Report to	Council	**Item**
	11 September 2013	7
Report of	Chief finance officer	
Subject	Treasury management full year review 2012-13	

Purpose

To set out the treasury management performance for the year to 31 March 2013.

Recommendation

The cabinet is asked recommend that council notes the report and the treasury activity.

Corporate and service priorities

This report helps to meet the corporate priority “Value for money services”.

Financial implications

The report has no direct financial consequences; however it does report on the performance of the council in managing its borrowing and investment resources.

Ward/s: All Wards

Cabinet member: Councillor Waters – Deputy leader and resources

Contact officers

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Report

Background

1. The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return. Counterparty risk is the term for the potential risks taken by an investor that the bank, building society, local authority or investing will be unable to repay the money invested.

2. The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

3. As a consequence treasury management is defined as:

   "The management of the local authority'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."

Introduction

4. 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. 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 22/03/2012);
   - a mid year (minimum) treasury update report (council 29/01/2013);
   - an annual review following the end of the year describing the activity compared to the strategy (this report).

6. 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.

7. This council also confirms that it has complied with the requirement under the ode to give prior scrutiny to all of the above treasury management reports by the cabinet before they were reported to the full council. Member training on treasury management issues will be undertaken during November 2013 in order to support members' scrutiny role.

8. This report summarises the following:

- **The council's capital expenditure and financing 2012-13**
  - Capital activity during the year (paragraphs 9 to 11);
- **The council's overall borrowing need**
  Impact of this activity on the council's underlying indebtedness (the capital financing requirement) and the actual prudential and treasury indicators (paragraphs 12 to 23);
- **Treasury position as at 31 March 2013**
  Overall treasury position identifying how the council has borrowed in relation to this indebtedness, and the impact on investment balances (paragraphs 24 to 27);
- **The strategy for 2012-13** and **The economy and interest rates**
  Review of treasury strategy and economic factors (paragraphs 28 to 34);
- **Borrowing outturn for 2012-13** and **Borrowing outturn for 2012-13**
  Borrowing rates and detailed debt activity (paragraph 35 to 39);
- **Investment rates in 2012-13** and **Investment outturn for 2012-13**
  Investment rates and detailed investment activity (paragraphs 40 to 46).

The council's capital expenditure and financing 2012-13

9. 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, revenue contributions 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 resources, the capital expenditure will give rise to a borrowing need, which will be satisfied by either external or internal borrowing.

10. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund	**2011-12 Actual**	**2012-13 Estimate**	**2012-13 Actual**
Capital expenditure	(1.7)	8.4	6.2
Financed in year	7.2	8.2	4.1
(Over)/unfinanced capital expenditure	(8.9)	0.2	2.1

£m HRA	2011-12 Actual	2012-13 Estimate	2012-13 Actual
Capital expenditure	19.2	30.7	24.7
Financed in year	12.5	29.9	26.5
(Over)/unfinanced capital expenditure	6.7	0.8	(1.8)

11. The General Fund negative expenditure is as result of the appropriation of general fund housing from the General Fund to the HRA to the value of £6.7m, which resulted in the £6.7m under-financing of the HRA capital expenditure. Actual capital expenditure excluding the appropriation for the General Fund and HRA was £5m and £12.5 respectively.

The council's overall borrowing need

12. The council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents the 2012-13 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

13. Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through the Public Works Loan Board (PWLB) or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR

14. The council's non HRA underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

15. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or,
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

16. The council’s CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council’s borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR £m General Fund	**2011-12 Actual**	**2012-13 Estimate**	**2012/13 Actual**
Opening balance	43.2	36.2	27.3
Add: Unfinanced capital expenditure (as above)	(8.9)	0.2	2.1
Less MRP	(1.1)	(3.8)	(1.0)
Less PFI & finance lease repayments	(5.9)	-	-
Rebase and recalculation adjustment	-	-	(2.1
Closing balance	27.3	32.6	26.3

CFR £m HRA	**2011-12 Actual**	**2012-13 Estimate**	**2012-13 Actual**
Opening balance	46.5	199.7	202.0
Add: Unfinanced capital expenditure (as above)	6.7	0.8	(1.8)
Add HRA Self-financing	148.9	-	-
Less PFI & finance lease repayments	(0.1)	(0.1)	(0.1)
Rebase and recalculation adjustment	-	-	13.3
Closing balance	202.0	200.4	213.5

17. During the year, it was discovered that the HRA CFR had been miscalculated since 2004, which resulted in the HRA CFR being understated and the general fund CFR being overstated. Both CFRs have been recalculated and adjusted to reflect the true position. This recalculation has been agreed with external audit.

18. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR

19. 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 2013-14 and 2014-15 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 table below highlights the council’s net borrowing position against the CFR. The council has complied with this prudential indicator.

20. It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013-14; this is expected to provide a more appropriate indicator.

£m	2011-12 Actual	2012-13 Estimate	2012-13 Actual
Net borrowing position	197.8	207.6	179.4
CFR	232.3	233.0	237.9

The authorised limit

21. 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

22. 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

23. 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.

£m	2012-13
Authorised limit	262.8
Maximum gross borrowing position	247.1
Operational boundary	242.8
Average gross borrowing position	241.1
Financing costs as a proportion of net revenue stream	6.25%

Treasury position as at 31 March 2013

24. The council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2012-13 the council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31 March 2012	**Rate / Return**	**Average Life years**	**31 March 2013**	**Rate / Return**	**Average Life years**
Fixed Rate Funding						
- PWLB	£218.9m	4.42%	13.24 yrs	£218.9m	4.42%	12.24 yrs
- Market	£23.4m	5.74%	9.93 yrs	£5.0m	4.80%	41.04 yrs
- Other	£0.5m	3.00%	Perpetually irredeemable	£0.5m	3.00%	Perpetually irredeemable
Total debt	£242.8m			£224.4m		
CFR	£230.2m			£237.9m		
Over /(under) borrowing	£12.8m			£(13.5)m		
Investments	£54.0m	1.26%	0.73 yrs	£43.5m	1.72%	0.72 yrs

25. The maturity structure of the debt portfolio was as follows:

£m	**31 March 2012**	**31 March 2013**
Under 12 months	19.7	1.3
12 months and within 24 months	-	-
24 months and within 5 years	15.8	17.8
5 years and within 10 years	9.2	9.7
10 years and above	199.4	196.9

26. The following table shows the movement in investments in the year:

Investments £'000	TMSS	Actual 31 March 2012	Movement			Actual 31 March 2013
			Invested	Matured	Transferred to Short Term	
Long Term						
Banks		16,500	1,000	-	(5,000)	12,500
Local Authorities		-	3,000	-	-	3,000
Short term						
Banks		2,000	16,000	(4,000)	5,000	19,000
Building Societies		21,000	14,000	(29,000)	-	6,000
Local Authorities		14,500	29,000	(40,500)	-	3,000
Total	**40,000**	**54,000**	**63,000**	**(73,500)**	**-**	**43,500**

27. The maturity structure of the investment portfolio was as follows:

£m	31 March 2012	31 March 2013
Longer than 1 year	16.5	15.5
Under 1 year	37.5	28.0

The strategy for 2012-13

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

29. 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.

30. The actual movement in gilt (which are fixed interest securities issued by the UK government) yields meant that PWLB rates fell during the first quarter of the year to historically very 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 (the Wall St bank which collapsed in 2008) type crisis of financial markets if the Greek debt crisis was 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

31. The original expectation for 2012-13 was that the bank rate would not rise in 2012-13 or 2013-14 and for it to start gently rising from quarter 4 2014. This forecast rise has now been pushed back to a start in quarter 1 2015 at the earliest. Economic growth (GDP) in the UK was virtually flat during 2012-13 due to the UK austerity programme, subdued domestic consumer expenditure, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (whereby the Bank of England pumps money directly into the economy by buying assets from newly created money), by £50bn in July to a total of £375bn. Bank rate therefore ended the year unchanged at 0.5% while consumer price index (CPI) inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time. The EU sovereign debt crisis was an ongoing saga during the year with an eventual very protracted agreement of a second bailout for Greece in December followed by a second major crisis, this time over Cyprus, towards the end of the year.

