



To: The Leader and Executive Councillor for Strategy:
Councillor Tim Bick

Report by: David Horspool - Director of Resources

Relevant scrutiny committee: Strategy & Resources
8/7/2013
Scrutiny Committee

Wards affected: All Wards

ANNUAL TREASURY MANAGEMENT REPORT 2012/13

Key Decision

1. Executive summary

- 1.1 The Council is required by regulations issued under the Local Government Act 2003, to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for each financial year.
- 1.2 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 2011) in respect of 2012/13.
- 1.3 This report also includes information on capital activity during the year together with associated prudential & treasury indicators.

2. Recommendations

- 2.1 The Executive Councillor is asked to recommend this report, which includes the Council's actual prudential and treasury indicators for 2012/13, for approval by Council.

3. Background

- 3.1 This report provides information on:
 - Capital expenditure and financing activity during the year;
 - The impact of capital spending on the Council's 'need to borrow'
 - The overall treasury position as at 31st March 2013
 - Recovery of Icelandic Bank Deposits

- The Council's compliance with prudential & treasury indicators
- The Council's Treasury Management advisors(Sector) view on UK and Global economies (Appendix B)
- The actual prudential and treasury indicators (Appendix C)
- A Glossary of Terms and Abbreviations (Appendix D)

3.2 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, developer contributions, revenue contributions, reserves 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 other resources, the funding of 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.

	2011/12 £'000 Actual	2012/13 £'000 Revised Estimate *	2012/13 £'000 Actual
Non-HRA capital expenditure	8,194	16,745	8,704
HRA capital expenditure	9,917	27,047	11,529
HRA Reform	213,572	-	-
Total capital expenditure	231,683	43,792	20,233
Resourced by:			
• Capital receipts	-4,093	-937	-920
• Other contributions	-14,018	-40,049	-17,561
• Borrowing (for HRA Reform)	-213,572	-	-
Total available resources for financing capital expenditure	-231,683	-40,986	-18,481
Un-financed capital expenditure	-	2,806	1,752

* Per Mid Term Treasury Management Report 2012/13 agreed on 21st January 2013

3.3 The Council's overall borrowing need

During 2012/13, there was no requirement for external borrowing. Un-financed capital expenditure for the Clay Farm Collaboration Agreement of £1.752 million, as shown above, was met temporarily from internal cash borrowing, until the expected future capital receipt can be used.

3.4 Treasury Position as at 31 March 2013

The Council's debt and deposit position is managed in order to ensure adequate liquidity for revenue and capital activities, security for deposits and to manage risk in relation to all treasury management activities. Procedures and controls to achieve these objectives are well established both through the application of approved Treasury Management Practices and regular reporting to Members.

The table below provides a comparison of deposit activity and outturn for 2012/13 against 2011/12.

Deposit Type	2011/2012			2012/2013		
	Average Deposits	Rate of Return	Benchmark Return	Average Deposits	Rate of Return	Benchmark Return
1. Internally Managed Funds						
Fixed Short-Term (<365 days)	£63.08m	0.75%	0.82%	£58.47m	0.86%	0.57%
Call/Overnight Accounts	£6.52m	0.38%	0.48%	£17.53m	0.65%	0.39%
Fixed Long-Term (>365 days)	-	-	-	-	-	-
2. Externally Managed Funds						
Managed Funds	-	-	0.48%	-	-	0.39%
3. Overall Deposit Return						
	£69.60m	0.72%	-	£76.00m	0.81%	-

Notes:

The 'Benchmark Return' figures are based upon Sector Treasury Management's average money market 3-month and 7-day LIBID rate respectively. The benchmark returns shown above equate to the average annual rate for deposits as quoted on 28 March 2013.

Similarly, the actual return equates to the Council's recorded average annual rate, also, on 28 March 2013.

The higher rate of return of 0.81% in 2012/13, compared with 0.72% in 2011/12, has been achieved due to undertaking deposits with a longer maturity date (based on advice from Sector), and increased yield arising from further extensive use of bank call accounts.

- 3.5 Interest of £618,000 has been earned on the Council's deposits during 2012/13 at an average rate of 0.81%. This rate of return compares favourably with the average 3 month LIBID rate of 0.57% as issued on 28th March 2013. The original budget for interest earned in 2012/13 was £604,000. Interest yield has therefore exceeded budget by £14,000 for the year 2012/13.
- 3.6 All of the Council's deposits had maturities of less than one year. A summary of deposits is shown at Appendix A.

