BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 8**

Resources Committee **17 July 2013**

Report of Head of Finance

TREASURY MANAGEMENT - ANNUAL REPORT 2012-13

1 Purpose of Report

1.1 The purpose of this report is to present the annual report of treasury management activity for 2012-13. The treasury management function contributes towards the Council's overall objective of the efficient use of resources.

2 Executive Summary

To inform Members of the outturn position in respect of the application of the treasury management strategy for 2012-13 and seek member approval.

3 Appendices

1. Prudential indicators
2. Policy – strategy for 2012-13
3. Economy Updates
4. Credit worthiness Policy Amendments for approval

4 The committee is invited to:

4.1 **RESOLVE to note the review of treasury management activities in 2012-13: and**

4.2 **RECOMMEND the incorporation of the amended creditworthiness policy set out in Appendix 4 in the report in the Council's Annual Investment Strategy**

5 Background

5.1 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).

5.2 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 1st March 2012)
- a mid-year treasury update report (Council 20th November 2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 This Council also 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 Resources Committee before they were reported to the full Council.

5.5 The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 1st March 2012. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

5.6 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

5.7 **Investments held by the Council**- the Council maintained an average balance of £28m of internally managed funds that earned an average rate of return of 2.15% which compares with a budget assumption of £28.5m investment balances earning an average rate of 1.9%.

6 Discussion

Investments

6.1 At 31st March 2013 the Council held the following investments.

Money Market transactions:

- Short term investments for periods of less than 1 year:

Investments	Range of Interest Rates Receivable %	Total Investment at 31st March 2012 £000	Total Investment at 31st March 2013 £000
Building Societies	0.8% - 2.3%	8,023	11,093
Banks	0.75% - 3%	12,043	11,194
Other Local Authorities	-	-	-
Total		**20,066**	**22,287**

- Long term investments for periods greater than 1 year:

Long Term Investments	Period	Range of Interest Rates Receivable %	Total Investment at 31st March 2012 £000	Total Investment at 31st March 2013 £000
Building Societies	1–3 years		5,146	2,045
Banks	1–5 years		4,435	3,049
Other Local Authorities		-	-	-
Total			**9,581**	**5,094**

6.2 Total investments for the year were therefore:

	31st March 2012	31st March 2013
Short Term Investments	20,066	22,287
Long Term investments	9,581	5,094
Total investments	29,647	27,381

The year on year variance for money market transactions is therefore £2.266m which is primarily due to capital spend in the year of £3.39m offset by capital receipts of £0.7m. The balance is accounted for by revenue activity of £1.2m used in support of budget funding and changes relating to the level of debtors and creditors at year end.

The average rate of interest earned on investments during the year was 2.15% (2011-12 1.85%).

6.3 Investment Trusts:

At the 31st March 2013 the Council held long term investments of share capital in the British Assets Trust investment with the following comparative values:

	31st March 2012 £000	31st March 2013 £000
Purchase Price	157	157
Market Value	317	332

6.4 The Authority's statutory accounts are required to disclose the fair value of investments. The difference in the value of the British Assets Trust Investment when compared to the historical cost, amounted to an increase in value of £15k (in 2011-12 there was a decrease of £17k), due to a rise in the share price to £1.33. The increase in value (£15k) has been debited to the Available for Sale Financial Instruments Reserve.

Borrowing

6.5 The Authority became debt free in December 2002, consequently the Authority has no outstanding borrowings (other than those inherent in Finance Leases).

Interest Received

6.6 Details of interest received during 2012-13 compared with the estimate are as follows:

	2012-13 Original Estimate £	**2012-13 Actual £**	**Variance Original Est. to Actual £**
Amount received:			
Investment income	541,000	602,035	61,035
Dividends	3,600	15,280	11,680
Other (incl. bank interest)	-	-	
Total	**544,600**	**617,305**	**72,705**

The variance in respect of Investment income is as a result of interest rates easing slightly from an assumed average rate of 1.9% to an actual average rate of 2.15%, accompanied by a proactive management of investments.

Future Prospects

6.7 Clearly, future prospects for generating investment income to support the annual revenue budget continue to be dependent on the level of balances and future movement in the level of interest rates. However, with balances reducing and interest rates continuing to be at historically low levels this again highlights the continuing need for increased treasury management skills internally and also external professional advice and support to assist in maximising future investment returns.

6.8 Interest rates reduced quite dramatically towards the end of 2013/14 (see appendix 3) and recent investment activity by the Council has highlighted the fact that the current market for investments with both banks and building societies is limited with the knock on effect that interest rates being offered are being reduced even further. This has lead to additional budget pressure in the current year of approximately £270k.

6.9 Revision to the Credit Worthiness Policy contained in the previously agreed Investment Strategy.

The Council agreed its Annual Investment strategy in February 2013. This contained a Credit Worthiness policy that governs the level of investments the Council makes with individual financial institutions.

In light of the reducing returns available and the pressures on the Revenue budget the committee is asked to agree to recommend to Council a revised Credit Worthiness policy to provide a more flexible approach to investments and to hopefully increase the return on investments made.

