Appendix A

Annual Treasury Management Review 2012/13

English Local Authorities
April 2013

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Annual Treasury Management Review 2012/13

Purpose

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13. This report 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).

During 2012/13 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 09/02/2012)
- a mid-year (minimum) treasury update report (Council 11/12/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly treasury management update reports.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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 members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Finance, Audit and Risk Committee before they were reported to the full Council.

Executive Summary

During 2012/13, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Capital expenditure	4,784	6,558	2,472
Capital Financing Requirement:	-34,878	-33,741	-32,741
External debt	4,892	4,265	4,265
Investments • Longer than 1 year • Under 1 year • Total	 29.250 18.61 47.86	 0 46 46	 7.00 40.33 47.33

The Original capital budget was reduced during the year from £6.6M to £4.6M mainly due to project slippage (£1.6M of this was with regard to the re-profiling of the District Museum and Community Facility project).

Other prudential and treasury indicators are to be found in the main body of this report. The Strategic Director of Finance also confirms that no borrowing was undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2012/13 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2012/13

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2012/13

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund	2011/12 Actual £000	2012/13 Working Budget £000	2012/13 Actual £000
Capital expenditure	**4,784**	**4,588**	**2,472**
Financed in year	2,730	1,914	1,336
Unfinanced capital expenditure	**2,054**	**2,674**	**1,136**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2012/13 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council has a negative CFR so is not required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. MRP is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2012/13 on 09/02/2012. Because the Council is in the unusual position of having a negative CFR there is no requirement currently to make an annual revenue charge (MRP).

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes finance leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m): General Fund	31 March 2012 Actual £000	31 March 2013 Actual £000
Opening balance	-36,931	-34,817
Add unfinanced capital expenditure (as above)	2,054	1,136
LAMS	0	1,000
Less MRP/VRP*	0	0
Less finance lease repayments	60	49
Closing balance	-34,817	-32,632

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator.

	31 March 2012 Actual	31 March 2013 Budget	31 March 2013 Actual
Net borrowing position	-£42.97m	-£43.22m	-£43.06m
CFR	-£34. 17m	-£33.98m	-£32.63m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2012/13 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2012/13
Authorised limit	£10.0M
Maximum gross borrowing position	£4.9M
Operational boundary	£8.0M
Average gross borrowing position	£2.7M
Financing costs as a proportion of net revenue stream	-6.4%

3. Treasury Position as at 31 March 2013

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. 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. At the beginning and the end of 2012/13 the Council's treasury position was as follows:

TABLE 1	31 March 2012 Principal	Rate/ Return	31 March 2013 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£1.892M	8.38%	£1.265M	8.49%
-Market	£3.000M	9.58%	£3.000M	9.17%
Variable rate funding:				
-PWLB	£0M		£0M	
-Market	£0M		£0M	
Total debt	**£4.892M**	**8.53**	**£4.265M**	**8.53**
CFR	**-£34.878M**		**-£33.742M**	
Over / (under) borrowing	**£29.986M**		**£29.477M**	
Investments:				
- in house	£1.86M	0.83%	£1.33M	0.45%
- Cash Managers	£46M	2.56%	£46M	2.30%
Total investments	**£47.86m**	**2.56%**	**£47.33M**	**2.30%**

The exposure to fixed and variable rates was as follows:

	31 March 2012 Actual	2012/13 Original Limits	31 March 2013 Actual
Fixed rate (principal or interest)	£35.97MCr	£27.0MCr - £38.6M	£36.32MCr
Variable rate (principal or interest)	£7.00MCr	£0 - £11.6MCr	£6.75MCr

The maturity structure of the debt portfolio was as follows:

	31 March 2012 actual	2012/13 original limits	31 March 2013 actual
Under 12 months	£2.627M	£2.606M	£2.606M
12 months and within 24 months	£0.605M	£0.087M	£0.087M
24 months and within 5 years	£1.179M	£1.116M	£1.116M
5 years and within 10 years	£0.094M	£0.088M	£0.088M
10 years and above	£0.387M	£0.368M	£0.368M

The maturity structure of the investment portfolio was as follows:

	2011/12 Actual £000	2012/13 Actual £000
Investments		
Longer than 1 year	29.250	7.00
Under 1 year	18.61	40.33
Total	47.86	47.33

4. The Strategy for 2012/13

The strategy in 2012/13 was to continue only lending to UK banks and building societies. Only UK banks with a credit rating, for longer term deals, greater than “BBB” and F3 or above for short term credit ratings were on the Council’s lending list. (These are Fitch definitions of ratings). Not all building societies are credit rated but this did not preclude them from the lending list as lending to a building society was dependant on their asset size. Where a society did have a rating, this was considered at the time of the deal taking into account the amount of investment and the length of the deal. As well as imposing maximum limits with each counter party, the overall percentage of outstanding investments with each counterparty was assessed to ensure a reasonable spread of investments.

