FAREHAM
BOROUGH COUNCIL

Report to the Executive for Decision
8 July 2013

Portfolio:	Policy and Resources
Subject:	**Treasury Management Annual Report 2012/13**
Report of:	Director of Finance and Resources
Strategy/Policy:	Finance and Treasury Management Strategies
Corporate Objective:	A dynamic, prudent and progressive Council

Purpose:
The Annual Report on Treasury Management for 2012/13 has been prepared in order to comply with the reporting requirements of the Code of Practice for Treasury Management produced by the Chartered Institute of Public Finance and Accountancy and adopted by the Council.

Executive summary:
The financial year 2012/13 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

Full details of investment and borrowing activity in 2012/13 are set out in the main body of this report. Investment activity in 2012/13 is summarised below:

	£m
Investments as at 1 April 2012	**32.9**
Investments made in 2012/13	141.1
Investments repaid in 2012/13	141.2
Investments as at 31 March 2013	**32.8**

Total investment interest receivable for the year was £647,761. The total of external interest paid on borrowing and other amounts invested with the Council was £1,401,421.

The net total of £753,660 has been allocated to the Council's funds as shown in the following table:

	£
Net amount credited to the General Fund	938,694
Net amount credited to the Whiteley Fund	6,440
Net amount debited to the Housing Revenue Account	(1,698,794)
Net Total	**(753,660)**

During 2012/13, the Council complied with its legislative and regulatory requirements of the Prudential Code.

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Recommendation:
That the Treasury Management Annual Report for 2012/13 be noted.

Reason:
This report has been prepared in order to comply with the reporting requirements of the Code of Practice for Treasury Management.

Cost of proposals:
Not applicable.

Appendices A: Total Investment Activity 2012/13

B: 2012/13 Prudential and Treasury Indicators

Background papers: None

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Executive Briefing Paper

Date: 8 July 2013

Subject: Treasury Management Annual Report 2012/13

Briefing by: Director of Finance and Resources

Portfolio: Policy and Resources

INTRODUCTION

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).

2. During 2012/13 the minimum reporting requirements were that the full Council should receive the following reports:

    - An annual treasury strategy at the start of the year (Council 26/04/12);
    - A mid-year (minimum) treasury update report (Council 13/12/12);
    - An annual report following the year describing the activity compared to the strategy (this report).

3. In addition, the Council has received quarterly treasury management update reports on 03/09/2012, 05/11/2012 and 11/02/2013 which were received by the Executive.

4. 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. The Council also confirms that it has complied with the requirement under the Code to give scrutiny to treasury management activity, by the Audit and Governance Committee.

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THE ECONOMY AND INTEREST RATES

6. 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 the UK's biggest export market - the European Union (EU).

7. 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 and Fitch followed up this warning by actually downgrading the rating to AA+ in February 2013 and April 2013 respectively. Key to retaining the AAA rating from 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.

8. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) 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.

9. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing rises which were met with bailouts after difficult fraught negotiations.

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

11. 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.

THE STRATEGY FOR 2012/13

12. 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 2011/12. 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.

13. The actual movement in gilt yields meant PWLB rates fell sharply 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 very 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.

14. 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 BORROWING REQUIREMENT AND DEBT

15. The abolishment of the housing subsidy system in March 2012 resulted in £40 million of fixed rate loans being taken out with PWLB, as detailed below:

Principal	Interest Rate	Maturity (years)
£4m	3.52%	40.5
£4m	3.51%	41.5
£4m	3.51%	42.5
£4m	3.51%	43.5
£4m	3.50%	44.5
£4m	3.50%	45.5
£4m	3.50%	46.5
£4m	3.49%	47.5
£4m	3.49%	48.5
£4m	3.48%	49.5

16. In addition to the fixed rate loans, the Council holds investments from Portchester Crematorium Joint Committee and the Cocks' Bequest Trust Fund which are treated as temporary loans.

17. Total interest payable by the Council in 2012/13 amounted to £1,401,421, as shown below:

	£
Interest payable to PWLB	1,393,147
Interest payable on investments with the Council	2,487
Other interest payable (e.g. HMRC, bonds)	5,787
Total	**1,401,421**

INVESTMENT RATES IN 2012/13

18. 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

19. The Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 26 April 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.).

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

21. The Council maintained an average balance of £31 million of internally managed funds earning an average rate of return of 1.30%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.37%.

22. The Council uses the external fund manager Tradition UK Ltd to invest up to £13 million of the Council's cash balances. The use of the external fund manager is a chargeable arrangement and has been in place since 2000. The performance of the fund was 2.23% compared to the 7-day LIBID benchmark return of 0.37%.

23. The list of approved institutions for the investment of the Council's surplus funds has been reviewed on a regular basis, taking account of the grading system for investment institutions operated by the Council's treasury management advisors, Sector Treasury Services.

24. The Council's investments were £32.9 million on 1 April 2012, which decreased slightly to £32.8 million on 31 March 2013. However, at times during the year the level of investment was higher, as shown in the following table:

The Overall Level of Investments	
Date	£m
1 April 2012	32.9
30 June 2012	38.7
30 September 2012	43.8
31 December 2012	41.3
31 March 2013	32.8

25. An analysis of internally and externally managed investment activity and call accounts used during the year is shown in the table below. During the year the Council also invested in Money Market Funds to help diversify the Council's investment portfolio. These are AAA-rated funds enabling instant access to cash whilst proving enhanced security and a yield reflective of their security and liquidity aspects.