The changes would be to the previous report section 6.9.8 and the Appendix on credit and Counterparty risk management..

An extract from the original report and the proposed changes are shown in appendix 4

7 Legal Powers

7.1 Local Government Act 2003.

8 Financial and Value For Money Implications

8.1 As shown in the report.

9 Risk Analysis

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Losses on invested funds	Potentially significant to the Council	Unlikely	Treasury management strategy
Fluctuations in interest rates	Beneficial if interest rates rise, adverse when interest rates fall	Investment income rates continue to be at historically low levels	Use of external advisors to determine best strategy

10 Implications for Resources

10.1 As shown in the report.

11 Implications for Stronger and Safer Communities

11.1 No direct implications.

12 Implications for Equalities

12.1 No direct implications.

13 Author and Contact Officer

A S King. Project Accountant.

14 Consultees

L Elliott, Head of Finance.
H Essom Technical Accountant

15 Background Papers

The Prudential indicators and Treasury Management Report 2012-13 – Resources committee 22nd February 2012.
2012-13 Final Accounts working papers
Information received from Sector Treasury Services Ltd., the Council's Treasury Management advisers.

Appendix 1

Prudential indicators for the year 2012/13

The Capital Prudential Indicators 2012/13 – 2014/15

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

Capital Expenditure. This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure **£m**	**2010/11** **Actual**	**2011/12** **Estimate**	**2012/13** **Estimate**	**2013/14** **Estimate**	**2014/15** **Estimate**
Total	1.952	3.921	3.546	3.047	2.957

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has two finance leases which effectively include borrowing instruments:

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure **£m**	**2010/11** **Actual**	**2011/12** **Estimate**	**2012/13** **Estimate**	**2013/14** **Estimate**	**2014/15** **Estimate**
Total	1.952	3.921	3.546	3.047	2.957
Financed by:					
Capital generated in year receipts	1.708	1.400	1.640	1.620	1.120
Capital grants	0.244	0.320	0.478	0.547	0.457
Capital receipts reserves		2.201	1.428	0.880	1.380
Revenue					
Net financing need for the year	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.476m of such schemes within the CFR. The Council is asked to approve the CFR projections below:

£m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Financing Requirement					
CFR – non housing					
Total CFR	-8.213	-8.371	-8.540	-8.683	-8.684
Movement in CFR	-0.147	-0.158	-0.169	-0.143	-0.001

Movement in CFR represented by					
Net financing need for the year (above)					
Less MRP/VRP and other financing movements	-0.147	-0.158	-0.169	-0.143	-0.001
Movement in CFR	**-0.147**	**-0.158**	**-0.169**	**-0.143**	**-0.001**

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of Finance Leases.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Fund balances / reserves	7.655	7.225	5.868	5.735	5.735
Capital receipts	15.929	13.728	12.300	11.420	10.040
Provisions	0.920	-	-	-	-
Other	0.628	0.628	0.628	0.628	0.628
Total core funds	**25.132**	**21.581**	**18.796**	**17.783**	**16.403**
Working capital*	2.303	2.303	2.303	2.303	2.303
Under/over borrowing	8.689	8.689	8.688	8.688	8.688
Expected investments	**36.124**	**32.573**	**29.787**	**28.774**	**27.394**

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Actual and estimates of the ratio of financing costs to 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.

%	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Non-HRA	-4.48	-4.94	-4.14	-4.79	-6.74

The estimates of financing costs include current commitments and the proposals in this budget report.

Estimates of the incremental impact of capital investment decisions on council tax. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Council tax - band D	£0.71	£1.34	£1.08	£0.93	£0.96

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
External Debt					
Debt at 1 April	-	-	-	-	-
Expected change in Debt	-	-	-	-	-
Other long-term liabilities (OLTL)	- 0.622	- 0.476	- 0.318	- 0.148	- 0.005
Expected change in OLTL	0.146	0.158	0.170	0.143	0.001
Actual debt at 31 March	**- 0.476**	**- 0.318**	**- 0.148**	**-0.005**	**- 0.004**
The Capital Financing Requirement	-8.213	-8.371	-8.540	-8.683	-8.684
Under borrowing	**-8.689**	**-8.689**	**-8.688**	**-8.688**	**-8.688**
Total investments at 31 March					
Investments	**36.124**	**32.573**	**29.787**	**28.774**	**27.394**
Investment change	-	-3.551	-2.786	-1.013	-1.380
Net Debt	**-**	**-**	**-**	**-**	**-**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Debt	0.050	0.050	0.050	0.050
Other long term liabilities	0.476	0.317	0.148	0.005
Total	0.526	0.367	0.198	0.055

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Debt	5.050	5.050	5.050	5.050
Other long term liabilities	0.476	0.317	0.148	0.005
Total	5.526	5.367	5.198	5.055

The Strategy for 2012/13

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 counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

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.

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. 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. 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.

