Gedling Borough Council

Report to Cabinet

Subject: **Annual Treasury Activity Report 2012/13**

Date: 6 June 2013

Author: Corporate Director (Chief Financial Officer)

Wards Affected

Not applicable

Purpose

To inform members of the outturn in respect of the 2012/13 Prudential Code Indicators, and to advise members of the outturn on treasury activity, both as required by the Treasury Management Strategy.

Key Decision

This is not a Key Decision

Background

1.1 The 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).

1.2 During 2012/13 the minimum reporting requirement was that the Full Council should receive the following reports:

- An annual treasury strategy in advance of the year.
- A mid-year treasury update report - members will note that, as in previous years and in accordance with best practice, quarterly monitoring reports for treasury activity have been provided, and that this exceeds the minimum requirements.
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.3 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.

Further information on the subject of this report is available from Alison Ball, Financial Services Manager, on (0115) 901 3980 or Sue Healey, Principal Accountant, on 0115 901 3856

1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports, by submitting them to Cabinet before they are reported to the full Council.

1.5 Member training on treasury management issues is undertaken by the Chief Financial Officer as needed, in order to support members' scrutiny role.

Proposal

2.1 <u>The economy and interest rates in 2012/13</u>

2.1.1 The financial year 2012/13 continued the challenging investment environment of previous years, with low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start rising gently, 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. Key to retaining this rating would 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 (QE) by £50bn in July 2012 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 of 2016. The EU sovereign debt crisis was ongoing during the year, with first Greece and then Cyprus experiencing crises which were met with bailouts after fraught negotiations.

2.1.2 Gilt yields fluctuated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into and out of UK gilts. This, together with a further £50bn of QE in July 2012 and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year, at historically low levels.

2.1.3 The Funding for Lending Scheme, announced in July 2012, 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 improved after the European Central Bank 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 investment.

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

2.2 The borrowing requirement

The Council's underlying need to borrow to finance its capital expenditure is termed the capital financing requirement (CFR).

	1 April 2012 (Actual)	Original Estimate 31 March 2013	31 March 2013 (Actual)
	£m	£m	£m
Capital financing requirement (CFR)	**10.197**	**13.095**	**11.436**

The variance is mainly due to slippage on the capital programme, and to some savings on capital programme items funded by borrowing.

2.3 The overall treasury position at 31 March 2013

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

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

	31 March 2012	31 March 2013
	£m	£m
Total external debt	10.812	11.412
Capital financing requirement (CFR)	10.197	11.436
Over/(under) borrowing to CFR	**0.615**	**(0.024)**
Total external debt	10.812	11.412
Total investments	(8.500)	(8.260)
Net debt	**2.312**	**3.152**

2.4 The treasury strategy for 2012/13

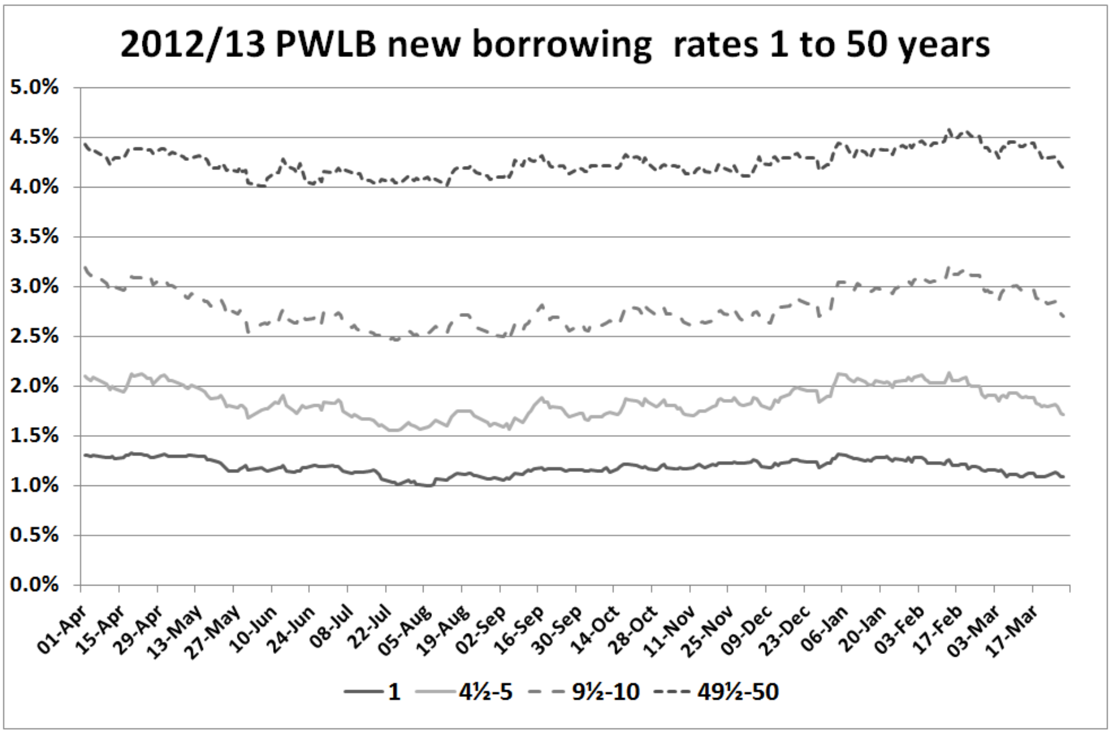
2.4.1 The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate, with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued 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.