Change in strategy during the year – the strategy adopted in the original Treasury Management Strategy Report for 2011/12, approved by the Council on 09/02/2012, was not subjected to any revision during the year.

5. The Economy and Interest Rates

Sovereign debt crisis. The EU sovereign debt crisis was an ongoing saga during the year. However, the ECB statement in July said that it would do "whatever it takes" to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was (at last) beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions Scheme in September. During the summer, a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in the new Five Star anti-austerity party gaining a 25% blocking vote; this has the potential to make Italy almost ungovernable if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election – but one which could yield an equally 'unsatisfactory' result! This result emphasises the dangers of a Eurozone approach heavily focused on imposing austerity, rather than promoting economic growth, reducing unemployment, and addressing the need to win voter support in democracies subject to periodic general elections. This weakness leaves continuing concerns that this approach has merely postponed the ultimate debt crisis, rather than provide a conclusive solution. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

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 statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe.

UK growth. 2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. In the March 2013 Budget, the Office of Budget Responsibility yet again slashed its previously over optimistic growth forecasts, for both calendar years 2013 and 2014, to 0.6% and 1.8% respectively.

UK 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. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

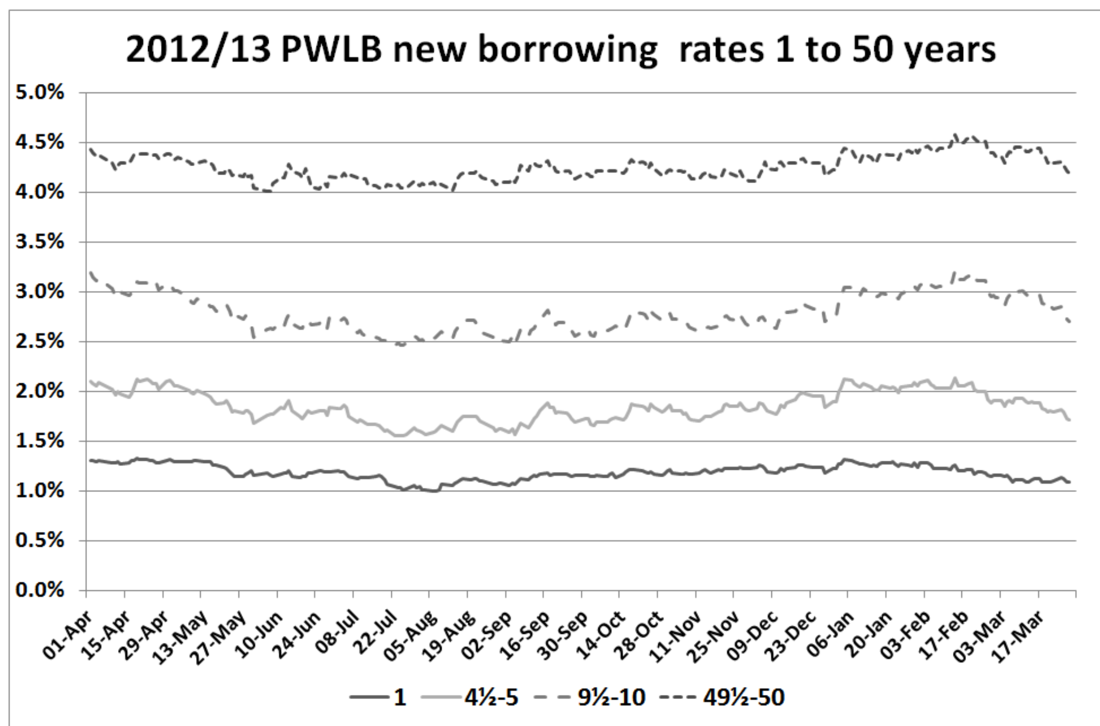
Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates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

Bank Rate was unchanged at 0.5% throughout the year, while expectations of when the first increase would occur were pushed back to quarter 1 2015 at the earliest.

Deposit rates. The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries.

