Audit Committee		Agenda Item: 5
Meeting Date	25 September 2013	
Report Title	Annual Treasury Management Report 2012/13	
Cabinet Member	Cllr Duncan Dewar-Whalley	
SMT Lead	Nick Vickers, Head of Finance	
Head of Service	Nick Vickers, Head of Finance	
Lead Officer	Olga Cole, Senior Accountancy Assistant	
Key Decision	No	
Classification	Open	
Forward Plan	Reference number	

Recommendations	1. To note the actual 2012/13 prudential indicators within the report.
	2. To note the Treasury Management stewardship report for 2012/13.

1 Purpose of Report and Executive Summary

1.1 The Council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.

1.2 Treasury Management is defined as "the management of the local Council'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".

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

1.4 This report:

- is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
- details the implications of treasury decisions and transactions;

- gives details of the outturn position on treasury management transactions in 2012/13; and

- confirms compliance with Treasury limits and Prudential Indicators.

1.5 This report was submitted to Cabinet on 11 September and Council on 18 September.

2 Background

Economic Background

2.1 The global economic outlook stabilised mainly due to central banks maintaining low interest rates and expansionary monetary policy for an extended period. Equity market assets recovered sharply with the FTSE All Share registering a 17% increase over the year. This was despite economic growth in G-7 nations being either muted or disappointing and economic growth in China cooling.

2.2 In the UK the economy shrank in the first, second and fourth quarters of calendar year 2012. It was the 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012. The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy. Avoiding a 'triple-dip' recession became contingent on upbeat services sector surveys translating into sufficient economic activity to overhaul contractions in the struggling manufacturing and construction sectors.

2.3 Household financial conditions and purchasing power were constrained as wage growth remained subdued at 1.2% and was outstripped by inflation. Annual CPI dipped below 3% falling to 2.4% in June before ticking up to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.

2.4 The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases Quantative Easing (QE) in July, taking total QE to £375 billion. The possibility of a rate cut was discussed at some of Bank's Monetary Policy Committee meetings, but was not implemented as the potential drawbacks outweighed the benefits of a reduction in the Bank Rate. In the March 2013 Budget the Bank's policy was revised to include the 2% CPI inflation remit alongside the flexibility to commit to intermediate targets.

2.5 The resilience of the labour market, with the unemployment rate falling to 7.8% was the main surprise given the challenging economic backdrop. Many of the gains in employment were through an increase in self-employment and part time working.

2.6 The Chancellor largely stuck to his fiscal plans with the austerity drive extending into 2018. In March the Office for Budgetary Responsibility (OBR) halved its forecast growth for 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The government is now expected to borrow an additional £146 billion and sees gross debt rising above 100% of GDP by 2015/16. The fall in debt as a percentage of GDP, which the coalition had targeted for 2015/16 was pushed two years beyond this horizon. With the national debt metrics out of kilter with a triple A rating it was not surprising that the UK's sovereign rating was downgraded by Moody's to Aa1. The AAA status was maintained by Fitch and S&P, albeit with a Rating Watch Negative and with a Negative Outlook respectively.

2.7 The Government's Funding for Lending (FLS) initiative commenced in August 2012 which gave banks access to cheaper funding on the basis that it would then result in them passing this advantage to the wider economy. There was an improvement in the flow of credit to mortgagees, but was still below expectation for Small & Medium Enterprises.

2.8 Gilt yields ended the year lower than the start in April. By September the 2 year gilt yield had fallen to 0.06%, raising the prospect that short-dated yields could turn negative. 10 year yields fell by nearly 0.5% ending the year at 1.72%. The reduction was less pronounced at the longer end; 30-year yields ended the year at 3.11% around 25bp lower than in April. Despite the likelihood that the Debt Management Office would revise up its gilt issuance for 2012/13, there were several gilt-supportive factors: the Bank of England's continued purchases of gilts under an extended QE programme; purchases by banks, insurance companies and pension funds driven by capital requirements and the preference for safe harbour government bonds.

2.9 One direct consequence of the Funding for Lending Scheme was the sharp drop in rates at which banks borrowed from local authorities. 3-month, 6-month and 12-month LIBID rates which were 1%, 1.33% and 1.84% at the beginning of the financial year fell to 0.44%, 0.51% and 0.75% respectively. This has significantly reduced the already low returns which we can achieve.

Borrowing Requirement and Debt Management

2.10 The overall borrowing position is summarised below:

	Balance on 31/3/2012 £000's	Debt Maturing £000's	New Borrowing £000's	Balance on 31/3/2013 £000's
Capital Funding Requirement	7,170			6,298
Short Term Borrowing	0	0	0	0
Long Term Borrowing	0	0	0	0
TOTAL EXTERNAL BORROWING	0	0	0	0
Other Long Term Liabilities	1,935			1,328
TOTAL EXTERNAL DEBT	**1,935**			**1,328**

2.11 All 'borrowing' is internally financed and the Council endorsed its approach to remain free from external borrowing as part of its Budget approval in February 2013.