The Economy and Interest Rates

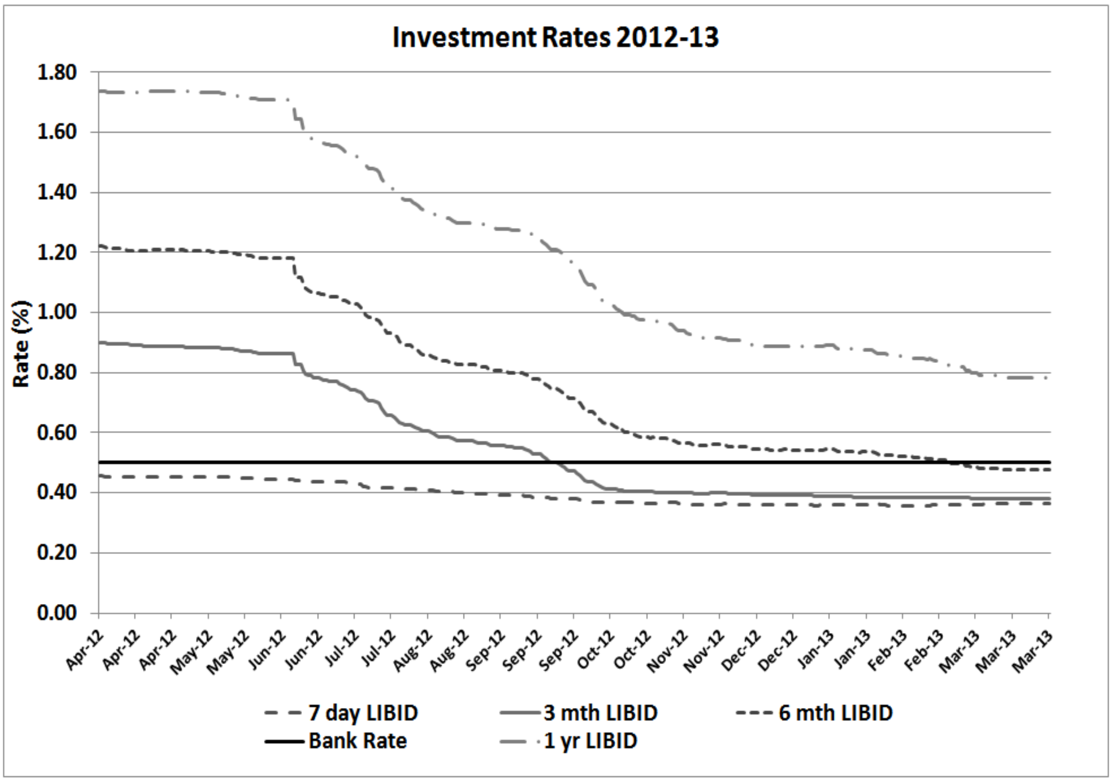
The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 2014. However, economic growth in the UK was disappointing during the year due to 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. 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. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £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 experiencing crises which were met with bailouts after difficult and fraught negotiations.

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 very low levels.

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. This has resulted in some return of confidence to move away from only very short term investing.

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.


Investment Rates 2012-13
Rate (%)
1.80
1.60
1.40
1.20
1.00
0.80
0.60
0.40
0.20
0.00
Apr-12
Apr-12
Apr-12
May-12
May-12
Jun-12
Jun-12
Jul-12
Jul-12
Aug-12
Aug-12
Sep-12
Sep-12
Sep-12
Oct-12
Oct-12
Nov-12
Nov-12
Dec-12
Dec-12
Jan-13
Jan-13
Feb-13
Feb-13
Mar-13
Mar-13
Mar-13
7 day LIBID
3 mth LIBID
6 mth LIBID
Bank Rate
1 yr LIBID

Update to the Annual Investment Strategy 2013-14

Credit worthiness Policy Amendment 2013/14 (all other aspects of the Strategy remain the same)

Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 Max Investment level £3m- good credit quality – the Council will only use banks which:
    - i. are UK banks; and/or
    - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA-

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

i. Short term – *F1 (Fitch or equivalent)*
ii. Long term – *A- (Fitch or equivalent)*

- Banks 2 Maximum Investment level £5m– Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own bankers for transactional purposes **if the bank falls below the above criteria,** although in this case balances will be minimised in both monetary size and time.
  - Building societies 1 - The Council will *use* all societies which have assets in excess of *:*

  Over £1bn Maximum Investment level £3m

  Over £500m Maximum Investment Level £1m

- Building societies 2 -Nationwide Building Society. As the Nationwide Building society currently has over £196bn of assets it is considered separately from other building societies and as such a maximum investment level of £5m will be applied due to its size.
- Money market funds
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Min Fitch Long term Rating (or equivalent)	Money Limit	Time Limit

Banks 1	***A-***	**£3m**	**2yrs**
Banks 2 – part nationalised **Nationwide Building Society**	**N/A**	**£5m**	**2yrs**
Building Societies 1 Assets >£1bn	**N/A**	**£3m**	**18 Months**
Building Societies 1 Assets >£500m <£1bn	**N/A**	**£1m**	**1 year**
DMADF	**AA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£3m**	**1yr**
Money market funds	**AAA**	**£3m**	**liquid**