

# REPORT TO GOVERNANCE AND AUDIT COMMITTEE

**REPORT OF: HEAD OF FINANCE**

**REPORT NO: HOF 238**

**DATE: 27th June 2013**

<b>TITLE:</b>	<b>Annual Report on Treasury Management Activity 2012/13</b>	
<b>KEY DECISION OR POLICY FRAMEWORK PROPOSAL:</b>	None	
<b>PORTFOLIO HOLDER: NAME AND DESIGNATION:</b>	Councillor Mike Taylor Well Run Council Portfolio Holder	
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<b>INITIAL IMPACT ASSESSMENT:</b>	Carried out and Referred to in paragraph (7) below:  N/A	Full impact assessment Required:  No
<b>Equality and Diversity</b>		
<b>FREEDOM OF INFORMATION ACT:</b>	This report is publicly available via the Your Council and Democracy link on the Council's website: <a href="http://www.southkesteven.gov.uk">www.southkesteven.gov.uk</a>	
<b>BACKGROUND PAPERS</b>	HOF189 – Budget Council 2012/13, HOF212 – Treasury Management Mid-year Review 2012/13 and HOF214 – Treasury Management Strategy Update 2012/13.  The above reports can be located by putting their reference number in the search section of the committee website via the link below: <a href="http://moderngov.southkesteven.gov.uk/ieDocSearch.aspx?bcr=1">http://moderngov.southkesteven.gov.uk/ieDocSearch.aspx?bcr=1</a>	

## 1. RECOMMENDATION

Members are asked to note and approve the contents of the annual report on Treasury Management Activity for 2012/13.

## **2. PURPOSE OF THE REPORT**

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 Council adhered to the suggested minimum reporting requirements as members received the following reports:

- an annual treasury strategy in advance of the year (Council 1<sup>st</sup> March 2012)
- a mid-year (minimum) treasury update report (Governance and Audit Committee 6<sup>th</sup> December 2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

Governance and Audit Committee has delegated powers from Council to deal with matters relating to the Councils Treasury Management activities. Specifically it has the responsibility to monitor, review and amend as appropriate the Council approved Treasury Management Strategy during the course of the financial year. During the course of 2012/13 the committee has exercised its delegated powers by reviewing and approving an updated Treasury Management Strategy at its meeting on 6 December 2012 (HOF214).

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This 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 members.

