REPORT OF THE CABINET

The Cabinet met on 15 November 2011. Attendances:-

Councillor Jones (Chairman)
Councillors Belsey, Bennett, Bentley, Elkin, Freebody, Glazier and Maynard

1. Reconciling Policy, Performance and Resources

Review of Capital Programme

1.1 As reported to the County Council in October 2011, the Cabinet previously agreed a fundamental review of the capital programme with schemes that contribute to economic development being given priority, together with an increased emphasis on projects delivering policy steers. To deliver the review Cabinet agreed to:

- identify specific economic development initiatives;
- critically review the current programme through to 2014/15; and
- generate and assess new bids, including service transformation opportunities.

1.2 It was also accepted that contractually or effectively committed projects (largely the current year's approvals) should continue. The review therefore focuses on projects or initiatives which would start in 2012/13 and beyond. The review has been structured into two phases: the first seeking confirmation of the prioritisation of three key economic development bids and a second phase compiling the draft Capital Programme (to be considered by the Cabinet in January 2012) using the prioritisation criteria set out in the report considered by the Cabinet.

1.3 When considering the pot of resources available for allocation it is simplest to work with projections of the net resources (ie excluding specific external grants) rather than gross funding. The current working estimate is that the County Council has £226m of its own resources available to fund capital projects, which are not the subject of specific grants, between 2012/13 and 2015/16.

1.4 The current Capital Programme agreed by County Council in February 2011 comprises of projects totalling £259m of gross expenditure between 2011/12 and 2014/15. This was to be funded by £129m of the County Council's resources and the remainder from scheme specific Government grants. Since the capital programme was agreed, the Council has been notified of an additional £41m un-earmarked Government grant over two years. This funding is not ring-fenced but there is a Government expectation that it is allocated along the following lines: £18m pa for highways and schools maintenance. We have assumed the remaining £5m as a contingency. This funding can be added to the £129m available for the Capital Programme from the Council's own resources. A further £30m can be added by reducing the Waste Reserve, following a reassessment of risk and other variables over the remaining contract period. There will also be £21m of borrowing capacity available in 2015/16 and an estimated additional £5m of capital receipts. This means a total of £226m.

1.5 Against the £226m of potential net resource, there is £51m of contractually or effectively committed schemes. These include the 2011/12 Local Transport Plan Structural Maintenance, The Keep, Bexhill High BSF and Academies. A full list of effectively committed schemes was set out in Appendix 1 of the report to the Cabinet.

The current estimate of available net resources through to 2015/16 is therefore £175m. This was set out in Appendix 2 of the report to the Cabinet. Clearly, there may be further grant announcements to come from 2012/13 onwards.

1.6 After the review process described above, there are a total of £222m bids against the £175m pot. It is important to note the total amount is bid through to 2015/16, but the issue of phasing is important. The bids were listed in Appendix 3 of the report to the Cabinet in the following categories:

- Economic Development
- Highways
- Buildings Maintenance
- Primary School Places
- School Priorities
- Efficiency and Transformation
- Service Specific

1.7 At this stage the focus is on net calls on resources. There are other schemes with an assessed net nil effect, which will have to form part of the final programme, e.g. Lansdowne Secure Unit and Property Rationalisation.

1.8 The first stage of the review involves officers proposing a draft prioritisation of the bids, having regard to the Council's priorities and statutory duties, so that a draft Capital Programme can be drawn up for consideration by Cabinet in January 2012, prior to consideration by County Council in February 2012. Within the Economic Development category there are three key bids

- Bexhill to Hastings Link Road – £24.3m
- Broadband £15m
- Public Service Network £1.9m (Invest to Save)

1.9 The Cabinet has agreed that in formulating the draft Capital Programme these bids, totalling £41.2m, form the first call given their importance to delivering the Council's priorities over the medium term. This prioritisation also emphasises the role of Economic Development in future planning. The consequence is that there will be £41.2m less resources for other currently listed bids in the second phase.

1.10 The second phase will involve further work being carried out to refine the bids and suggest how they should be prioritised and phased in the Capital Programme. The Phase 2 work will enable bids to be prioritised against the following criteria agreed by the Cabinet:

- Economic Development / NNDR gains
- Delivery of revenue savings
- Deliverability in short term
- Key risks, e.g. primary school places
- Return on investment

1.11 Further work will also be carried out to complete a review of other reserves and the future prospects for capital receipts. By January 2012 we should also know the outcome of bids for Government funding (of which the Hastings to Bexhill Link Road is the most significant) and may have better information about any further Government grant awards. This will enable Cabinet to consider a balanced Capital Programme for recommendation to the County Council.

1.12 This approach covers capital bids, but because of the importance placed by Cabinet, on integrating capital and revenue planning more closely, it is likely that we will need to take into account significant revenue bids against this resource. For example, the emerging Children's Strategic Transformation Plan may require capital support. Our capital capacity comes from regular revenue contributions to the cost of new borrowing. The challenge of meeting future revenue requirements, such as dealing with the effects of the council tax freeze adds pressure to those regular revenue contributions to capital, which in turn would put pressure on overall capital resources.

Revenue Budget

1.13 Since July Chief Officers and Lead Members have been carrying out financial and business planning on the basis of the following framework previously agreed by Cabinet:

- 12 distinct service areas;
- modelling service offers and savings using "pro rata" cash reductions applied to each service area; and
- future cash availability based upon known and estimated 'grant' changes and a 2% council tax increase per annum.

1.14 The task for each service area was to identify the service offer consequences of the savings required by its agreed cash limit, including managing spending pressures. The Cabinet has considered - Appendix 1 of the report to the Cabinet - a summary of the position for each of the 12 service areas over the next three years against the indicative cash limits provisionally agreed by Cabinet in July 2011.

1.15 All departments apart from Children's Services are close to identifying savings plans and the service changes required to manage within the agreed cash limits. Each Chief Officer will consider the specific risks and issues associated with the changes proposed as the work develops. Appendix 2A of the report considered by the Cabinet set out a narrative on the broad service changes proposed for each service area in order to make the savings required. Scrutiny Boards will be held in December to look at the developing Portfolio Plans and savings proposals.

1.16. Spending pressures of up to 14% are forecast in Children's Social Care next year and high levels of pressures are predicted in future years. The Children's Services Department is developing a service transformation plan to ensure its services are affordable and sustainable in the long term. This may involve significant one-off investment over the next two years. If Cabinet is minded to agree to the principle of making additional funding available to Children's Services, this would reduce the funding available for capital expenditure. The Children's Services Department is developing a detailed business case for its transformation programme. Further information was provided in Appendix 2B of the report to the Cabinet. When making a final decision Members will need to consider that there is a risk that failure to deliver the required transformation would create a significant future challenge.

1.17 The financial assumptions for the next three years against which we have been planning are set out below:

	Base	Change		
	11/12	12/13	13/14	14/15
	£m	£m	£m	£m
Formula Grant	117.8	- 9.4	- 1.1	- 6.4
Council Tax	239.2	4.9	4.9	5.0
CT surplus	1.1	- 1.1		
	358.1	- 5.6	3.8	- 1.4

Notes:
(a) Formula Grant is relatively certain for 2012/13 but average national assumptions are made for 2013/14 onwards.
(b) 2012/13 funding could be undermined by a further Academy grant cut.
(c) In each year it is assumed that our base council tax income increased by £5m or 2% p.a.
(d) The pressure in 2012/13 is the reversal of the council tax surplus in 2011/12.

1.18 The Government is offering a promise of no increase for council tax payers in 2012/13, financed by a one-off grant to Councils. This is different to the treatment applied in the current year, where the freeze was fully funded over the whole Comprehensive Spending Review period. The one off grant would have the effect of making our underlying base income lower than our underlying costs once the grant is removed. This would therefore need to be addressed by making greater savings in the following financial year to bring our expenditure in line with our income.