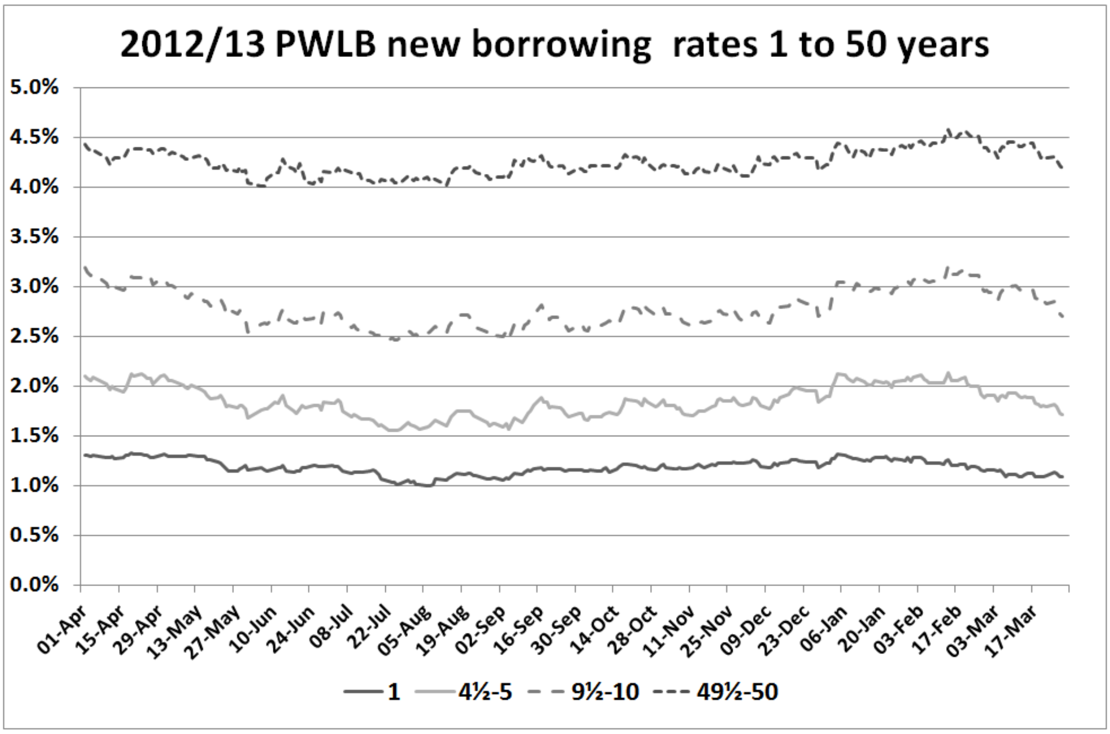
32. Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB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

33. The Funding for Lending Scheme announced in July has resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling drastically in the second half of the year. However, perceptions of counterparty risk have improved after the European Central Bank (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.

34. The UK coalition Government maintained its tight fiscal policy (use of government revenue collection [taxation] and expenditure [spending] to influence the economy) 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. Negative watch is a status that the credit-rating agencies (Standard and Poor's, Moody's and Fitch) give a company/entity while they are deciding whether to lower their credit rating, once placed on negative watch, it has a 50% chance of its rating being lowered in the next three months.

Borrowing Rates in 2012-13

35. Public Works Loan Board borrowing rates - the graphs and table for PWLB maturity rates below show for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



Borrowing outturn for 2012-13

36. Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Repayments

37. On 5 February 2013 the council repaid £9.5m at an average rate of 6.03% upon maturity of the loan.

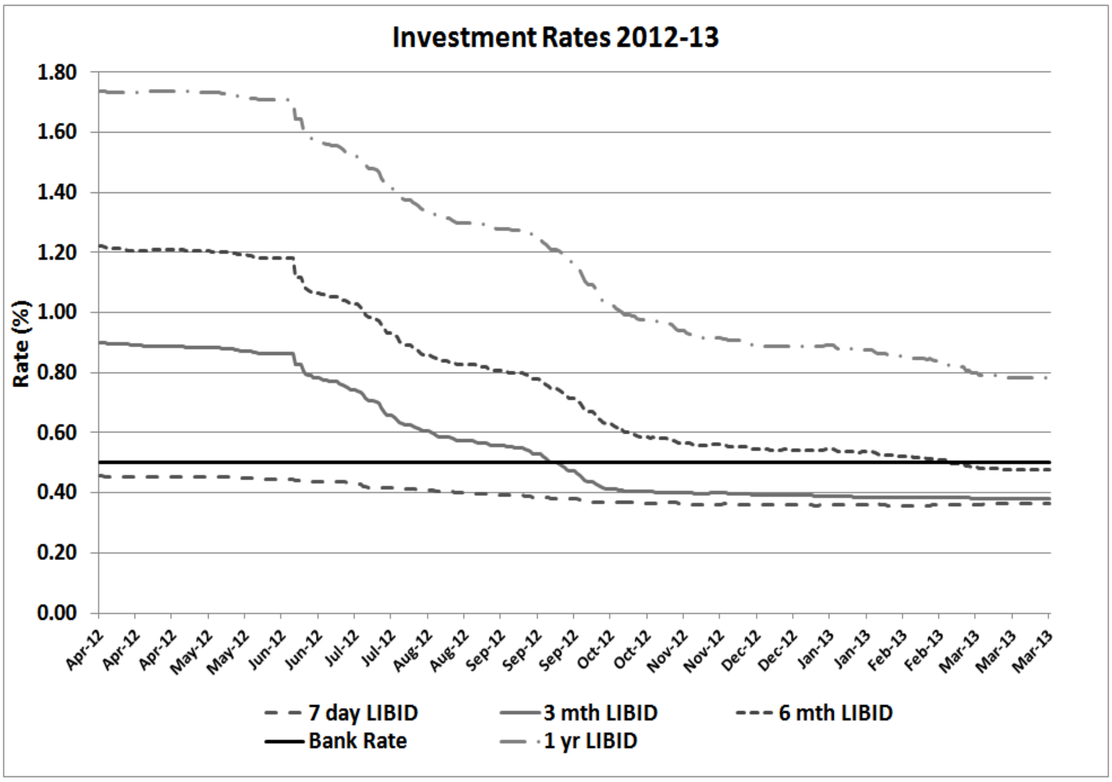
38. On 25 February 2013 the council repaid £9.4m at an average rate of 5.97% upon maturity of the loan.