## **3. DETAILS OF REPORT**

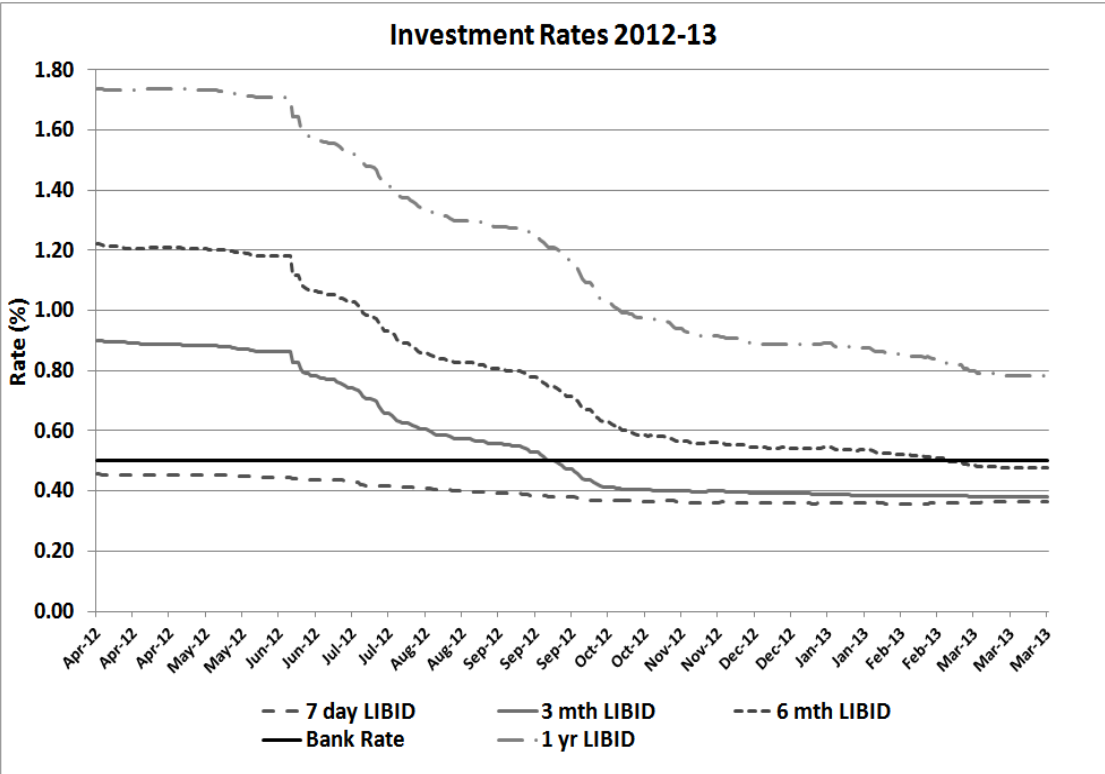
### The Economy

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 2012. However, economic growth in the UK was disappointing during the year under the weight of the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market – the European Union (EU). 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. This came to fruition in February 2013 when Moody's downgraded the UK's AAA credit rating one notch to AA+. There was little reaction in the financial markets, as this had been widely anticipated. Fitch put its AAA rating on negative watch in March. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity

plan timeframe. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing of £50bn in July to a total of £375bn. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation fell from 3% at the start of the year to end at 2.8% in March, with a fall back to below 2% pushed back to quarter 1 2016. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experience crisis which were met with bailouts after difficult and fraught negotiations.

Interest Rates

The 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.



During the year the Council experienced short term fixed term investment rates ranging from 1.10% to 3.25%.

## Treasury Position at 31 March 2013

A summary of the Councils position as at the 31<sup>st</sup> March 2013 was as follows:

Actual borrowing position	31 March 2012		31 March 2013	
	Principal	Average Rate	Principal	Average Rate
<b>Fixed Interest Rate Debt</b>	<b>£124.152m</b>	<b>2.960%</b>	<b>£120.930m</b>	<b>2.970%</b>
Capital Financing Requirement	£128.707m		£128.293m	
Over/(Under) borrowing	(£4.555m)		(£7.363m)	
Investment position	31 March 2012		31 March 2013	
	Principal	Average Rate	Principal	Average Rate
<b>Fixed Interest Investments</b>	<b>£26.400 m</b>	<b>1.33%</b>	<b>£26.000 m</b>	<b>1.72%</b>
<b>Variable Interest Investments</b>	<b>£6.605m</b>	<b>0.76%</b>	<b>£7.375 m</b>	<b>0.71%</b>
Total Investments	£33.005m	1.24%	£33.375m	1.17%
Net borrowing position	£91.147m		£87.555m	

## The Strategy Agreed for 2012/13

The strategy for 2012/13 was approved by Council on 1<sup>st</sup> March 2012. A key element of the Treasury Management Strategy report focuses on the Annual Investment Strategy which was updated in conjunction with advice from the Councils Treasury Management advisors on the approach to managing the Councils investments. This section was updated to take into account more information sources to greater assist in selecting counterparties to invest with based on a creditworthiness methodology.

The aim of the updated strategy was to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk whilst providing security of investment and minimisation of risk

These changes were incorporated into an amended Treasury Management Strategy which was approved by Governance and Audit Committee on 6<sup>th</sup> December 2012.

## Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR) and is summarised below. The Council has ensured borrowing levels to fund capital expenditure have remained with the set levels.

	<b>31 March 2012 Actual</b>	<b>31 March 2013 Estimated</b>	<b>31 March 2013 Actual</b>
CFR General Fund (£m)	<b>£4.534m</b>	<b>£4.476m</b>	<b>£4.482m</b>
CFR HRA (£m)	<b>£124.173m</b>	<b>£124.480m</b>	<b>£123.811m</b>
Total CFR	<b>£128.707m</b>	<b>£128.956m</b>	<b>£128.293m</b>

### Actual debt management activity during 2012/13

**Long Term Borrowing** – There was no additional long term borrowing in 2012/13. The long term debt outstanding as at 31 March 2013 was £119.930m of which £118.430 is in relation to the HRA self financing payment and £1.5m PWLB (Public Works Loan Boards) loans.

