Report to:	**Audit Committee**
Date of Meeting:	**14th March 2012**
Report of:	**Head of Strategic Finance**
Title:	**Treasury Management Annual Report and Actual Prudential Indicators 2010/11, Mid Year Treasury Management Monitoring Report for 2011/12 and Treasury Management Strategy Statement 2012/13 – 2014/15 (DCRG)**

1.0 SUMMARY

1.1 To inform Members of Treasury Management Annual Report and Prudential Indicators for 2010/11; to present to Members a mid year review of the Treasury Management function in 2011/12; and to report the Treasury Management Strategy for 2012/13 – 2014/15.

2.0 RECOMMENDATIONS

2.1 That the Committee notes the Treasury Management Annual Report and Actual Prudential Indicators 2010/11, Mid Year Treasury Management Monitoring Report 2011/2012, and Treasury Management Strategy Statement 2012/13 – 2014/15 (Appendices 1, 2 & 3).

2.2 The Audit Committee is recommended to approve each of the key elements of the Treasury Management Strategy Statement (Appendix 3), and recommend these to Council:

- The Prudential Indicators and Limits for 2012/13 to 2014/15, including the Authorised Limit Prudential Indicator.
- The Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP.
- The Treasury Management Strategy 2012/13 to 2014/15 and the treasury Prudential Indicators.
- The Investment Strategy 2012/13 and the detailed criteria contained in the treasury management strategy.

2.3 That the Audit Committee recommend to Council that the facility to borrow up to a maximum of £10m from external parties be approved and that all Treasury Management Strategy Statements be amended accordingly.

3.0 SALIENT ISSUES

3.1 This report has a similar problem to the Statutory Statement of Accounts namely that it is largely incomprehensible to a lay person but regrettably has to be followed as it is a format devised by professional experts (CIPFA) and has been fleshed out by the Council's Treasury adviser, Sector (and will be widely adopted by most local authorities).

3.2 This ''introduction'' attempts to draw out the key issues reflected within subsequent sections of this report.

3.3 **Appendix 1** formally reviews the Councils activities/ performance during 2010/2011 and has been reported previously in regular reports to the Audit Committee. It confirms the Council did not incur any external debt, only invested with approved counterparties, and outperformed the investment return benchmark.

3.4 **Appendix 2** reports upon the half year treasury management activities/ performance and has again been reported to Audit Committee (in a more concise form) at its meeting on 29th September 2011. It again reports no external debt, investments only with approved counterparties; a forecast investment rate of return of 1.24% (original estimate 1.3%); and an expectation that £346k of cash will accrue on our investments (as per Original estimate).

3.5 **Appendix 3** is the most interesting part of the report and details the parameters for borrowing and investments within which officers are required to operate. In essence it recommends the ability to borrow up to a maximum of £10m (and reflects the probability of an interest free loan from the Herts Local Enterprise Partnership and funding from the West Herts Hospital Trust); and the criteria for determining to whom the Council should be lending its money. The next section of this report discusses in greater depth the issues surrounding external borrowing longer than 12 months duration.

4.0 DEBT FREE STATUS

4.1 Under previous capital finance regulations there was a requirement that a proportion of capital receipts had to be 'set aside' to cover any outstanding external debt and could not therefore be used to finance future capital investment. If however an authority was debt free then all capital receipts could be accessed for future development. For the past few years the regulations have been changed and all receipts can be accessed providing any local authority is able to make repayments of this debt (and associated interest) from its annual revenue budget. This is called the 'Prudential Borrowing' test and from that point of view there is no absolute advantage in being debt free other than having no annual debt repayments to make.

4.2 Watford Council has had/ has an ambitious capital programme which has included the provision of new leisure facilities (circa £20m of investment); remodelling of existing facilities such as Colosseum (£6m) and 'green spaces' in its widest sense (£6m); and regeneration projects such as Charter Place (a £60m project) and the Health Campus (£500m). The consequence of this is that our accumulated holding of capital receipts has been/ will be used for investment projects for the benefit of the community rather than sitting in the bank accruing a small rate of return.