6. Borrowing Rates in 2012/13

PWLB borrowing rates - the graphs and table for PWLB maturity rates below, and in appendix 3, show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



7. Borrowing Outturn for 2012/13

Borrowing - One loan was drawn to fund a temporary short fall in cash flow. This loan was taken on the 13th March and repaid on the 2nd April:

The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity
East Riding of Yorkshire Council	£2.0M	Fixed Interest Rate	0.45%	20 Days

The loans repaid were:

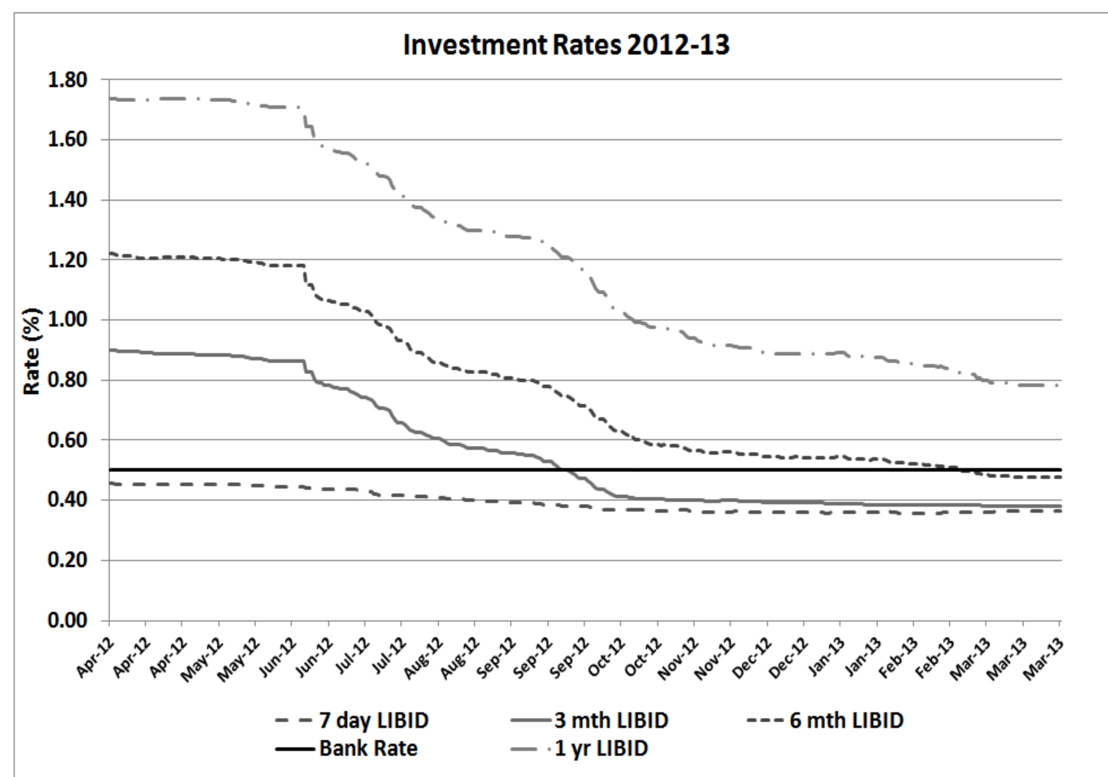
Lender	Principal	Type	Interest Rate	Maturity
Derbyshire County Council	£2.00m	Fixed interest rate	0.5%	11 days
PWLB	£0.627M	Fixed interest rate	Various	Various

The average borrowing rate increased from 8.85% to 8.975% due to loans maturing during the year with relatively low interest rates.

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

8. Investment Rates in 2012/13

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for four years. Market expectations of the start of monetary tightening were pushed back during the year to early 2015 at the earliest. The Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.



9. Investment Outturn for 2012/13

Investment Policy – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 09/02/12. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the Fitch credit rating agency for banks and asset size for building society investments. This is supplemented by spreading the investments over a number of counterparties.

The investment activity during the year conformed to the approved strategy.

Investments placed by cash managers – the Council uses two external cash managers to invest £46M of its cash balances. The performance of the managers against the benchmark return was:

Cash Manager	Investments Placed	Interest	Return	Benchmark*
Sterling	£23M	£0.537M	2.34%	0. 52%
Tradition	£23M	£0.582M	2.53%	0.26 %
Total	£46M	£1,119M	2.43%	

*Ave 3 Month LIBID Rate 0.52%
Ave 7 days notice Rate 0.26%

This compares with an original budget assumption of average investment balances of £46M at 2% investment return.

