Derby City Council

AUDIT AND ACCOUNTS COMMITTEE
12 December 2012

ITEM 05

Report of the Strategic Director of Resources

Treasury Management – Progress Report 2012/13

SUMMARY

1.1 This report covers the Council's treasury management activity for the period 1 April 2012 to 30 September 2012.

1.2 Treasury management activity during the half-year has generated an average rate of return on investments of 0.71%. The forecast average rate of interest charged on our Council borrowing is 4.70%.

1.3 The very low rate of return on investments relative to the interest payable on loans continues, with consequent upward pressure on the Council's revenue costs.

1.4 The forecast outturn for the Treasury Management budget in 2012/13 is currently £18.1m, against an annual budget of £18.6m. It is proposed to appropriate the £0.5m forecast under-spend to the Treasury Management Reserve to cover one-off budget pressures in 2013/14.

1.5 This report also covers the Council's Minimum Revenue Provision (MRP) policy and an extension that is required to cover loans to external organisations.

1.6 As the Council intends to offer mortgage support for first-time-buyers in Derby under the Local Authority Mortgage Scheme - LAMS, an extension to the Council's investment strategy is also proposed.

1.7 Treasury Management advice to the Council continues to be provided by Arlingclose.

RECOMMENDATIONS

2.1 To note the progress report on Treasury Management for the period 1 April 2012 to 30 September 2012.

2.2 To approve an appropriation of £0.5m to the Treasury Management Reserve to cover one-off budget pressures in 2013/14.

2.3 To approve the addition to the Council's Minimum Revenue Provision - MRP - statement as outlined in paragraph 6.3 below.

2.4 To approve the extension to the Council's investment strategy, which allow the Council to offer mortgage support to first-time-buyers in Derby under LAMS.

REASONS FOR RECOMMENDATION

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to monitor performance at least twice a year. This report covers treasury activity since the 2012/13 strategy was approved in February 2012.

3.2 Since the MRP Policy was drawn up in February 2010, the council have made a number of external loans for which we need an extension to the policy on MRP to cover this.

3.3 The Council's investment strategy is approved by Council and covers all financial instruments entered into by the Council. LAMS investment would be prohibited without the appropriate modification of this strategy.

SUPPORTING INFORMATION

4 Investments

4.1 The guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. Security of capital is the Council's main objective, by following the Councils counterparty criteria and using AAA rated Money markets as set out in its Treasury Management Strategy 2012/13.

4.2 The average size of the Council's investment portfolio for the first half of 2012/13 was £68.9m. This is 28% lower than the corresponding figure of £95.3m for 2011/12 due to the Council continuing to keep cash balances low and deferring the cost of borrowing until the PWLB certainty rate applies in November 2012 (see paragraph 5.2 below).

4.3 Interest rates on investments have also remained consistently low over the past two years, largely mirroring the Bank of England's base rate all-time low of 0.5%, which still shows no immediate sign of increasing. In its own investments the Council obtains around 0.6% when it places money in instant access Money Market Funds. Higher rates can be obtained if longer-term investments are made, but the Council's Treasury Management Strategy currently avoids such investments as not providing enough liquidity.

4.4 The average rate of interest on the Council's fixed term investments for the first half of 2012/13 is 0.82%. This figure is slightly higher than could have been obtained in the instant access money market funds because it includes the fixed term investments that were obtained with Nationwide at the beginning of the year at a rate of 0.95% when interest rates were higher, but the market no longer offers such high rates. This means that, looking forward, the Council cannot realistically expect to make more than around 0.60% for the second half of the year.

4.5 Due to the low rate of return on new investments, and the smaller size of the Council's investment portfolio, the forecast investment income for 2012/13 is approximately £360,000 compared with £707,000 in 2011/12.

5 Borrowing

5.1 The Council's capital financing requirement - CFR - for 2012/13 is currently estimated to be around £550m. This is the amount the Council can have expected to borrow to finance its cumulative capital programme, although actual borrowing is below this since the Council uses its existing cash balances to postpone borrowing. The costs of borrowing (both principal and interest) are built into the Council's treasury management budget.

5.2 The PWLB remains an attractive source of borrowing for the Council as it offers flexibility and control. In August HM Treasury announced details of the "Certainty Rate" which will enable "eligible authorities" to access cheaper PWLB funding, with a 20 basis point reduction on the standard PWLB borrowing rate. Initially announced in the March 2012 Budget, HM Treasury have introduced this initiative to encourage local authorities to provide robust forecasts on borrowing plans. This rate was introduced in November 2012, and the Council qualifies for this lower borrowing rate.

5.3 Whilst many banks also offer loans equivalent to long-dated PWLB debt, the Council will continue to adopt a cautious and considered approach to obtaining funding.