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

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

2.5 Borrowing rates in 2012/13

PWLB rates remained close to historically low levels during the year as demonstrated in the graph below.



2.6 The borrowing outturn for 2012/13

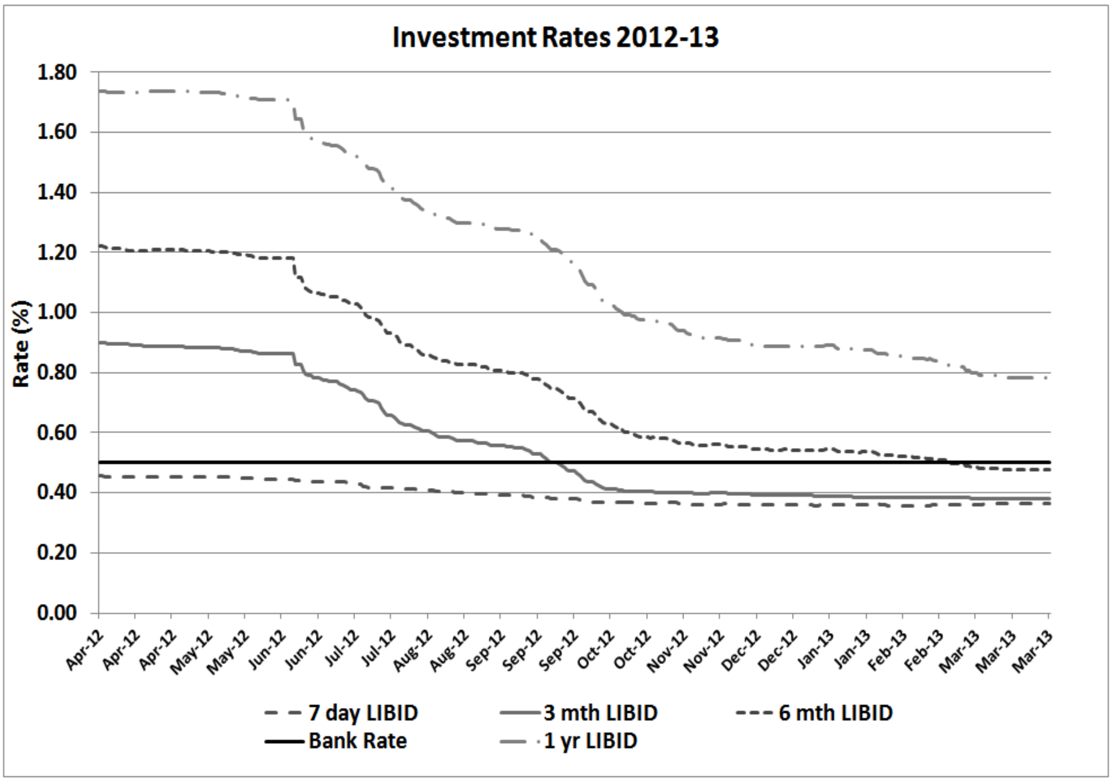
2.6.1 No new long term debt was taken during 2012/13. A small number of temporary loans were arranged during the year for cashflow purposes, but the average duration of these was only 5 days, and the average rate just 0.32%. When compared to the average 7 day LIBOR of 0.52% at 28 March 2013, this represents a saving of 0.2%.