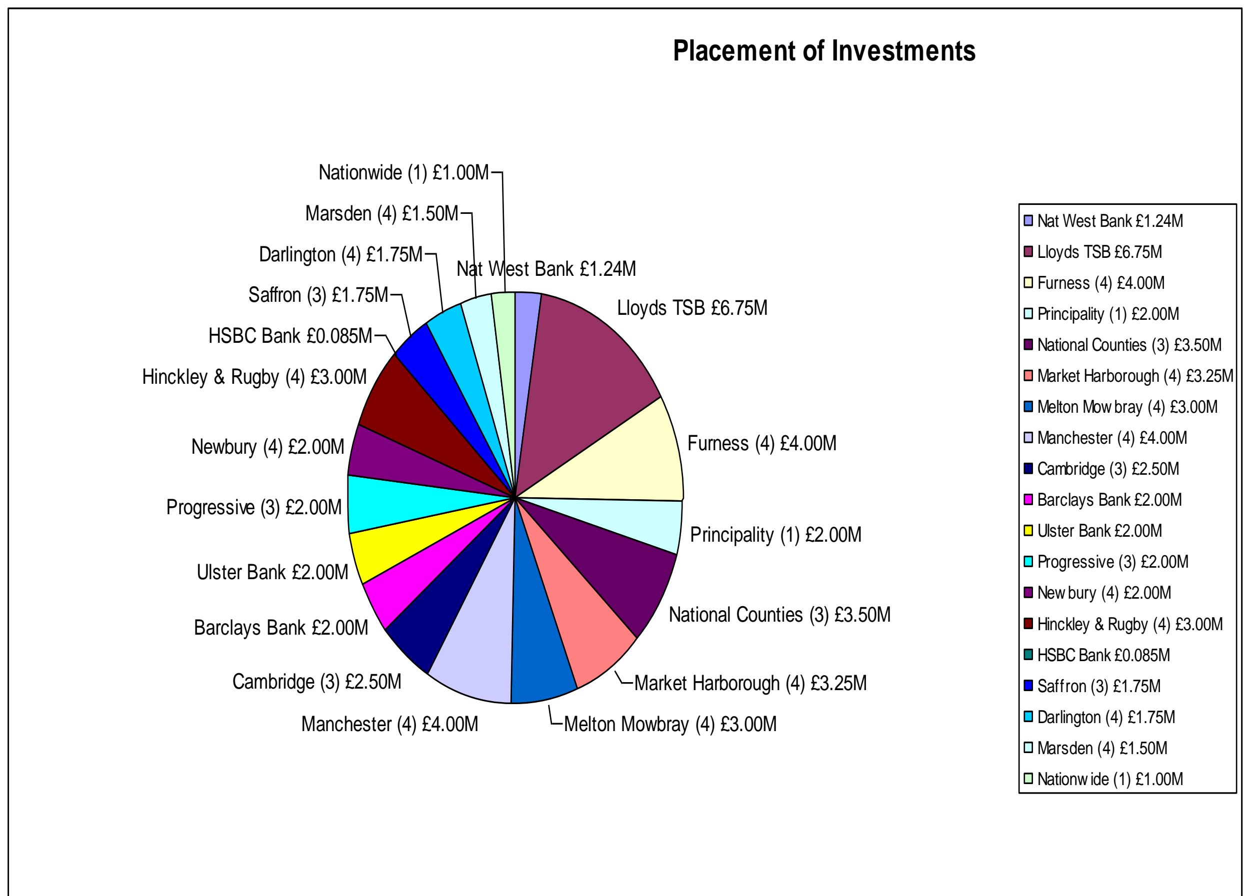
	Ave. Int. Rate Deals made in 1st Qtr %	Ave. Int. Rate Deals made in 2nd Qtr%	Ave. Int. Rate Deals made in 3rd Qtr %	Ave. Int. Rate Deals made in 4th Qtr %	Ave. Int. Rate Deals made in Year	Ave. Int. Rate for All Investments during Year %
NHDC	0.89	0.85	0.79	0.77	0.84	0.81
Sterling	2.36	2.09	1.80	1.07	1.76	2.36
Tradition	2.24	2.96	1.25	1.0	2.08	2.53

The table below summaries where investments were held at 31 March:

	Investments 31 March 2011	Investments 31 March 2012
Banks	£8.86m	£10.08m
Building Societies	£39.00m	£37.25m
Local Authorities	-	-
Total	£47.86m	£47.33m

The pie chart below shows the spread of investment balances as at 31 March 2013. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

(1) Building Societies with Assets over £4.5bn
(2) Building Societies with Assets between £2.5bn - £4.5bn
(3) Building Societies with Assets between £1.0bn - £2.5bn
(4) Building Societies with Assets between £0.3bn - £1.0bn



The average daily balance of investments was £53.99m with balances varying between £46.01m and £63.38m.

