AUD020
FOR DECISION
WARD(S): GENERAL

AUDIT COMMITTEE

5 December 2011

TREASURY MANAGEMENT STRATEGY 2011/12 - IMPLICATIONS OF HOUSING FINANCE REFORM

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

CAB2117 – Treasury Management Strategy 2011-12, 9 February 2011

AUD015 – Treasury Management 2011-12 Mid year review, 5 December 2011

EXECUTIVE SUMMARY:

The Housing Finance Reform will result in the Council having to pay an expected £157.393m to CLG on the 28 March 2012.

This report indicates the consequential changes that will be required to the Treasury Management Strategy for 2011/12 and the associated revisions to Prudential Indicators, to enable the discharge of the Council's financial responsibilities and to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

It is expected that the final determinations will be announced in January and the Revised Treasury Management Strategy for 2011/12 will be presented to Cabinet and Council for approval in February.

RECOMMENDATIONS:

That the Audit Committee note the implications of the Housing Finance Reform on the Treasury Management Strategy for 2011/12 and the Prudential Indicators that will be affected.

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TREASURY MANAGEMENT STRATEGY 2011/12 - IMPLICATIONS OF HOUSING FINANCE REFORM

REPORT OF HEAD OF FINANCE

1 Reform of Council Housing Finance,

1.1 In its publication "Implementing self-financing for council housing" issued in February 2011, the CLG set out the rationale, methodology, and financial parameters for the initiative. Enabling legislation is included in the Localism Act 2011 which received royal assent on 15 November, final self-financing determinations are expected in January 2012, and the proposed payment date is 28th March 2012.

1.2 The self-financing model provides an indicative sustainable level of opening housing debt. As the Council's debt level generated by the model is higher than the Subsidy Capital Financing Requirement (SCFR), the Council will be required to pay the CLG the difference between the two, which is currently calculated at £157.393m per the Housing Revenue Account Self-financing Determinations – Consultation, published by CLG 21 November 2011. This will require the Council to fund this amount in the medium term through internal resources and/or external borrowing. Theoretically, the Council has the option of borrowing from the PWLB or the market.

1.3 However, on 20th September, following an announcement by HM Treasury, the PWLB confirmed that the interest rate offered to local authorities would be temporarily reduced to allow councils to borrow at lower levels for their one-off HRA reform settlement payment. This will enable the Council to borrow at around 0.13% above the equivalent gilt yield (current borrowing rates are 1% above the gilt yield) to fund the HRA transaction. This effectively undercuts all current alternatives.

1.4 Furthermore it was announced by Debt Management Office Circular 150, 21 November 2011, that these lower rates will only be available on the 28 March 2012, the day settlement has to be made to central government.

1.5 The treasury management implications of housing finance reform and an appropriate strategy to manage the process are being actively reviewed with the Council's Treasury Adviser.

2 Payment

2.1 The purpose of this report is to advise of changes that will be necessary to limits to borrowing activity and related Prudential Indicators (Appendix A) to give the Head of Finance the necessary authority to meet the Council's obligations arising from the housing finance reform.

2.2 It should also be noted that on the 28 March that there will be circa £160m "daylight exposure" on the Council's National Westminster bank account as funds to finance the payment to CLG are received, plus usual operating cash, until the payment to CLG of £157.393m is made (expected to be by 12:00 noon).

OTHER CONSIDERATIONS:

3 SUSTAINABLE COMMUNITY STRATEGY AND CHANGE PLANS (RELEVANCE TO):

3.1 Effective treasury management supports the delivery of the Efficient and Effective outcomes in particular which in turn supports the delivery of the Council's Change Plans and the Sustainable Community Strategy for the District.

4 RESOURCE IMPLICATIONS:

4.1 The specific treasury management financial implications are detailed in the report. There will also be a need to increase the resources applied to the treasury management function as a consequence of the self financing of housing to manage the cash flow implications and the consequential borrowing.

5 RISK MANAGEMENT ISSUES

5.1 These are addressed within the report

BACKGROUND DOCUMENTS:

Operational and financial records held in the financial services team

APPENDICES:

Appendix A - Prudential Indicators

PRUDENTIAL INDICATORS

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and how it is financed.

Capital Financing Requirement	**2011/12 Approved £m**	**2011/12 Revised (AUD015) £m**	**2011/12 Revised for Hsg Reform £m**
Non-HRA	3.8	(1.2)	(1.2)
HRA	10.1	10.1	167.5
Total CFR	**13.9**	**8.9**	**166.3**

Authorised Limit and Operational Boundary for External Debt:

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	**2011/12 Approved £m**	**2011/12 Revised for Hsg Reform £m**
Borrowing	13.9	166.3
Other Long-term Liabilities	0.0	0.0
Total	**13.9**	**166.3**

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

PRUDENTIAL INDICATORS

The Head of Finance has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the February meeting of the Cabinet and Council.

Operational Boundary for External Debt	**2011/12 Approved £m**	**2011/12 Revised for Hsg Reform £m**
Borrowing	8.9	161.3
Other Long-term Liabilities	0.0	0.0
Total	**8.9**	**161.3**

Gross and Net Debt:

The purpose of this treasury indicator is to highlight if there is a situation where the Council is planning to borrow in advance of need.

Gross and Net Debt	**2011/12 Authorised £m**	**2011/12 Revised for Hsg Reform £m**
Outstanding Borrowing (at nominal value)	3.7	157.4
Other Long-term Liabilities (at nominal value)	0.0	0.0
Gross Debt	3.7	157.4
Less: Investments	0.0	2.9
Net Debt	**3.7**	**154.5**

Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:
These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

PRUDENTIAL INDICATORS

Interest Rate Exposures	2011/12 Approved £m/%
<u>Fixed</u>	
Upper Limit for Fixed Interest Rate Exposure on Debt	100%
Upper Limit for Fixed Interest Rate Exposure on Investments	100%
Net Fixed Exposure	**100%**
<u>Variable</u>	
Upper Limit for Variable Interest Rate Exposure on Debt	100%
Upper Limit for Variable Interest Rate Exposure on Investments	£5.0m
Net Variable Exposure	**100%**

The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy. Further consideration will be given to these limits before the Revised Strategy is finalised.

Maturity Structure of Fixed Rate borrowing:

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment. Further consideration will be given to these limits before the Revised Strategy is finalised.

Maturity structure of fixed rate borrowing	Approved		Revised	
	Lower Limit for 2012/13 %	Upper Limit for 2012/13 %	Lower Limit for 2012/13 %	Upper Limit for 2012/13 %
under 12 months	0%	100%	0%	100%
12 months and within 24 months	£0	£5m	0%	100%
24 months and within 5 years	£0	£5m	0%	100%
5 years and within 10 years	£0	£5m	0%	100%
10 years and within 20 years	£0	£5m	0%	100%
20 years and within 30 years			0%	100%
30 years and within 40 years			0%	100%
40 years and within 50 years			0%	100%
50 years and above			0%	100%