**Short-Term/Temporary Borrowing** – The short term borrowing that was outstanding as at 31 March 2013 was £1.0m.

**Debt 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.

### Investment Outturn for 2012/13

**Investment Policy** – The Council's investment policy is governed by Communities for Local Government (CLG) Guidance, which has been implemented in the annual investment strategy approved on 1<sup>st</sup> March 2012 and subsequently revised on 6<sup>th</sup> December 2012. The investment activity during the year complied with the approved strategy.

As at 31 March 2013 the Council held only short term investments of £33.375 million which is compliant with the Council's policy to hold not more than 25% of investments as long term.

**Short Term Fixed Deposits** – In the year short term fixed deposits were made on 9 separate occasions for amounts ranging from £1 million to £4 million. £26 million of deposits were being lent out as at 31 March 2013. There was also £7.375m being invested in instant access deposit accounts including Money Market Funds.

**Long Term Fixed Deposits** – In the year there were no long term fixed deposits made.

The average rate of our portfolio is 1.17%, compared with a budget assumption of average investment balances of £29.706m at 1.5% investment return. Whilst overall the performance rates were lower due to the depressed markets the actual amount of investment income generated was £649k compared to the budget figure of £502k. This is due to the average investment balance being higher than anticipated and it was only in the 4<sup>th</sup> quarter that the average interest rate dropped due to the maturity of some investments with higher interest rates ranging from 1.35% to 3.10%.

Performance Indicators set for 2012/13

This service has set the following performance indicators:

- Debt – Average rate movement year on year
  - 2011/12 of 2.960% compared with 2012/13 average rate of 2.970%
- Investments – Internal returns above the 7 day LIBID rate
  - The Council exceeded the target 7 day LIBID rate of 0.39% through achieving average returns on short term deposits of 1.17%.

Appendix 1 provides more details of the prudential and treasury indicators for 2012/13

As part of role performed by our treasury advisors we are also provided with benchmarking comparative information across all their clients which helps the council understand how its investment portfolio is performing in relation to others. The table below shows for each quarter analysis our average weight of return was higher when compared to other district councils along with managing the risk. This reflects the positive work undertaken within the team to maximise our investment returns whilst balancing the exposure to risk.

<b>Quarter ending</b>	<b>SK WARoR*</b>	<b>District WARoR*</b>	<b>SK WARR**</b>	<b>District WARR**</b>
Q1 – June 2012	1.59%	1.33%	2.7%	3.4%
Q2 – Sept 2012	1.79%	1.34%	2.6%	3.4%
Q3 – Dec 2012	1.81%	1.22%	2.7%	3.1%
Q4 – Mar 2013	1.65%	1.34%	3.1%	3.3%

\*WARoR – average rate of return

\*\*WARR – average rate of risk

## Expected Future Activity

The treasury advisors view is for the bank rate to remain at 0.5% until March 2015 when it is anticipated that it will increase to 0.75%. Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during 2013/14 as investor fears and confidence, ebb and flow, between favouring more risky assets i.e., equities, and safer bonds. Equity prices have staged an ongoing rise since mid 2012. Correspondingly, there had been a trend of a fall in bond prices and a rise in bond yields, until the Cyprus crisis reversed this trend in late February.

The overall balance of risks to economic recovery in the UK remains weighted to the downside. Our advisors believe that the longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. However, near-term, the prospect of further QE (Quantitative Easing) is likely to keep gilt yields lower than they are likely to view the beneficial effects of further QE as being exhausted, could lead to the reversal of this effect.

Given the week outlook of economic growth, the prospects for any increase in Bank rate before 2015 are very limited indeed, and the first increase could be even further delayed if growth disappoints.

Locally an updated Treasury Management Strategy for 2013/14 was presented to Council on the 1<sup>st</sup> March 2013 taking into consideration the current and future economic climate, whilst maintain the balance between Risk and Returns.

It its prudent to bring to members attention that some of the rates the Council has been achieving are based on deals placed in excess of 12 months ago which have attracted preferential rates at the time of placing these investments. As these mature we are seeing current investments rates being offered at much lower rate of return coupled with base rate remaining low will mean the income levels for 2013/14 will be lower. This is reflected in the budgeted level of investment income of £565k compared to the £649k achieved in 2012/13.