2.6.2 No rescheduling of PWLB debt was undertaken during the year since the average 1% differential between PWLB new borrowing rates and premature repayment rates made such action non-viable.

2.7 Investment rates in 2012/13

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

The graph below demonstrates investment rates during the year:



2.8 <u>The investment outturn for 2012/13</u>

2.8.1 The Council's investment policy is governed by CLG guidance, and this was implemented by the annual investment strategy approved by the Council on 5 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).

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

2.8.3 All the Council's investments are internally managed. The equated investment rate achieved for 2012/13 was 1.89%, which outperformed the average uncompounded 7-day LIBID rate of 0.39% by 1.5%, and the average uncompounded 3-month LIBID rate of 0.57% by 1.32%.

The original estimate for investment interest for 2012/13 was £119,800, based on equated investment of £8m, at a rate of 1.5%. The outturn exceeded this estimate by £109,000. As indicated above, the equated rate achieved for 2012/13 was 1.89%, and this extra 0.39% has contributed £31,000 of additional interest. Furthermore, slippage on the capital programme together with careful cashflow management has resulted in actual equated investment totalling £12.1m. This additional £4.1m at the achieved rate of 1.89% has contributed a further £78,000 of additional interest.

Members will note that estimates for investment interested have been revised throughout the year, and that the outturn differs by only £7,000 to the latest approved estimate.

2.9 Compliance with Prudential and Treasury Indicators

2.9.1 The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS), which was approved by Council on 5 March 2012.

During the financial year 2012/13 the Council at all times operated within the treasury limits and Prudential Indicators set out in the TMSS, and in compliance with the Council's Treasury Management Practices. The outturn in respect of the 2012/13 Prudential and Treasury Indicators is shown at Appendix 3.

2.10 Other Issues

No other significant treasury management issues arose during the year 2012/13.

Alternative Options

3. There are no Alternative Options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

Financial Implications

4. No specific financial implications are attributable to this report.

Appendices

5. Appendix 1 – Annual Treasury Activity Report 2012/13
Appendix 2 - Definitions of LIBOR and LIBID
Appendix 3 - Outturn Prudential and Treasury Indicators for 2012/13

Background Papers

6. None identified.

Recommendation

THAT: Members note the Annual Treasury Activity Report for 2012/13 together with the appendices, and refer it to Council for approval.

Reasons for Recommendations

7. To comply with the requirements of the Treasury Management Strategy Statement.

APPENDIX 1

Annual Treasury Activity Report 2012/13

For the year ended 31 March 2013

	Bal. BFwd 1 April 2012	New Loans 2012-13	Loans Repaid 2012-13	Bal. CFwd 31 March 2013
	£	£	£	£
Long Term Borrowing				
PWLB	**10,811,577**	**0**	**0**	**10,811,577**
Temporary Borrowing				
Local Authorities	0	8,250,000	(7,650,000)	600,000
Central Government	0	0	0	0
Banks and other Institutions	0	0	0	0
Total Temporary Borrowing	**0**	**8,250,000**	**(7,650,000)**	**600,000**
TOTAL BORROWING	**10,811,577**	**8,250,000**	**(7,650,000)**	**11,411,577**
Temporary Investment				
Bank of Scotland	(6,000,000)	(8,000,000)	6,000,000	(8,000,000)
Barclays	(1,000,000)	(1,000,000)	2,000,000	0
HSBC Treasury	0	(26,290,000)	26,290,000	0
Ignis Money Market Fund	0	(16,640,000)	16,640,000	0
Royal Bank of Scotland	(500,000)	(53,050,000)	53,290,000	(260,000)
Santander	(1,000,000)	(1,590,000)	2,590,000	0
Total Banks	**(8,500,000)**	**(106,570,000)**	**106,810,000**	**(8,260,000)**
Building Societies	0	0	0	0
Debt Management Office	0	0	0	0
Local Authorities and Others	0	0	0	0
TOTAL INVESTMENT	**(8,500,000)**	**(106,570,000)**	**106,810,000**	**(8,260,000)**
NET BORROWING / (INVESTMENT)	**2,311,577**	**(98,320,000)**	**99,160,000**	**3,151,577**