Borrowings by the council

39. During 2012-13 the council paid £11,139,227 in interest cost, this compares to a budget assumption of £12,590,160. At the time of budget setting for 2012-13, the interest rates for the PWLB borrowing for HRA self financing, which commenced on 27 March 2012, was unknown. Therefore an estimated rate of 3.8% was used; the actual rates on the three loans are between 2.56 and 3.08%, causing a variance of £1,406,336. The remaining variance is due to the budget not taking into account the lack of interest for market loans in March 2013, following their repayment in February 2013.

Investment rates in 2012-13

40. 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 outturn for 2012-13

Investment policy

41. The council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the council on 20 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 [a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event]., bank share prices etc.).

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

Resources

43. The council's cash balances comprise revenue and capital resources and cash flow monies. The council's core cash resources comprised as follows:

£m Balance sheet resources	**31 March 2012**	**31 March 2013**
Balances	18.5	32.7
Earmarked Reserves	2.6	2.7
Useable Capital receipts	12.6	15.2
Major Repairs Reserve	11.2	-
Capital grants Unapplied	1.9	1.6
Total	46.8	52.2

Investments held by the council

44. The council maintained an average balance of £85.262m of internally managed funds. The internally managed funds earned an average rate of return of 1.61%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.39%. This compares with a budget assumption of £55.1m investment balances earning an average rate of 1.09%.

45. The council's investment return for 2012/13 is £1,373,113 which is £773,113 above the amount budgeted for the year of £600,000. The variance is due to the budget being set using the TMS approved by council on 22 January 2012 which had lower limits for investments with counterparties that meant investments were restricted and use of the Debt Management Office (part of HM Treasury which manages debt and cash for the UK Government, lending to local authorities and managing certain public sector funds) was envisaged where the return is 0.25%. On 25 July 2012 council approved an amendment to the TMS which raised the limits for investments with certain counterparties, allowing a better rate of return to be obtained.

46. The council is part of a benchmarking group across Norfolk, Suffolk and Cambridgeshire, the table below shows the performance of the council's investments compared to the other councils (whom have been made anonymous). This shows that the rate of return that will be achieved by investments held at the year end by the council as being second highest of the benchmarking group with average risk and longest time to maturity when compared to the rest of the benchmarking group.

Council	WARoR[1]	WA Risk[2]	WAM[3]	WA Tot. time[4]
Norwich	1.72%	3.9	293	566
A	1.45%	3.5	147	291
B	0.82%	3.4	103	137
C	1.92%	4.0	64	240
D	1.65%	3.6	164	270
E	0.51%	4.4	26	32
F	0.66%	3.3	0	0

[1] WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate.

[2] WA risk – Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated.

1 Up to 5 years

2 Up to 2 years

3 Up to 1 year

4 Up to 6 months

5 Up to 3 months

6 0 months

A number of 3.4 means between 6 months to a year.

[3] WAM – Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount.

[4] WA Tot. Time – Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

Integrated impact assessment	NORWICH City Council

Report author to complete	
Committee:	Cabinet
Committee date:	9 September 2013
Head of service:	Caroline Ryba
Report subject:	Full Year Treasury Management Report 2012-13
Date assessed:	2 September 2013
Description:	

	Impact			
Economic (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues