ASSEMBLY

17 July 2013

Title: Treasury Management Annual Report 2012/13	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision: Yes**
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Accountable Divisional Director: Jonathan Bunt, Divisional Director of Finance	
Accountable Director: Graham Farrant, Chief Executive	

Summary

Changes in the regulatory environment now place a greater onus on elected Members for the review and scrutiny of treasury management policy and activities. The Treasury Management Annual Report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly.

This report presents the Council's outturn position in respect of its treasury management activities during 2012/13 financial year. The key points to note are as follows:

- Investment income for the year was £1.87m (2011/12: £1.2m);
- There was no General Fund borrowing in 2012/13 to finance the capital programme as, in line with part of the 2012/13 treasury management strategy, the Council relied on internal borrowing;
- A £10m Public Works Loan Board was repaid during the year and was not replaced;
- The Council did not breech its 2012/13 authorised borrowing limit of £528m and complied with all other set treasury and prudential limits.

This report was considered and endorsed by the Cabinet at its meeting on 25 June 2013.

Recommendation(s)

The Assembly is recommended to:

(i) Note the Treasury Management Annual Report for 2012/13;

(ii) Note that the Council complied with all 2012/13 treasury management indicators;

(iii)	Note that the Council did not borrow to finance its capital programme in 2012/13 but utilised internal cash in line with its strategy;
(iv)	Note the change required in the 2013/14 Treasury Management Strategy Statement to the wording for the counterparty limit for Lloyds TSB, as outlined in section 6.3; and
(v)	Approve the actual Prudential and Treasury Indicators for 2012/13 as set out in Appendix 1 to the report.
Reason(s) This report is required to be presented to the Assembly in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.	

1. Introduction and Background

1.1. The Council is required by regulations issued under the Local Government Act 2003 (as amended 2010) to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13.

1.2 The report has been produced in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services 2009 adopted by this Council on 16 February 2010 and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.3 This report also reviews the external cash portfolio manager for the financial year.

1.4 During 2012/13 the full Council received the following reports:

- an annual treasury strategy in advance of the year (Assembly 22/02/2012);
- a mid-year (minimum) treasury update report (Assembly 05/12/2012); and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.5 This Annual Treasury Report covers:

- The Council's treasury position as at 31 March 2013;
- Economic Factors and Interest rate in 2012/13;
- The Strategy for 2012/13;
- Annual Strategy Statement 2012/13;
- Changes in strategy during the year;
- Performance Measurement in 2012/13;
- Council's Treasury Performance in 2012/13
- Borrowing Outturn;
- Treasury Management costs in 2012/13;
- Compliance with Treasury limits and Prudential indicators;

- Lending to Commercial and External Organisations; and
- Prudential Indicators for 2012/13 (Appendix 1)

2. Treasury Position as at 31 March 2013

2.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

2.2 Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

2.3 The Council's treasury position at the start and end of 2012/13 is shown in Table 1:

Table 1: Council's treasury position at the start and end of 2012/13

	31 March 2013 Principal £'000	Rate /Return	Average Life (yrs)	31 March 2012 Principal £'000	Rate /Return	Average Life (yrs)
Fixed Rate Funding:						
PWLB	285,912	3.54%	38.75	295,912	3.55%	39.46
Variable Rate Funding:						
PWLB	0	0	0	0	0	0
Market	40,000	4.02%	55.61	40,000	2.37%	56.39
Total Debt	**325,912**	**3.60%**	**40.45**	**335,912**	**3.41%**	**41.43**
Investments						
In-House*	70,766	2.01%		60,736	1.10%	
External Managers:						
Investec	39,088	1.05%		38,743	1.67%	
Total Investments	**109,854**	**1.67%**		**99,479**	**1.28%**	

* In-house cash figure excludes a prepayment made to Elevate.

3. The Economy and Interest rate in 2012/13

3.1 The original expectation for 2012/13 was that Bank Rate would not rise in 2012/13 or 2013/14 and for it to start gently rising from quarter 4 2014. This forecast rise has now been pushed back to start in quarter 1 2015 at the earliest. Economic growth (GDP) in the UK was virtually flat during 2012/13, due to the UK austerity programme, subdued domestic consumer expenditure, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU).

3.2 The weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn. The Bank Rate, therefore, ended the year unchanged at 0.5%, while CPI inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time.

3.3 The EU sovereign debt crisis was an ongoing saga during the year, with an eventual very protracted agreement of a second bailout for Greece in December followed by a second major crisis, this time over Cyprus, towards the end of the year.

3.4 Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically low levels.

3.5 The Funding for Lending Scheme, announced in July, has resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling drastically in the second half of the year. However, perceptions of counterparty risk have improved after the European Central Bank (ECB) statement in July that it would do “whatever it takes” to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

3.6 The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody’s followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget in March.

4. The Strategy for 2012/13

4.1 The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate (starting in quarter 4 of 2014), with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

4.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

4.3 The actual movement in gilt yields meant that PWLB rates fell during the first quarter of the year to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt, and from shares, as investors became concerned about the potential for a Lehman’s type crisis of financial markets, if the Greek debt crisis were to develop into a precipitous default and exit from the Euro.

4.4 During the second and third quarters, rates rose gradually and agreement of a second bail out for Greece in December saw the flight to quality into gilts reverse somewhat, as confidence rose that the Eurozone crisis was finally subsiding.

4.5 However, gilt yields then fell back again during February and March as Eurozone concerns returned, with the focus now shifting to Cyprus, and flight to quality flows into gilts resumed. This was a volatile year for PWLB rates, driven by events in the Eurozone which oscillated between crises and remedies.

5. Annual Strategy Statement 2012/13

5.1 The Assembly approved the annual strategy for 2012/13 on the 22 February 2012.

5.2 The key points from that strategy were:

- To set an authorised borrowing limit of £528m for 2012/13;
- That challenging and uncertain economic outlook has several key treasury management implications:
    - The Eurozone sovereign debt difficulties 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.
- The Council's borrowing strategy will give consideration to the following when deciding to take-up new loans:
    - Use internal cash balances, while the current rate of interest on investments remains at an all-time low, with consideration given to weighing the short term advantage of internal borrowing against potential long term costs if long term borrowing rates begin to increase more than forecast;
    - Using Public Works Loan Board (PWLB) variable rate loans;
    - Using long term fixed rate market loans where rates were significantly less than PWLB rates for the equivalent maturity period;
    - Maintain an appropriate balance between PWLB and market debt in the debt portfolio for the General Fund;
    - Use short dated PWLB fixed rate loans where rates are expected to be significantly lower than rates for longer period;
    - Ensure that new borrowing, if required, is timed at periods when rates are expected to be low; and
    - Consider the issue of stocks and bonds if appropriate.

- That the Council and its cash managers will have regard to the Council's investment priorities being:

  (a) The **security** of capital;

  (b) The **liquidity** of its investments; and

  (c) **Yield** (after ensuring the above are met).

- That the Council and its cash managers adhere to the procedures set for use of different classes of asset (specified and non-specified) and the maximum periods which funds can be committed;
- That the Council and its cash managers adhere to its counterparty limits;
- The Council would operate both borrowing and investment portfolios at short and long term periods and as a consequence reduces the risk of being impacted by a sharp unexpected rise in short-term variable interest rates; and
- That the Council maintain a balance of funding at shorter-term rates to match short-term investments thus maintaining balanced treasury risk.
- The Council during the financial year will carefully consider the difference between borrowing rates and investment rates to ensure that the Council obtain value for money.
- The Council will continue to utilise internal borrowing rather than external borrowing as the opportunity arises.

6. Change in strategy for 2012/13 and 2013/14

6.1 The strategy was revised as part of the 2012/13 Treasury Management Strategy Statement (TMSS) Mid-year Review Report, approved by Council on 5 December 2012.