3.7 Icelandic Bank Deposits Update

This authority had the following deposit (s) in Icelandic banks and their UK subsidiaries at the time of the collapse of the Icelandic banking system in October 2008, as detailed below:-

Counterparty	Principal	% Rate	Deposit Date
Heritable Bank Limited	1,000,000	5.65000%	09-Jan-08
Heritable Bank Limited	1,000,000	6.21000%	13-Jun-08
LBI hf	2,000,000	6.22000%	30-Jun-08
Heritable Bank Limited	2,000,000	6.00000%	05-Sep-08
LBI hf	1,000,000	6.35000%	01-Jul-08
LBI hf	2,000,000	6.42000%	01-Jul-08
Total:-	9,000,000		

Heritable Bank Limited

The total of distributions now received from the administrators of Heritable Bank plc is £3,147,134. This represents 77.25 pence in the pound of the total claim. The next distribution is forecast for July 2013.

LBI hf

To date, the Council has received three distributions for a total of £2,458,741 from the winding-up board in respect of Landsbanki Islands Hf. This equates to approximately 47% of the claim.

The distributions received include both principal and interest elements of the Council's claims.

Based on the latest CIPFA Local Authority Accounting Panel Bulletin 82 (updated in May 2013), the Council is still anticipating that it will recover between 86% and 90% of its claim against Heritable Bank Ltd and 100% of its claim against LBI hf (formerly Landsbanki Islands hf).

3.8 Economic Update provided by Sector

Sector Treasury Services Ltd is the Council's independent treasury advisor. In support of effective forecasting the Council needs to be aware of the potential influence of the worldwide economy on treasury management issues for the Council. Sector's opinion on the wider global economy is presented at Appendix B, and provides an overview of the economic position as at 28th March 2013.

3.9 Compliance with Treasury Limits

During the financial year the Council operated within the 'authorised' and 'operational' borrowing limits contained within the Prudential Indicators set out in the Council's Treasury Management Strategy Statement. The outturn for these Prudential Indicators is shown in Appendix C.

4. Implications

(a) Financial Implications

None.

(b) Staffing Implications

None.

(c) Equal Opportunities Implications

No negative impacts identified.

(d) Environmental Implications

None.

(e) Procurement

None.

(f) **Consultation and communication**

None required.

(g) **Community Safety**

No community safety implications.

5. Background papers

5.1 LAAP bulletin 82 Update No. 7 May 2013

6. Appendices

6.1 Appendix A – The Council's deposits as at 31st March 2013
Appendix B – Sector's opinion on UK and global economies
Appendix C – Prudential Indicators – outturn for 2012/13
Appendix D – Glossary of Terms and Abbreviations

7. Inspection of papers

7.1 To inspect the background papers or if you have a query on the report please contact:

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DEPOSITS as at 31 March 2013

The Council's deposits as at 31 March 2013 are summarised (by counterparty) in the table below, excluding remaining claims/deposits with Icelandic banks.

Counterparty	Principal (£)
Bank of Scotland Plc	9,000,000
Barclays Bank plc	10,000,000
Basildon District Council	2,000,000
Birmingham City Council	2,000,000
HSBC Bank plc	2,350,000
Lloyds TSB Bank Plc	6,000,000
London Borough of Enfield	2,000,000
National Westminster Bank Plc	10,000,000
Nationwide BS	10,000,000
Newport City Council	3,000,000
Salford City Council	4,200,000
The Royal Bank of Scotland Plc	4,900,000
TOTAL	65,450,000

Sector's Opinion on UK and Global Economies – As at 28th March 2013.

Introduction

The paragraphs that follow reflect the views of the Council's Treasury Management advisors (Sector) on UK and Global Economies as at 28th March 2013.

Interest rates

Members of the Bank of England Monetary Policy Committee (MPC) kept the bank rate at 0.5% and Quantitative Easing (QE) at £375 bn during 2012/13. Going-forward, the Council's treasury advisor, Sector, provides the following forecast:

	June-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB rate	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB rate	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB rate	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70

The Sector central forecast is for the first increase in bank rate to be in March 2015. With low growth predictions for the U.K, and financial markets unconvinced that politicians have resolved the Eurozone sovereign debt crisis, we are likely to continue to experience high levels of volatility.