4.3 Reports relating to the Health Campus have been regularly considered by the Major Projects Board and Cabinet and have included significant external investment related to the Croxley Rail Link (£120m); and funding of £7m from the West Herts Hospital Trust for a new road and bridge (a pre requisite before the construction of a new hospital). Watford Council is close to finalising an agreement with a Private Sector Partner (PSP) to set up a Local Asset Backed Vehicle (LABV) whereby the PSP provides the construction costs and WBC primarily provides the land and some element of infrastructure expenditure. Best and Final Offers are anticipated to be finalised in the Summer and the Council would hope to get a return on its investment by way of a combination of a capital receipt and an annual rental income. Details have yet to be finalised at this stage.

4.4 Central Government has recently changed the way in which regional investment is distributed and has involved the demise of Development Agencies such as EEDA and the creation of Local Enterprise Partnerships. For the Hertfordshire area an LEP has been set up contiguous with existing Hertfordshire boundaries and has been allocated circa £11m to support priority infrastructure projects. The LEP is considering county wide 'bids' and has a short list of 5 competing projects and which includes infrastructure costs associated with the Health Campus. Should the Council be successful, then any support from the LEP would be by way of an interest free loan repayable to correspond to the investment return arising out of the Campus Development. A decision from the LEP is anticipated in early April 2012.

4.5 From the Council's point of view, providing the financial modelling associated with the Health Campus Development shows a positive return, then access to an interest free loan would make financial sense. Section 6 of this report also relates to a contribution from the West Herts Hospital Trust (anticipated to be received prior to 31st March 2012) and the potential implications are that technically we would no longer be debt free and Council will need to agree that an external borrowing facility should be permitted. **It is recommended therefore** that the Treasury Management Strategy Statement should include the ability for the Council to borrow up to £10m for longer than a twelve month period and this is reflected within the attached Treasury Management Strategy at Appendix 3.

5.0 DETAILED EXPLANATION OF THE TREASURY MANAGEMENT REPORTS

5.1.1 CIPFA defines treasury management as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

5.1.2 The reports meet the requirements of both the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities and complies with the Local Government Act 2003.

5.2 Treasury Management Annual Report and Actual Prudential Indicators 2010/11 (Appendix 1)

5.2.1 This report provides details of actual prudential and treasury indicators and actual treasury operations during 2010/11 compared to the estimates within the strategy. The report is made in line with the Council's approved policy on Treasury Management.

5.2.2 During 2010/11, the Council complied with its legislative and regulatory requirements. Other prudential and treasury indicators are to be found in Appendix 1. The Head of Strategic Finance confirms that the statutory borrowing limit (the authorised limit), was not breached.

5.2.3 The financial year 2010/11 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

5.2.4 The Head of Strategic Finance also confirms that no borrowing was undertaken. At 31 March 2011, the Council had no external debt and its investments totalled £31.874m (£34.827m at 31 March 2010)

5.2.5 This report contains:

- Capital activity during the year;
- Reporting of the required prudential and treasury indicators;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Overall treasury position and the impact on investment balances;
- Summary of the economy and interest rates;
- Investment Rates in 2010/11
- Investment Outturn for 2010/11

5.3 Mid Year Treasury Management Monitoring Report (APPENDIX 2)

5.3.1 This report updates members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

5.3.2 The underlying economic environment remains difficult for the Council, foremost being the concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.

5.3.3 The basis of the treasury management strategy, the investment strategy and the performance indicators are not changed.

5.3.4 The prudential code requires the Council to update:

- The Council's capital expenditure plans;
- How these plans are being financed;

These requirements are met by the Council's Budget Monitoring & reporting framework, which includes revised capital expenditure and funding statements in the Budget Book.

5.4 Treasury Management Strategy Statement 2012/13 – 2014/15 (APPENDIX 3)

5.4.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment returns.