6.2 The strategy revision was to the Council's Investment Strategy, as detailed below:

- Increase the limit on investment with Lloyds TSB from £30m to a maximum of 40% of the average monthly cash available to invest; and

- Set a fixed investment limit of £40m to be invested with Lloyds TSB after which all additional investment need to be invested in the Lloyds TSB call account.

6.3 Change to 2013/14 TMSS

On 25 February 2013 the 2013/14 TMSS was agreed by full Council. A change is required to be made to the wording for the counterparty limit for Lloyds TSB.

The Counterparty limit read "**Lower** of £40m or 40% of total investable cash". This should read "**Higher** of £40m or 40% of total investable cash". This change will bring the Lloyds investment restrictions in line with the changes outlined in points 6.1 and 6.2 above.

7. Performance Measurement in 2012/13

7.1 Investment Policy

The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Assembly on 22 February 2012. The policy sets out the Council's approach for choosing investment counterparties.

7.2 Economic Issues Which Directly Impacted Treasury Management Performance

The difference between investment rates and borrowing rates continued to be a major issue for treasury management throughout 2012/13. Although some attractive rates were available in the first part of 2012/13, rates decreased sharply towards the end of 2012 and continued to decline during the first quarter of 2013.

Security and liquidity continued to be an issue for both the in-house and investment cash managers, with all investments invested in instruments and counterparties which may sometimes have generated lower rates of return but higher security and liquidity.

8. Council's Treasury Performance in 2012/13

8.1 Investment Funds Available

The level of investments available to the Council as at 1 April 2012 was £99.5m. This figure was made up of a range of balances including, revenue reserves and general operational cash balances. The amount available for investment will vary throughout the financial year depending on:

- Use of investment funds;
- Profile for the receipt of grants;
- Temporary use of internal cash to fund new capital projects rather than borrowing at periods of high borrowing interest rates; and
- Cash flow management.

At 31 March 2013 the level of investments had increased to £109.9m, with £39.1m held by Investec and £70.8m internally managed. This position was anticipated through the regular monitoring and projections of cash flow movement and was in line with projections at the beginning of the year.

8.2 Management of Investment Funds

The Council's investments are now managed by two sources being:

- Council In House Team; and
- External Cash manager: Investec Asset Management Limited.

The Council meets quarterly with the external investment manager as well as with its Investment Adviser to discuss financial performance, objectives and targets in relation to the investments and borrowing managed on behalf of the Council.

The Council manages a proportion of its investments in-house. This is invested with institutions of high credit standing listed in the Council's approved lending list and specified limits. The Council invests for a range of periods from overnight to one year and in some cases over one year dependent on the Council's cash flows, its treasury management adviser's view, its interest rate view and the interest rates on offer.

8.3 Overall Performance

The Council earned £1.87millon gross of fees in interest from its investments in 2012/13. This represented an average return for the year of 1.45%. This performance is against a back drop of 3 Month LIBID uncompounded rate of 0.56% and 7 day LIBID uncompounded rate of 0.39%.

8.4 Cash Manager (external)

Throughout 2012/13 approximately £39m of the Council's cash was managed by a cash manager Investec. The performance of the managers against the benchmark return was:

Cash manager	Average Balance Held	Average Gross Return	Council's Average Return
Investec	£38,926,000.00	1.04%	1.62%

The average return achieved is significantly lower than the rate achieved by the Council. However, by investing a portion of the Council's cash in an external cash manager provided the Council with diversification and reduced the risk from concentrating investments in a few counterparties, thereby ensuring security of capital. In addition most instruments used by the cash manager can be traded at short notice thereby ensuring that the Council can maintain liquidity of its funds at short notice. In addition the rate achieved by Investec is higher than the main other options available to the Council, for example Money market Funds, Call Accounts and short-term deposits.

8.5 In–House Team

The majority of the Council's in-house investments were made with the partially nationalised UK banks that offer quasi government risk at interest rates much higher than could be achieved from investing with the UK government itself.

A substantial part of the investment portfolio was held in liquidity accounts with main UK banks. These accounts offered instant access at competitive rates, which enabled the treasury management to maintain a very liquid portfolio at a competitive rate of return.

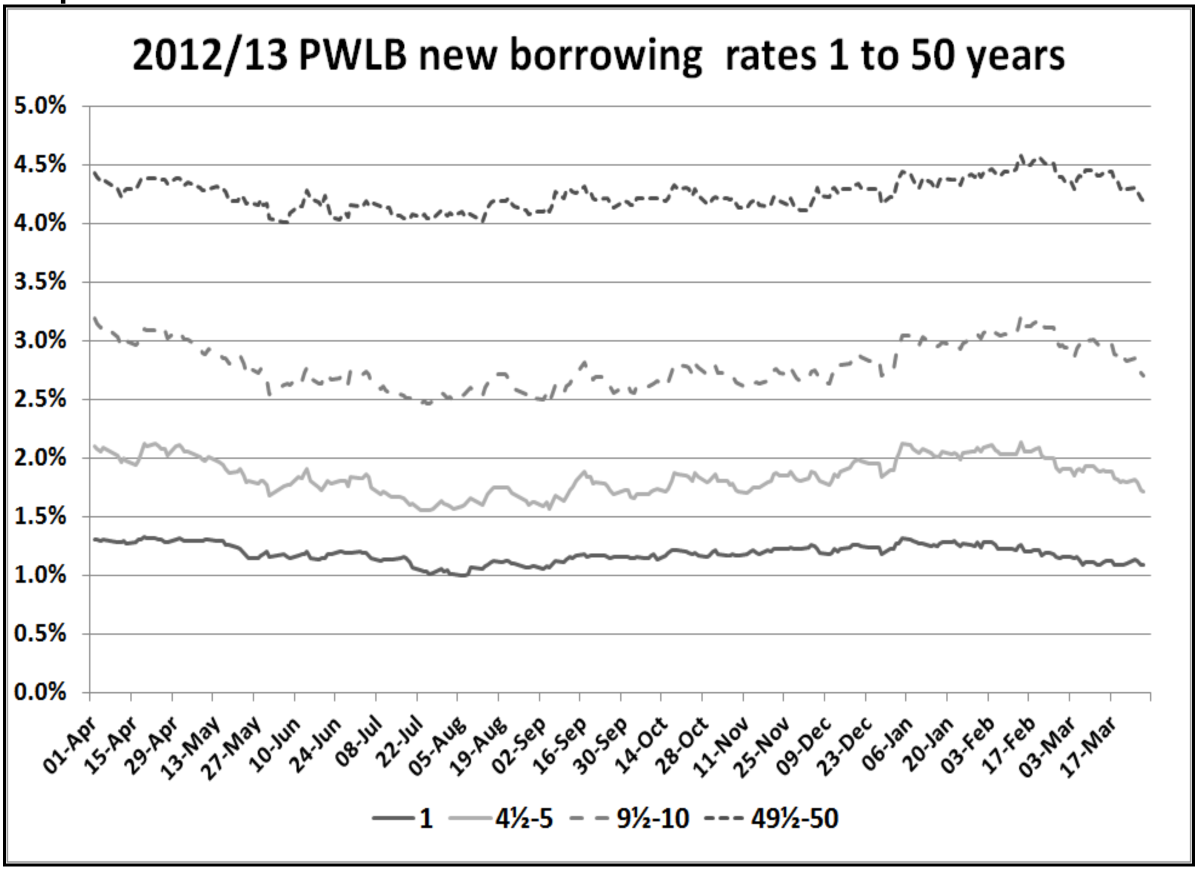
The rate of return for the year was 1.62% (2011/12: 1.1%). Performance was higher compared to 2011/12 due to investments being held for up to a year in higher paying part nationalised banks (Lloyds TSB and the Royal Bank of Scotland).

During the year the in-house team invested in a number of Money Market Funds (MMFs), which were all AAA rated and provided the Council with a very liquid, secure investment option and increased the diversity of the Council's investments.