Investment Activity

2.12 The Council held average cash daily balances of £20 million during the year. These represented working cash balances / capital receipts, and the Council's reserves. Over recent years the Council's reserves have been increasing due to a combination of revenue budget underspends, one-off VAT rebates and one-off capital receipts.

2.13 The Communities and Local Government's (CLG's) Guidance on Investments, revised during 2009-10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance became operative on 1 April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.

2.14 The criteria applied by the Head of Finance for the approval of a counterparty are:

- a strong likelihood of Government intervention in the event of liquidity issues based on systematic importance to the UK economy (for individual financial institutions);
- credit rating. Until February 2013 the Council's minimum long term counterparty rating was A+ across all three rating agencies (Fitch, Standard & Poor's and Moody's). However, from February 2013 onwards this was amended to a minimum long-term rating of A- ;
- credit default swaps;
- share price;
- reputational Issues;
- exposure to other parts of the same banking group;
- country exposure.

2.15 The investments permissible are:

Investment Instrument (in sterling)	Limits and Maturity dates
Term deposits with :- Government backed deposits • The UK government • Gilt Edged Securities	 Unlimited amount and maturity up to 364 days Unlimited amount and maturity up to 364 days
Banking deposits • Money Market Funds	 £2m limit for AAA rated funds as defined by Fitch, Moody's and Standard and Poor (funds are held on call).

Investment Instrument (in sterling)	Limits and Maturity dates
• UK Banks and Building Societies	£4m limit per counterparty for minimum A- rated institutions as defined by Fitch, and/or equivalent ratings by Moody's and Standard & Poor's. Where counterparties belong to the same group, a £6m group limit was introduced from February 2013. Maximum period of 364 days.

2.16 The UK financial institutions used in 2012/13 were:

- Lloyds TSB Bank Plc
- Barclays Bank Plc
- HSBC Bank Plc
- Royal Bank of Scotland Plc
- National Westminster Bank
- Santander UK Plc
- Nationwide Building Society
- We also make use of Debt Management Account Deposit Facility Account with the Debt Management Office

2.17 The deposits for the year are summarised below:

Investments	Balance on 31/3/2012 £'000	Investments Made £'000	Maturities £'000	Balance on 31/03/2013 £'000	Average Rate %	Average Life (days)
Short Term Investments	15,423	149,353	(154,826)	9,950	0.51	27
Long Term Investments	3	0	0	3	3.15	undated
TOTAL INVESTMENTS	15,426	149,353	(154,826)	9,953		
Increase/ (Decrease) in Investments £'000				(5,473)		

2.18 **Liquidity:** In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds / overnight deposits / the use of call accounts.

2.19 **Yield:** The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which has a significant impact on investment income.

2.20 The Council's budgeted investment income for 2012/13 was £75,000 and the actual income received was £100,000.

2.21 The approach taken to treasury policy is to focus on security of funds. Use of reserves will be a central feature of how the Council manages further funding reductions over coming years and for funding one-off initiatives in the borough in support of the Council's over-arching objectives.

Compliance with Prudential Indicators

2.22 The Council has complied with its Prudential Indicators for 2012/13 which were set as part of the Treasury Management Strategy agreed by Council on 22 February 2012.

2.23 In Appendix I the outturn position for the year against each Prudential Indicator is set out.

Treasury Advisers

2.24 Arlingclose has been the Council's treasury advisers since May 2009. Officers of the Council meet with them regularly and high quality and timely information is received from them.

3. Proposal

3.1 Members are asked to approve the report.

4. Alternative Proposals

4.1 No alternative proposals have been considered and compliance with the CIPFA Code is mandatory.

5. Consultation Undertaken

5.1 Arlingclose have been consulted.

6. Implications

Issue	**Implications**
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	The Council's Treasury Strategy is agreed annually as part of the budget process.
Legal and Statutory	Need to comply with CLG guidance on treasury management.
Crime and Disorder	Not relevant to this report
Risk Management and Health and Safety	Not relevant to this report
Equality and Diversity	Not relevant to this report
Sustainability	Not relevant to this report

7. Appendices

7.1 Appendix I: Prudential Indicators

8. Background Papers

8.1 Treasury Strategy report, Council 20 February 2013.

8.2 Treasury Strategy report, Council 22 February 2012.

Appendix I

Prudential Indicators for 2012-13

1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Gross Debt and the Capital Financing Requirement (CFR)