1.19 The Cabinet has agreed that planning for the final budget proposals should be undertaken on the assumption that the Government offer of a grant to support a council tax freeze in 2012/13 being accepted and recovered in the following two years.

1.20 Both the localisation of business rates and changes to council tax benefits bring considerable risk to our funding in 2013/14. The resource review could have a detrimental effect on our baseline funding. The changes to Council Tax Benefit could result in significant pressure on council tax collection rates, because localisation of the function will be accompanied by a 10% grant cut. Failure to achieve that cut would affect council tax yield.

1.21 There is a further financial risk if the number of schools converting to academy status increases significantly, which is likely if the schools continue to be given a financial incentive to do so.

1.22 As yet, for 2013/14, no contingency has been built into our base assumptions for the three elements set out above, but the associated risks need to be planned for and managed. In addition, the possible loss of £6.9m of specific adult social care income in 2013/14 also represents a risk; however, Adult Social Care will plan to address this issue.

2 Treasury Management 2011/12

2.1 The Code of Practice for Treasury Management requires the review of the Council's treasury management performance to be reported half way through the year as well as at the end of each year. The County Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance. The County Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis and its treasury management practices demonstrate a low risk approach.

The Treasury Management Strategy

2.2 The Strategy for 2011/12, agreed By the Council in February 2011, continued a prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year. Given the changed market conditions compared to when the Strategy was agreed, the Cabinet has considered proposed amendments to the Strategy. A more prudent approach has been adopted because of the uncertainties in the market. Investments in some banks were reduced from a period of up to three months to being on call (overnight only). By the middle of September, all investments were able to be called without notice.

Proposed Amendments to the Treasury Management Strategy

2.3 The Council's Treasury Management Policy recognises that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend the Strategy in order to safeguard Council funds.

2.4 Although the Strategy allows for investments up to one year, the continuing uncertainties in the markets dictated that the Council continued with a mainly overnight (on call) policy with some small investments in three month investments. In the summer we switched to a complete on call policy and by mid September all of our investments could be returned within a working day.

2.5 On 7 October, the ratings agency Moody's reduced the credit ratings of twelve UK financial institutions including NatWest/RBS, Lloyds / HBOS and Santander UK. On 13 October, the ratings agency Fitch reduced the credit ratings of two UK financial institutions NatWest/RBS and Lloyds / HBOS. These rating agency reviews were part of a previously announced (May 2011) reassessment of the likely level of systemic (Government) support these institutions would get if they were to get into financial difficulty in the future. The resultant downgrading should not necessarily be construed that these institutions are experiencing difficulty that would result in a default.

2.6 The consequence of the bank downgrades means we are operating outside our normal rating criteria with two banks i.e. - NatWest/RBS and Lloyds/HBOS - which fall below our minimum rating agency thresholds but within overall policy because the Director of Corporate Resources has discretion.

2.7 Our current position is that we have continued to invest in both Nat West/RBS and Lloyds/HBOS because

- The high level of Government Ownership of NatWest./RBS (83%) and Lloyds HBOS (40.2%)
- UK Sovereign rating remains at AAA.
- We have an overnight policy and monies can be withdrawn without notice.
- Nat West/RBS is the County Council's banker.

2.8 The changes referred to above will require the Strategy for 2011/12 (set out in Paragraph 3 of Appendix A of the Cabinet report) to be amended to continue with the prime objective of the effective management of risk and following our prudent policy.

2.9 It is proposed to amend the Strategy in relation to where the County Council funds will be invested as follows:-

(A) UK Investment Without Government Equity Holding

<u>Up to a maximum of £60m deposited up to a period of up to one year</u> with any of the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank / Fund / Local Authority
Barclays
Santander UK
HSBC
Nationwide
Individual Treasury Type Money Market Funds (AAA rated) which invest in Government Securities only
Individual Cash Type Money Market Funds (AAA rated)
Another Local Authority (Equivalent to the low risk of investing with the Government but not formally rated)

Only banks which meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	**Long Term**	**Short Term**
Fitch	AA-	F1+
Moody	AA3	P-1
Standards and Poors	AA-	A-1+

(B) UK Investment With Government Equity Holding of minimum of 30%

We are taking 30% as a minimum level of significant associated company influence. In practice it serves as a trigger to formally review our position.