Global Interest Rates and Global Economies update

Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in February 2013. Sector has left unchanged its forecast for the first increase in Bank Rate to be in March 2015. However, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. The rise in equity prices has, conversely, resulted in a sell-off in bonds and some diminution of the UK as a safe haven from more risky assets. However, towards the end of March, the Cyprus crisis has partially reversed these general trends during the quarter, although this is likely to be a temporary phase.

Eurozone

- Most Eurozone countries are now battling against negative economic growth in 2013, although Germany is experiencing a resurgence of business confidence and surveys are pointing towards a resumption of growth. Growth prospects, for many Eurozone countries, are poor due to the need to adopt austerity programmes to bring government deficits under control.
- Although market anxiety about Greece has subsided after the agreement to a further major financial support package.
- There is also increasing concern that the contraction in Spain's economy and the very high level of unemployment of 25%, similar to Greece's level, could mean that both countries could get into a downward deflationary spiral, making corrections to this, difficult. Spain has resisted asking for an official national bailout, although it has received financial support to re-capitalise its four largest banks.
- The general election in Italy has created a highly unstable political situation where no party can form a viable coalition, which has created an unstable economic environment. There could therefore be volatility in Spanish and Italian bond yields over the next year, depending on political and economic developments.
- A general election is due in Germany in the autumn of 2013. It currently looks likely that this will lead to little change in current policy on the Euro and support for peripheral countries. However, polls are indicating that 25% of the electorate now favour Germany leaving the Euro and stopping the flow of money from Germany.
- A bailout for Cyprus was eventually agreed in the last week of March. However, huge damage will be done to the Cypriot economy by the fallout from this bailout and many commentators consider it is only a matter of time before another bailout will be needed – or exit from the Euro.

US

- There has been a strong resurgence of confidence in US financial markets as the “fiscal cliff” has been largely averted or postponed. Confidence has bolstered recovery in employment and the housing market and has provided the wider economy with a solid base for optimism looking forward.

- The Federal Reserve is unlikely to increase the central rate until 2015, as it has now set a specific target of first reducing unemployment to 6.5% (currently 7.7% at the end of March).
- The housing market is showing signs of having turned a corner, both in price rises and the volume of house sales.

China

- Efforts to stimulate the economy appear to be succeeding. However, there are still concerns around an unbalanced economy, heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector.

UK

- The Bank of England February 2013 Inflation Report has again pushed back the timing of a return to trend growth and the rate at which inflation will fall back towards the target rate of 2%. If quarter 1 2013 results in negative growth, this would be the first triple dip recession since records began in 1955. Over the year to Q4 2012, total growth came in at only 0.2%.
- A fair proportion of UK Gross Domestic Product (GDP) is dependent on overseas trade; the high correlation of UK growth to US and EU GDP growth means that the UK economy is likely to register weak growth over both 2013 and 2014.
- Consumers are likely to remain focused on reducing national debt. Weak consumer sentiment and job fears will all act to keep consumer expenditure suppressed; this will be compounded by inflation being higher than increases in average earnings i.e. disposable income will continue to be eroded.
- The Coalition government is hampered in promoting growth by the need to tackle the budget deficit. However, the March budget did contain measures to boost house building and the supply of mortgages, and brought forward, by one year to April 2014, the start of a £10,000 tax-free allowance for incomes.
- Little sign of a co-ordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth.
- There is a limited potential for more Quantitative Easing in 2013.

- In February 2013 Moody's downgraded the UK's AAA credit rating one notch to Aa1. There was little reaction in financial markets, as this had been widely anticipated. Fitch put its AAA rating on negative watch in March and recently downgraded to AA+.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

Failure of Italian political parties to form a viable coalition;

The impact of the Eurozone crisis on financial markets and the banking sector;

Monetary policy action failing to stimulate growth in western economies;

The impact of the UK Government's austerity plan on confidence and growth;

Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt; and;

Overall, there is a potential for weak growth in the UK.

Given the weak outlook for economic growth, Sector sees the prospects for any increase in Bank Rate before 2015 as very limited indeed, and the first increase could be even further delayed if growth disappoints.