Investment				
Fixed Rate	(8,000,000)	(35,290,000)	35,290,000	(8,000,000)
Variable Rate	(500,000)	(71,280,000)	71,520,000	(260,000)
TOTAL INVESTMENT	**(8,500,000)**	**(106,570,000)**	**106,810,000)**	**(8,260,000)**

Temporary Investment and Borrowing Statistics at 31 March 2013:

Proportion of Fixed Rate Investment	96.85%
Proportion of Variable Rate investment	3.15%
Temporary Investment Interest Receivable	£228,906
Equated Temporary Investment	£12,119,122
Weighted Average Interest Rate Received	1.89%
7 Day LIBID (Benchmark) 28 March 2013	0.39%
3 Month LIBID 28 March 2013	0.57%

Borrowing

Temporary Borrowing Interest Payable	£380
Equated Temporary Borrowing	£120,412
Weighted Average Interest Rate Paid	0.32%
7 Day LIBOR (Benchmark) 28 March 2013	0.52%

APPENDIX 2

LIBOR - the London Interbank Offered Rate

LIBOR is the interest rate at which the London banks are willing to offer funds in the inter-bank market. It is the average of rates which five major London banks are willing to lend £10 million for a period of three or six months, and is the benchmark rate for setting interest rates for adjustable-rate loans and financial instruments.

ie. the London banks are LENDING to each other, which affects the rate at which the banks will lend to other parties eg. local authorities, ie. Gedling are BORROWING money

LIBID - the Interbank BID (LIBID) rate

LIBID is the interest rate at which London banks are willing to borrow from one another in the inter-bank market. It is the average of rates which five major London banks willing to bid for a £10 million deposit for a period of three or six months.

ie. the London banks are BORROWING from each other, which affects the rates at which they will borrow from other parties eg. local authorities, ie. Gedling are LENDING money.

APPENDIX 3

Outturn Prudential and Treasury Indicators for 2012-13

Prudential Indicators

		2012-13 Original Estimate	2012-13 Outturn
a)	Capital Expenditure	£3,958,200	3,182,729
b)	Ratio of Fin'g Costs to Net Revenue. Stream	6.46%	5.25%
c)	Capital Financing Requirement (CFR)	£13,095,100	£11,435,999
d)	Net Borrowing and CFR	£14,207,400	£3,151,577
e)	Incremental impact of new 2012/13 capital investment decisions	£0.57	Not Applicable

Treasury Management Indicators

		2012-13 Original Estimate	2012-13 Outturn
a)	Authorised Limit for External Debt:		
	Borrowing	£16,200,000	£11,411,577
	Other Long Term Liabilities	£1,500,000	-
	Total Authorised Limit	**£17,700,000**	**£11,411,577**
b)	Operational Boundary for External Debt:		
	Borrowing	£15,200,000	£11,411,577
	Other Long Term Liabilities	£1,500,000	-
	Total Operational Boundary	**£16,700,000**	**£11,411,577**
c)	Upper limit for fixed interest exposure (Max o/s net Borrowing)	£14,200,000	£3,411,577
	Local indicator-Investment only	100%	96.85%
	Local indicator-Borrowing only	100%	100.0%
d)	Upper limit for variable interest exposure (Max o/s net Borrowing)	£2,000,000	(£260,000) Nb. net investment
	Local indicator-Investment only	100%	3.15%
	Local indicator-Borrowing only	50%	0.00%
e)	Upper limits for maturity structure of outstanding borrowing during 2012/13 (Lower limits 0%)		
	Under 1 year	20%	0.0%
	1-2 years	25%	0.0%
	2-5 years	50%	37.0%
	5-10 years	50%	0.0%
	Over 10 years	100%	63.0%
f)	Upper limits for outstanding principal sums **initially** invested for periods **over** 364 days		
	Maturing beyond 31 March 2013	£5,000,000	£3,000,000
	Maturing beyond 31 March 2014	£3,000,000	£0
	Maturing beyond 31 March 2015	£1,000,000	£0