Up to a maximum of £60m deposited up to a period of up to three months with the following: -

Bank
Lloyds/HBOS Nat West/RBS

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Only banks which meet the following minimum rating criteria for at least two of the designated agencies are to be used. The banks will not be used if the UK Sovereign rating falls below AAA.

Ratings Agency	**Long Term**	**Short Term**
Fitch	A	F1
Moody	A2	P-1
Standards and Poors	A	A-1

The policy retains the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten.

2.10 In addition to the Credit Ratings Agencies, various methods have and will be used to monitor the Banks and Funds. Other very safe alternative investments will be explored when they become available.

2.11 The changes in our policy can be summarised as follows:-

- The new policy splits the investments into two groups,
  (A) UK Investment Without Government Equity Holding and
  (B) UK Investment With Government Equity Holding of a minimum of 30%

UK Investment Without Government Equity Holding

- The reference to the Government's Credit Guarantee Scheme has been deleted as it is not now relevant.

- Investments can be made to other Local Authorities. (Equivalent to the low risk of investing with the Government but not formally rated)

- The policy would allow investments up to one year but would only be used if market conditions improve. The current policy is overnight only.

UK Investment With Government Equity Holding of a minimum of 30%

- Lloyds/HBOS and Nat West/RBS included within UK Investment With Government Equity Holding of over 30%

- The investment allowed up to three months but the current policy is overnight and allows changes to reflect market conditions if and when they improve.

- New lower ratings criteria but the banks will not be used if the UK Sovereign rating falls below AAA.

2.12 It continues to be recognised that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this Strategy in order to safeguard Council funds. As in the past, any such actions would be reported to the next Cabinet meeting.

Short term lending

2.13 The total amount received in short term interest for the six months to 30 September 2011 was £1.31m at an average rate of 0.94%. This was above the average of base rates in the same period (0.5%) but fell short of the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. This is against a backdrop of ensuring, so far as possible in the current financial climate, the security of principal and the minimisation of risk. The Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield.

Long term borrowing

2.14 Details of our long term borrowing were included in Appendix B of the report considered by the Cabinet. The key points are:

- No new borrowing was undertaken through the Public Works Loans Board during 2011/12 to date and is unlikely in the rest of the year. It was agreed to continue to use "internal borrowing" to finance new capital investment
- Although a proactive approach has been taken to repayment and restructuring of debt, no cost effective opportunities have arisen in the first six months of this year.

Short term borrowing

2.15 No borrowing was undertaken on a short-term basis in the first six months of 2011/12 to cover temporary overdraft situations.

Prudential Indicators which relate to the Treasury function and compliance with limits

2.16 The County Council is required by the Prudential Code to report the actual prudential indicators after the end of each year. There are eight indicators which relate to treasury management and they were set out in Appendix C of the report considered by the Cabinet. The actual position for the County Council for 2011/12 so far this year is that performance against all borrowing and prudential indicators is within the limits set in the Strategy for the year.

2.17 This report updates the Cabinet and fulfils the requirement to submit a half yearly report in the form prescribed in the Treasury Management Code of Practice.

Short term lending has achieved returns better than base rate. However, the rate is below the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. This reflects the aim to ensure so far as possible in the financial climate, the security of principal and the minimisation of risk. This Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield. Exposure to future risk continues to be minimised through proactive and constant review of the treasury management policy. The Treasury Management Strategy has been altered to reflect changes in market conditions and the importance of the Government's part ownership of certain Banks. The current emphasis must now be to be able to react quickly if market conditions worsen.

2.18 The Cabinet recommends the County Council to –

✡ (a) approve the amendment of the Treasury Management Strategy for 2011/12 as set out in this report (paragraphs 2.9 and 2.10); and

(b) note the treasury management performance for the half year to 30 September 2011.

15 November 2011

PETER JONES
Chairman