9. Borrowing Outturn

9.1 **PWLB borrowing rates -** Graph 1 below shows how PWLB rates fell to near historic low levels towards the end of the financial year.

Graph 1: PWLB rates 2012/13



9.2 **Debt Performance**

The average debt portfolio interest rate, excluding HRA refinancing, increased slightly over the course of the year as the rate of two variable rate loans increased.

No additional borrowing was made for the General Fund, with cash balances used to finance new capital expenditure in order to run down cash balances and minimise counterparty risk incurred on investments. This strategy provided treasury management budget savings as investments rates were on average over 2% lower than new borrowing rates.

This strategy will be continually reviewed throughout 2013/14, with borrowing in-line with the capital financing requirements potentially made if borrowing rates rise.

9.3 **Debt Rescheduling, Repayment and New Borrowing**

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

On 27 April 2012 a £10m PWLB loan at an average rate of 3.85% was repaid and was not refinanced.

As investment rates remained low during the year and the cash flow forecasts remained strong, the treasury management continued using cash balances rather than borrowing, which helped to keep borrowing costs low and also meant reduced counterparty risk on the investment portfolio. Consequently no new borrowing took place in 2012/13.

10. Treasury Management Costs

10.1 The costs associated with the Treasury Management function comprises of a recharge of a proportion of the internal team's salary and senior officers salary, treasury management advisers fees and external managers fees. Treasury management costs are summarised in table 2 below:

Table 2: Treasury Management costs for 2012/13

Salary Recharge	32,500
Software and other costs	3,810
Sector Treasury Limited	17,000
Investec Asset Management	60,100
	113,410

11. Compliance with Treasury limits and Prudential Indicators

11.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordable limits) are included in the approved Treasury Management Strategy

11.2 During the financial year to date the Council has operated within and complied with the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The Council's prudential indicators are set out in Appendix 1 to this report. In 2012/13, the Council did not breach its authorised limit on borrowing of £528m.

11.3 The Operational limit set in the 2012/13 Treasury Management Strategy Statement was £431.3m, with the final position of was £325.9m.

12. Lending to commercial and external organisations

12.1 As part of the Council's mitigation of risk strategies around delivering and continued value for money services with external organisations, the Council should from time to time have the ability to make loans to external organisations.

12.2 Section 2 of the Local Government Act 2000 (power of well-being) gives authorities the power to lend as part of promotion or improvement of economic /social wellbeing of the Borough. The guidance encourages local authorities to use the well-being power as the power of first resort removing the need to look for powers in other legislation. Further the power provides a strong basis on which to deliver many of the priorities identified by local communities and embodies in community strategies. The Chief Finance Officer determines the rates and terms of such loans.

13. Conclusions

13.1 The key conclusions to draw from this report are as follows:

a) That the Council complied with prudential and treasury indicators in 2012/13 financial year;

b) That the value of investments as at 31 March 2011 totalled £109.9million; and

c) That value of long term borrowing as at 31 March 2011 totalled £325.9m. This comprised both market and PWLB loans.

14. Options Appraisal

14.1 There is no legal requirement to prepare a Treasury Management Annual Report, however, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

15. Consultation

15.1 The Chief Financial Officer has been informed of the approach, data and commentary in this report.

16. Financial Implications

Implications completed by: Jonathan Bunt, Divisional Director of Finance

16.1 This report sets out the outturn position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

17. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

17.1 The legal and governance provisions have been incorporated in the body of this report. There are no further legal implications to highlight.

18. Other Implications

18.1 **Risk Management -** The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income throughout the past year.

Background Papers Used in the Preparation of the Report:

- Treasury Management Strategy Statement - Assembly Report 22 February 2012
- Sector Economic and Interest Rate Report
- CIPFA – Revised Treasury Management in the Public Sector
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities

List of appendices:

Appendix 1 - Council's Prudential Code for Capital Investment in Local Authorities 2012/13

Appendix 2 - Glossary of Terms