## Summary

Despite a very challenging year given the continued nature of the economic climate the Council's Treasury Management functions have operated effectively during 2012/13 and have successfully achieved the following;

- Repayment of principals have been secured in all deposits;
- Council's cash liquidity requirement has been met throughout the financial year;
- Investment income levels have been higher than predicted;
- Complied with all prudential indicators set for 2012/13;
- Robust management of the Council's debt position;
- Performance Indicators set for 2012/13 have been achieved.
- Benchmarking information shows we are achieving a higher average weight of return compared to the group average.

**4. OTHER OPTIONS CONSIDERED**

None

**5. RESOURCE IMPLICATIONS**

These are stated in the report.

**6. RISK AND MITIGATION (INCLUDING HEALTH & SAFETY AND DATA QUALITY)**

Risk has been considered as part of this report and no exceptional / high risks have been identified

**7. ISSUES ARISING FROM EQUALITY IMPACT ASSESSMENT**

None

**8. CRIME AND DISORDER IMPLICATIONS**

None

**9. COMMENTS OF FINANCIAL SERVICES**

These are included in the report.

**10. COMMENTS OF LEGAL AND DEMOCRATIC SERVICES**

This report provides details of the Councils performance in respect of Treasury Management against policy set out as part of the Budget and Policy Framework. Members should note the performance and scrutinise any elements to assist the role of the Governance and Audit Committee in its review of the Treasury Management Strategy.

**11. COMMENTS OF OTHER RELEVANT SERVICE MANAGER**

None

**12. APPENDICES:**

Appendix 1 – Prudential and Treasury Indicators 2012/13

## APPENDIX 1 – PRUDENTIAL AND TREASURY INDICATORS 2012/13

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:

Actual prudential and treasury indicators	2011/12 Actual £000	2012/13 Estimated £000	2012/13 Actual £000
<b>Capital expenditure</b>			
• General Fund	£2.639m	£6.477m	£5.534m
• HRA	£4.717m	£4.411m	£4.835m
• Total	£7.356m	£10.888m	£10.369m
<b>Capital Financing Requirement:</b>			
• General Fund	£4.534m	£4.476m	£4.482m
• HRA	£2.159m	£124.480m	£123.811m
• HRA due to housing finance reform ( <i>if applicable</i> )	£122.014m	£0.000m	£0.000m
• Total	£128.707m	£128.956m	£128.293m
<b>Net borrowing</b>	£91.147m	£95.148m	£87.555m
<b>External debt</b>	£124.152m	£122.484m	£120.930m
<b>Investments</b>			
• Longer than 1 year	£3.000m	n/a	£0.000m
• Under 1 year	£30.005m	n/a	£33.375m
• Total	£33.005m	n/a	£33.375m

**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 2012/13 and 2013/14 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2012/13.

**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.

	2011/12 post housing finance reform	2012/13
Authorised limit	£148.0m	£148.0m
Maximum gross borrowing position	£145.5m	£145.5m
Operational boundary	£133.0m	£133.0m
Average gross borrowing position	n/a	n/a

Ratio of financing costs to net revenue stream	31 March.2012 actual	2012/13 original limits	31 March.2013 Actual
General Fund	(0.51%)	(1.04%)	(2.87%)
HRA	(0.60%)	20.95%	15.23%

TABLE 1	31 March 2012 Principal	Rate/ Return	31 March 2013 Principal	Rate/ Return
Total debt	£124.152m	2.960%	£120.930m	2.970%
CFR	£128.707m		£128.293m	
Over/ (under) borrowing	(£4.555m)		(£7.363m)	
Total investments	£33.005m	1.24%	£33.375m	1.17%
Net debt	£91.147m		£87.555m	

The maturity structure of the debt portfolio was as follows:

	31 March.2012 Actual	31 March.2013 Actual
Under 12 months	£0.000m	£1.000m
12 months and within 24 months	£1.000m	£0.500m
24 months and within 5 years	£0.500m	£1.000m
5 years and within 10 years	£26.000m	£25.000m
10 years and above	£96.652m	£93.430m

The exposure to fixed and variable rates was as follows:

	31 March 2012 Actual	31 March 2013 Actual
Fixed rate (principal or interest)	£26.400m	£26.000m
Variable rate (principal or interest)	£6.605m	£7.375m