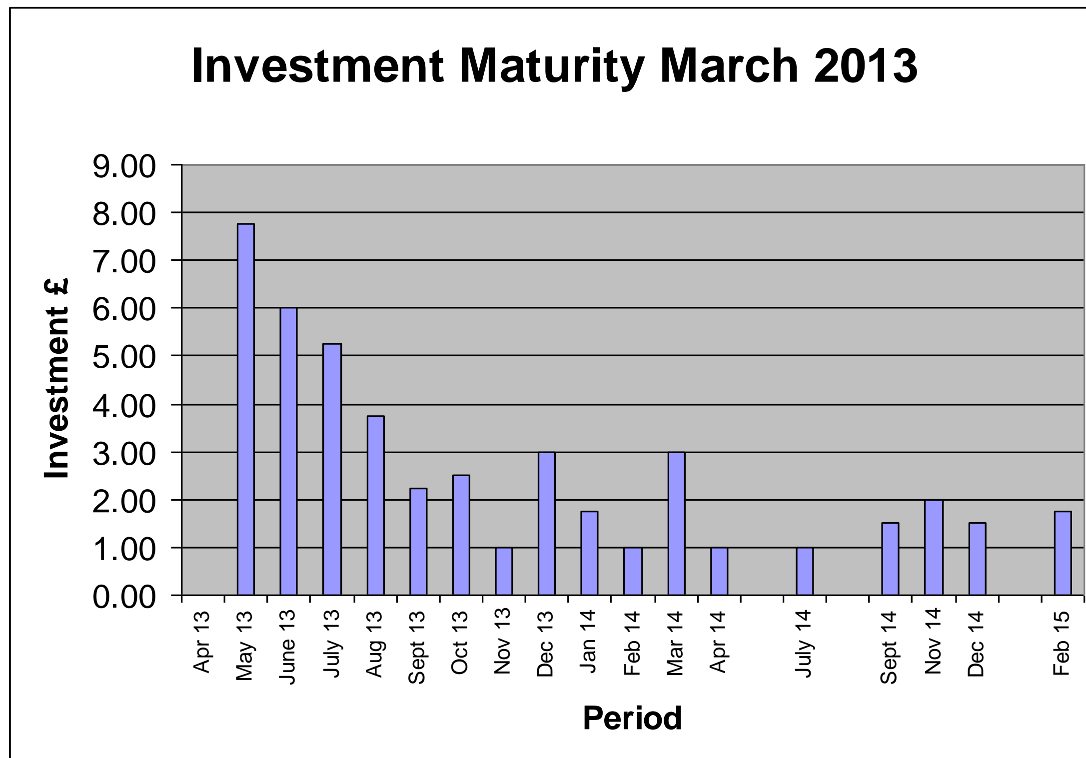
£1.184m of interest was generated from investments during the year. This is slightly more than the estimated interest of £1.183m. The original estimate of £1.092m was increased by £0.088m in the first quarter to £1.18m and adjusted by £0.004m in the second and third quarters to reflect the higher rate of interest achieved on investments made by the cash managers.

	Interest Accrued to 31 March £	Interest Received by 31 March £	Total Interest for the Year £
NHDC	2,604	62,428	65,032
Sterling	204,302	332,939	537,241
Tradition	280,230	302,032	582,262
Total	487,136	697,399	1,184,535

Investments held by the Council - the Council maintained an average balance of £7.64m of internally managed funds. The internally managed funds earned £67,000 of interest with an average rate of return of 0.88%. This compares with a working budget assumption of £0.62m.

Investments held by the Council - the Council maintained an average balance of £7.99M of internally managed funds. The internally managed funds generated £0.065M interest and earned an average rate of return of 0.81%.

The graph below shows the maturity profile of investments at 31st March 2013.



10. Other Issues

Local Authority Mortgage Scheme (LAMS)

This is a new mortgage scheme which will help first time buyers take their first step on to the housing ladder. Under the scheme, first time buyers will only need a 5% deposit to buy their first home, with local councils guaranteeing a further 20%, giving them access to lower mortgage rates.

Prospective buyers will still need to be able to afford their mortgage repayments, but will not need to save the large deposit that lenders now ask for, with 20-25% of the price of a property being common place.

The Council has deposited funds of £0.5M with both Lloyds Bank and Leeds Building Society as guarantee for 20%. This has been matched by HCC. This is a 5 year scheme which earns the Council 2.14% interest with Lloyds and 2.9% with Leeds (£10.7K and £14.5K per annum respectively). These rates are fixed for the 5 year period. The Council's funds remain with Lloyds and Leeds and will only be called on if a mortgagor defaults on their repayments. Interest earned from this arrangement will be held in a reserve outside of the General Fund and used if a default occurs. After the five year period has elapsed, the remaining balance will be transferred back to the General Fund.