5.4.2 This report covers two main areas:

Capital Issues
- the capital plans and the prudential indicators 2012/13 – 2014/15;
- the Minimum Revenue Provision strategy and policy statement

Treasury management Issues
- the current portfolio position;
- treasury indicators: limits to borrowing activity;
- prospects for interest rates;
- the borrowing strategy;
- annual investment strategy;
- reporting requirments;
- policy on use of external service providers; and
- member and officer training

5.4.3 The Treasury Management Policy Statement, stating the policies, practices, objectives and approaches to risk management of its treasury management activities, has previously been adopted by the Audit Committee. There are no changes to the Treasury Management Policy Statement to report and the treasury service confirm that they are complying with all aspects of the the Treasury Policy Statement and will continue to comply in future years.

5.4.4 It should be noted however that the criteria for placing any investments have been tightened (see very last page of this report) whereby only building societies having an asset base in excess of £5,000m qualify; and the maximum ceiling on any cumulative bank investment has been reduced to £5m (was £10m) and reflects best practice in 'spreading risk'. There is an exception with regard to the National Westminster 'call account' where a £10m ceiling applies.

5.4.5 It is necessary for Council to agree the degree of risk to which it is prepared to expose the investment portfolio. The Head of Strategic Finance would define this as follows:

- Low Risk—limited to use of the Debt Management Office facility and other UK sovereign financial instruments; major clearing banks possessing high credit rating (or substantially owned by the UK Government); triple AAA money market funds; local authorities.
- Medium Risk—the use of Building Societies with an asset base above £5,000m as this sector is generally not rated by the Credit Rating Agencies;
- High Risk—low rated clearing banks; banks based outside the UK (this is a generalisation as many German/ Dutch/ Scandinavian/ and French banks would almost certainly be deemed too big to fail); building societies having a small asset base.

5.4.6 By the above 'crude' criteria, Watford might be considered to have a medium appetite for risk and the Audit Committee and Council will need to feel comfortable with this approach.

6.0 WEST HERTS HOSPITAL TRUST (WHHT)

The WHHT has been notified that it will receive £7m of financial support towards the construction of a road and bridge at the Health Campus and it is probable that this money will be transferred over to WBC prior to 31st March 2012 to invest until such time as the construction commences. This £7m will be kept separate from WBC's own investment portfolio and all interest earned will accrue to the construction project. As this money is effectively being held 'in trust' for the WHHT it is intended that it only be invested in low risk counterparties as detailed at Paragraph 5.4.5 above. All such investments will not affect the financial criteria detailed at the end of this report but can be additional to the recommended ceilings. So for example, even where the WBC investment portfolio has £5m investment with a UK clearing bank, that will not preclude part of the £7m WHHT portfolio from having a tranche of its money similarly invested.

7.0. IMPLICATIONS

7.1 **Financial**

7.1.1 The Head of Strategic Finance comments that the Treasury Management Statements have no direct financial implications although Appendix 3 does, in particular, set parameters within which officers should operate and could result in indirect financial implications which are not possible to evaluate at this time.

7.1.2 The proposal to enable the Council to enter into a loan facility of up to a £10m maximum ceiling does not of itself have financial implications as the take up of any loan facility will need to be evaluated at the time that any drawdown is contemplated.

7.2 Legal Issues (Monitoring Officer)

7.2.1 The Head of Legal and Property Services comments that It is a statutory requirement that the Treasury Management Strategy and Treasury Management Practices are reviewed annually by the Audit Committee and Full Council.

7.3 Potential Risks

Potential Risk	Likelihood	Impact	Overall Score
That the Council will exceed its borrowing parameters	1	3	3
That the Council will be unable to service its annual borrowing costs	1	3	3
That the Council will be unable to repay any loans at maturity date	1	4	4
Investment placed with a non approved body	1	3	3
Investment with a counterparty that subsequently defaults	1	4	4

Background papers:
UK Economic Forecasts provided by Sector, the Council's treasury advisors.
CIPFA Prudential Code for Capital Finance in Local Authorities, 2011 Edition
CIPFA Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes, 2011 Edition
CIPFA Treasury Management in the Public Services, Guidance Notes for Local Authorities, 2011 Edition
Outturn figures from E Financials, Logotech Treasury Management and Statement of Accounts.

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