This is a key indicator of prudence. In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that the net debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Head of Finance reports that the authority had no difficult meeting this requirement in 2012/13, nor is there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Gross Debt and the Capital Financing Requirement	**31/03/12 Actual £'000**	**31/03/13 Original Estimate £'000**	**31/03/2013 Actual £'000**	**31/03/14 Original Estimate £'000**	**31/03/15 Original Estimate £'000**
Gross CFR	7,170	6,326	6,298	6,104	5,727
Less: Other Long Term Liabilities	(1,935)	(1,121)	(1,328)	(1,205)	(992)
Borrowing CFR	**5,235**	**5,205**	**4,970**	**4,899**	**4,735**
Less: Existing Profile of Borrowing	0	0	0	0	0
Cumulative Maximum External Borrowing Requirement.	**5,235**	**5,205**	**4,970**	**4,899**	**4,735**

3. Actual Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	**2011/12 Actual £'000**	**2012/13 Original Estimate £'000**	**2012/13 Actual £'000**	**2013/14 Original Estimate £'000**	**2014/15 Original Estimate £'000**
Total	1,748	1,068	1,611	1,360	956

Capital expenditure will be financed as follows:

Capital Financing	2011/12 Actual £'000	2012/13 Original Estimate £'000	2012/13 Actual £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Capital receipts	97	97	64	102	0
Government Grants	1,540	906	1,168	1,178	906
Revenue contributions	111	65	118	80	50
Total Financing	**1,748**	**1,068**	**1,350**	**1,360**	**956**

4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2011/12 Actual £'000	2012/13 Original Estimate £'000	2012/13 Actual £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Total	4.87	5.09	4.76	2.99	1.91

5. Capital Financing Requirement

The Capital Financing Requirement 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 it's financing.

Capital Financing Requirement	2011/12 Actual £'000	2012/13 Original Estimate £'000	2012/13 Actual £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Total CFR	7,170	6,326	6,298	6,104	5,727

6. Actual External Debt

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This indictor is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2013	£'000
Borrowing	0
Other Long-term Liabilities	1,328
Total	**1,328**

7. Incremental Impact of Capital Investment Decisions on Council Tax

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2011/12 Actual £'000	2012/13 Original Estimate £'000	2012/13 Actual £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Increase / (Decrease) in Band D Council Tax	(0.14)	(0.14)	0.05	(0.01)	(0.01)

8. 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	2012/13 Original Estimate £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Borrowing	5,000	5,000	5,000
Other Long-term Liabilities	2,000	2,000	2,000
Total	**7,000**	**7,000**	**7,000**

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.

Operational Boundary for External Debt	2012/13 Original Estimate £'000	2013/14 Original Estimate £'000	2014/15 Original Estimate £'000
Borrowing	4,000	2,000	2,000
Other Long-term Liabilities	1,121	1,205	992
Total	**5,121**	**3,205**	**2,992**

The Head of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2012/13.

9. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council has adopted the principles of best practise.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 24 July 2002.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

10. 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. This Council calculates these limits on net principal outstanding sums (i.e. fixed rate debt net of fixed rate investments).

Upper Limits	2012/13 Original Estimate %	2012/13 Actual %	2013/14 Original Estimate %	2014/15 Original Estimate %
Interest on fixed rate borrowing	100	0	100	100
Interest on fixed rate investments	-100	-48	-100	-100
Upper Limit for Fixed Interest Rate Exposure	**0**	**-48**	**0**	**0**
Interest on variable rate borrowing	100	0	100	100
Interest on variable rate investments	-100	-52	-100	-100
Upper Limit for Variable Interest Rate Exposure	**0**	**-52**	**0**	**0**

As the Council has no borrowing, these calculations have resulted in a negative figure.

11. 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. It 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.

Maturity structure of fixed rate borrowing	Existing level at 31/03/13 %	Lower Limit for 2013/14 %	Upper Limit for 2013/14 %
Under 12 months	0	0	100
12 months and within 24 months	0	0	0

Maturity structure of fixed rate borrowing	Existing level at 31/03/13 %	Lower Limit for 2013/14 %	Upper Limit for 2013/14 %
24 months and within 5 years	0	0	0
5 years and within 10 years	0	0	0
10 years and above	0	0	0

The Council does not have any external borrowing for capital purposes, and did not need to borrow for cash flow purposes during 2012/13.

12. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent and its sovereign (minimum AA+ or equivalent for non-UK sovereigns):
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indictors of creditworthiness are considered in relative rather than absolute terms.

The Head of Finance confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

13. Upper Limit for total principal sums invested over 364 days

There are currently no proposals for the Council to invest sums for periods longer than 364 days.

14. Investment Benchmarking

Average Actual Return on Investments 2012/13	**Original Estimate Return on Investments 2012/13**	**Average Bank Rate 2012/13**	**Average 7 day LIBID Rate 2012/13**
0.51%	0.64%	0.50%	0.49%