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2011/12 £'000	Original 2012/13 £'000	Revised 2012/13 £'000	Actual 2012/13 £'000
<u>PRUDENTIAL INDICATORS</u>				
Capital expenditure				
- General Fund	8,194	13,920	16,745	8,704
- HRA	223,489	22,465	27,047	11,529
Total	231,683	36,385	43,792	20,233
Incremental impact of capital deposit decisions on:				
Band D Council Tax (City element)	0.00	0.00	0.00	0.00
Average weekly housing rent	0.00	0.00	0.00	0.00
Capital Financing Requirement (CFR) as at 31 March				
- General Fund	(1,177)	(1,177)	1,629	858
- HRA	215,031	214,748	214,748	214,748
Total	213,854	213,571	216,377	215,606
Deposits at 31 March	63,903	60,487	63,210	65,543
Net borrowing Requirement	149,951	153,084	153,167	147,063
Change in the CFR	0	(283)	2,806	(771)
External Gross Debt	213,572	213,572	213,572	213,572
Ratio of financing costs to net revenue stream				
-General Fund	(2.46%)	(3.13%)	(3.13%)	(3.13%)
-HRA	0.05%	20.06%	20.06%	20.06%
Total	(2.41%)	16.93%	16.93%	16.93%

Note1: 'Original' refers to the Council's Mid Term Treasury Management Strategy Report 2012/13 as agreed by Council on 21st January 2013.

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2011/12 £'000	Original 2012/13 £'000	Revised 2012/13 £'000	Actual 2012/13 £'000
<u>TREASURY INDICATORS</u>				
Authorised limit				
for borrowing	250,000	250,000	250,000	250,000
for other long term liabilities	0	0	0	0
Total	250,000	250,000	250,000	250,000
HRA Debt Limit	230,839	230,839	230,839	230,839
Operational boundary				
for borrowing	213,854	213,571	216,377	215,606
for other long term liabilities	0	0	0	0
Total	213,854	213,571	216,377	215,606
Upper limit for total principal sums deposited for over 364 days	5,000	5,000	5,000	5,000
Upper limit for fixed & variable interest rate exposure				
Net interest on fixed rate borrowing/deposits	(448)	6,840	6,840	6,840
Net interest on variable rate borrowing/deposits	(23)	(23)	(23)	(23)
Maturity structure of new fixed rate borrowing during 2012/13		Upper Limit	Lower Limit	
10 years and above (PWLB borrowing for HRA Reform)		100%	100%	

Note1: 'Original' refers to the Council's Mid Term Treasury Management Strategy Report 2012/13 as agreed by Council on 21st January 2013.

Treasury Management – Glossary of Terms and Abbreviations

Term	Definition
Authorised Limit for External Borrowing	Represents a control on the maximum level of borrowing
Capital Expenditure	Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day to day items including employees' pay, premises costs and supplies and services)
Capital Financing Requirement	A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources
CIPFA	Chartered Institute of Public Finance and Accountancy
Counter-parties	Financial Institutions with which funds may be placed
Credit Risk	Risk of borrower defaulting on any type of debt by failing to make payments which it is obligated to do
DCLG	Department for Communities & Local Government
Eurocurrency	Any deposits residing in banks located outside borders of the country that issues the deposit that it is denominated in
Gross Domestic Product (GDP)	GDP per capita is considered an indicator of a country's 'standard of living'
HRA	Housing Revenue Account - a 'ring-fenced' account for local authority housing account where a council acts as landlord
HRA Self-Financing	A new funding regime for the HRA introduced in place of the previous annual subsidy system
LBI hf	Formerly Landsbanki Islands hf
London Inter-bank Bid Rate (LIBID)	The average estimated interest rate leading banks in London are willing to pay for eurocurrency deposits
London Inter-bank Offered Rate (LIBOR)	The average interest rate estimated by leading banks in London would be charged if borrowing from other banks
Liquidity	A measure of how readily available an investment is
MCP	Monetary Policy Committee - The Bank of England Committee responsible for setting the UK's bank base rate
Net Borrowing Requirement	External borrowing less deposits
Operational Boundary	Limit which external borrowing is not normally expected to exceed
PWLB	Public Works Loans Board - an Executive Government Agency of HM Treasury from which local authorities & other prescribed bodies may borrow at favourable interest rates
Security	A measure of the creditworthiness of a counter-party
Yield	Interest, or rate of return, on an investment