing and investment instruments;
    - Credit ratings/market information service comprising the three main credit rating agencies;

44. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

## 4. Financial Implications

These are contained in the body of the report.

## 5. Legal Implications

There are none arising directly from this report.

## 6. Corporate Plan Implications

Delivery of the Prudential Indicators contributes to the achievement of Strategic Objective 3: “Deliver the Councils Medium Term Financial with a sustained focus on the Council’s priorities whilst working to resolve the continuing pressure of service requirements in the context of available resources”.

## 7. Risk Implications

It is the Council’s policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer’s opinion based on the information available, that the significant risks associated with this decision/project have been identified, assessed and that controls are in place to manage them effectively.

The following significant risks associated with this report/decision were identified from this assessment:

| Management of Significant (Net Red) Risks | | |
|---|---|---|
| Risk Description | Mitigating Actions | Owner |
| Failure to achieve planned level of capital expenditure on the Capital Programme | Monitor expenditure via Budget Monitoring process and Capital Forum | Ilyas Bham |
| Failure to generate sufficient Capital Receipts and/or grants and other external funding to support the proposed programme | Look to revise the programme to bring spend into line with available resources | Ilyas Bham |

## 8. Knowing your Community- Equality and Rural Implications

Schemes in the Capital Programme cover all services and all areas of the Borough including rural areas.

## 9. Corporate Implications

By submitting this report, the report author has taken the following into account:

- Community Safety Implications
- Environmental Implications
- ICT Implications
- Asset Management Implications
- Human Resources Implications
- Voluntary Sector Implications

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Background Papers
Capital Programme 2010/11 to 2013/14
The CIPFA Prudential Code
Treasury Management Policy
Revenue Budget 2012/13

Contact Officer: David Bunker, Accountancy Manager ext 5609

Executive Member: Cllr KWP Lynch

**Appendix 1**

**Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management**

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 30 June 2003 and will apply its principles to all investment activity. In accordance with the Code, the Deputy Chief Executive (Corporate Direction) has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

**Annual Investment Strategy** - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

**Strategy Guidelines –** The main strategy guidelines are contained in the body of the treasury strategy statement.

**Specified Investments –** These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society ). For category 5 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

**Non-Specified Investments –** Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

| | Non Specified Investment Category | Limit (£ ) |
|---|---|---|
| a. | **Supranational Bonds greater than 1 year to maturity**<br>**(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.).<br>**(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO})<br>The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. | AAA long term ratings<br>£3m<br><br>£3m |
| b. | **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. | £3m |
| c. | **The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.** | £3m |
| d. | **Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £500m, but will restrict these type of investments to £2m | £2m |
| e. | Any **bank or building society** that has a minimum long term credit rating of A, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment). | £5m |
| f. | Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a limit of £2m for a period of 6 months | £2m |

**The Monitoring of Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Deputy Chief Executive (Corporate Direction), and if required new counterparties which meet the criteria will be added to the list.

**Security, Liquidity and Yield Benchmarking**

**Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service** - 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. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield - These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments - Internal returns above the 7 day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

Liquidity - This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.6m
- Liquid short term deposits of at least £1m available with a week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 0.75 years, with a maximum of 1 year**.**

Security of the investments - In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category over the period 1990 to 2009.

| Years | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| AAA | 0.00% | 0.01% | 0.05% | 0.10% | 0.17% |
| AA | 0.03% | 0.06% | 0.08% | 0.14% | 0.20% |
| A | 0.08% | 0.22% | 0.37% | 0.52% | 0.70% |
| BBB | 0.24% | 0.68% | 1.19% | 1.79% | 2.42% |
| BB | 1.22% | 3.24% | 5.34% | 7.31% | 9.14% |
| B | 4.06% | 8.82% | 12.72% | 16.25% | 19.16% |
| CCC | 24.03% | 31.91% | 37.73% | 41.54% | 45.22% |

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.055% historic risk of default when compared to the whole portfolio.

And in addition that the security benchmark for each individual year is:

| | 1 year | 2 years | 3 years | 4 years | 5 years |
|---|---|---|---|---|---|
| Maximum | 0.24% | 0.68% | 1.19% | 1.79% | 2.42% |

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

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