5.4 Taking account of the CFR and the planned under-borrowing, there is a need for the Council to borrow approximately £123m before the end of the financial year. None of this had been borrowed by the time of writing this report. The Council has been prudently using its own cash balances in the short term. The precise point of borrowing will be decided largely by cashflow considerations, and this depends on the expenditure profile of the Council's larger capital projects

5.5 For information, the Council's 2012/13 mid-year borrowing positions stands at £303,459m. Apart from £20m borrowed from Royal Bank of Scotland, and £10m borrowed from other local authorities, all of this borrowing has been taken from the PWLB. Its maturity profile and average weighted interest rates are shown in the table below:

Period remaining as at 30 September 2012	**%**	**£000**
Under 1 year	0.330	10,000
1 - 2 years	0.000	0
2 - 3 years	0.000	0
3 - 4 years	0.000	0
4 - 5 years	4.135	20,000
5 - 10 years	3.846	10,000
10 - 20 years	5.503	21,795
20 - 30 years	4.766	37,500
30 - 40 years	4.603	55,000
40 - 50 years	4.559	149,164
Total		**303,459**

5.5 Over the course of the year, taking into account the further planned borrowing of £123m, the forecast 'consolidated rate of interest' on the Council's debt portfolio for 2012/13 is projected to be 4.70%. This figure will be finalised at year-end.

6 Forecast Out-turn

6.1 The treasury management budget for 2012/13 is £18.6m and forecast expenditure is currently £18.1m. This under-spend is due mainly to slippage in the capital programme, which means that some anticipated borrowing can now be postponed until 2013/14.

6.2 It is proposed to appropriate the £0.5m under-spend to the Council's Treasury Management Reserve and use it to fund an additional pressure arising in 2013/14, relating to regeneration schemes. This is highlighted in paragraph 7.2 below.

7 Minimum Revenue Provision - MRP

7.1 In February 2010, the Council approved the following MRP statement:

- For capital expenditure incurred before 1 April 2008 or which in the future is Supported Capital Expenditure, the MRP policy will be to set aside a provision equal to 4% of the previous year's Capital Financing Requirement.
- From 1 April 2008 for all unsupported borrowing, excluding PFI and finance leases, the MRP policy will use the Asset Life Method on an annuity basis; ie. MRP will be based on the estimated life of the assets, with MRP being equal to the principal element of an annuity calculation based on a cost of capital deemed reasonable by the Corporate Director of Resources. The provision will be set aside in the year following the capital expenditure.
- For all PFI schemes and finance leases, the MRP will be equal to the element of the actual unitary charge or actual finance lease repayment that reduces the ongoing balance sheet liability, ie. the principal element of the charge or repayment, in line with CLG guidance.

7.2 Since this policy was adopted the Council has considered supporting a number of building regeneration schemes involving making secured loans to developers, the repayments on which will be used to fund further regeneration projects. Previously it was assumed that the borrowing costs underlying these loans could be spread over the life of the buildings regenerated. However, revised accounting guidelines mean that the borrowing costs should be spread only over the term of the loan (which may be much shorter than the life of the regenerated building), and spreading costs over a shorter period unfortunately results in higher costs in each individual year. For clarity the MRP policy needs to be extended to cover the borrowing underlying this sort of activity.

7.3 It is therefore proposed to extend the above policy as follows:

- For all secured loans made to external organisations, the MRP will be based on the life of the loan, with MRP being equal to the principal element of an annuity calculation based on a cost of capital deemed reasonable by the Strategic Director of Resources. The provision will be set aside in the year following the draw down of the loan.

8 Local Authority Mortgage Scheme

8.1 The Local Authority Mortgage Scheme - LAMS - has been designed to give a boost to local property markets. LAMS works in such a way as to allow first time buyers to obtain the rates associated with a 75% mortgage with only a 5% deposit. This should allow more first time buyers to get their feet on the property ladder.

8.2 Under LAMS the Council would match a first time buyer's 5% deposit with a 20% deposit of its own. The 20% deposit would then be held by the mortgage lender and used if the borrower defaulted within the first 7 years of the mortgage. Up until that point, the 20% deposit would attract interest, and would therefore be classed by the Council as a 7-year treasury investment.

8.3 LAMS investments represent a new direction in treasury management since, as well as making a return, the local authority's investment also assists the property market. Such investments are therefore considered slightly higher risk than the Council's current investments. Therefore a limit of £1m of Council money is being applied to LAMS investment. It is expected that this sum would provide the necessary 20% deposits for up to 40 mortgage applicants.

8.4 To accommodate this sort of investment within the Council's treasury management strategy it is proposed to extend both the time limit and the counterparty credit-worthiness criteria for LAMS investments. However, the precise credit-worthiness criteria to be applied to LAMS applicants have still to be determined. It is therefore recommended that:

- the Council's treasury management strategy be extended to cover LAMS investments for up to 7 years. A £1m total limit will apply to such investments.

OTHER OPTIONS CONSIDERED

9.1 None.

This report has been approved by the following officers:

Legal officer	N/A
Financial officer	Roger Kershaw, Strategic Director – Resources
Human Resources officer	N/A
Service Director(s)	N/A
Other(s)	N/A

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Background papers:	Council Cabinet report -Treasury Management Strategy and Prudential Code Indicators 2012/13 Council Cabinet report July 2012 Treasury Management Annual Report 2012/13
List of appendices:	Appendix 1 – Implications

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As detailed in the report.

Legal

2.1 None.

Personnel

3.1 None.

Equalities Impact

4.1 None.

Health and Safety

5.1 None.

Environmental Sustainability

6.1 None.

Asset Management

7.1 None.

Risk Management

8.1 All treasury management activity carries an inherent financial risk, which is managed through the Council’s treasury management strategy.

Corporate objectives and priorities for change

9.1 The priorities of the Council’s Treasury Management Strategy contribute to minimising Council Tax and providing value for money.