	Externally Managed £m	Internally Managed £m	Call Accounts £m	Money Market Funds £m	Total £m
Investments at 1 April 2012	**12.0**	**10.0**	**7.9**	**3.0**	**32.9**
New investments	7.0	21.0	110.1	3.0	141.1
Investments repaid	9.0	19.0	107.2	6.0	141.2
Investments at 31 March 2013	**10.0**	**12.0**	**10.8**	**0.0**	**32.8**

26. The level of investment activity with each authorised institution is set out in Appendix A.

27. As the base rate has remained unchanged at 0.5% since March 2009, this has had a major impact on the rate of return on the Council's investments as the longer-term investments have matured.

28. The following table shows the range of interest rates for the investment portfolio at the end of the year compared with the position in the previous year:

At 31 Mar '12 (£m)	Investments	At 31 March '13	
		£m	**%**
18.9	Interest Rate between 0.51% and 1.00%	17.8	54
0	Interest Rate between 1.00% and 1.50%	3.0	9
2.0	Interest Rate between 1.51% and 2.00%	0	0
2.0	Interest Rate between 2.01% and 2.50%	0	0
6.0	Interest Rate between 2.51% and 3.00%	10.0	30
4.0	Interest Rate between 3.01% and 3.50%	2.0	6
32.9	**Total**	**32.8**	**100**

29. The total interest received in respect of the 2012/13 investment activity and other interest received from car loans and housing association loan payments is set out in the following table:

	£
Investments	503,299
Call Accounts	111,992
Money Market Funds	24,236
Other	8,234
Total	**647,761**

INTEREST ALLOCATION

30. The interest receivable by the Council of £647,761 has to be allocated between the General Fund and the Housing Revenue Account (HRA), but interest was also payable in respect of the balances on the Whiteley Fund.

31. The allocation of interest to the HRA is based on the average balance for the year on the HRA itself, the Housing Repairs Account and the Major Repairs Reserve, using the average interest rate earned on external investments. The interest to be credited to the other funds is calculated in a similar way:

	£
Total interest receivable	647,761
Less:	
Amount due to Housing Revenue Account	164,926
Amount due to Whiteley Fund	6,440
Balance credited to the General Fund	476,395

32. The interest payable by the Council of £1,401,421 also has to be allocated between the General Fund and the HRA. The amount payable by the HRA is made up of the interest payable on external PWLB loans, internal General Fund loan and the HRA capital financing requirement.

33. This calculation means that the amount payable by the HRA to the General Fund is actually greater than the amount payable by the General Fund, as shown in the following table:

	£
Total interest payable by the General Fund	1,401,421
Less:	
Amount chargeable to the HRA	1,863,720
Surplus accruing to the General Fund	(462,299)

34. The net balance credited to the General Fund of £938,694 is shown in the General Fund as "Interest on Balances" for which the revised budget was £874,500.

PRUDENTIAL AND TREASURY INDICATORS

35. During 2012/13, the Council complied with its legislative and regulatory requirements. Appendix B shows the actual prudential and treasury indicators for 2012/13. Detailed information on actual capital expenditure and how this was financed can be found in a separate report on this agenda.

SUMMARY

36. This report gives details of the treasury management activity in 2012/13 in accordance with the reporting requirements set out in the CIPFA Code of Practice for Treasury Management. Members of the Executive are asked to note the report.

RISK ASSESSMENT

37. There are no significant risk considerations in relation to this report.

Reference Papers: CIPFA Code of Practice for Treasury Management

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APPENDIX A

Total Investment Activity 2012/13 with Each Approved Institution

	Externally Managed £	Internally Managed £	Call Accounts £	Money Market Funds £	Total £
Clearing Banks					
RBS (incl Nat West)	4,000,000	3,000,000	217,284,000		224,284,000
Barclays Bank	2,000,000	15,000,000			17,000,000
Lloyds Banking Group	2,000,000	8,000,000			10,000,000
HSBC			6,000,000		6,000,000
Other Banks					
Santander UK	2,000,000		2,000,000		4,000,000
Building Societies					
Nationwide	5,000,000	5,000,000			10,000,000
Skipton	2,000,000				2,000,000
Nottingham	2,000,000				2,000,000
Money Market Funds					
Ignis Sterling Liquidity Fund				3,000,000	3,000,000
LGIM Sterling Liquidity Fund				3,000,000	3,000,000
Total Investments	**19,000,000**	**31,000,000**	**225,284,000**	**6,000,000**	**281,284,000**

APPENDIX B

2012/13 Prudential and Treasury Indicators - Actual Performance

Indicator	Description	2012/13 Indicator	2012/13 Actual
Aff.1	***Affordability Measure: Financing Costs as a percentage of net revenue stream***		
	Overall Position	3%	4%
1a	General Fund	-11%	-9%
1b	Housing Revenue Account	15%	15%
Aff.2	***Affordability Measure: Incremental impact of capital investment on Council Tax and Housing Rents***		
2a	Council Tax increases, borrowing costs only	£2.06	£1.53
2b	Housing Rent increases, borrowing costs only	£0.82	£0.00
Aff.3	***Affordability Measure: Capital Expenditure (£'000s)***		
	General Fund	£5,940	£4,415
	Housing Revenue Account	£2,326	£1,803
	Total Capital Expenditure	**£8,266**	**£6,218**
Aff.4	***Affordability Measure: External Debt Level (£'000s)***		
	Authorised limit, comprising	£66,000	£40,463
	- borrowing	*£49,555*	*£40,000*
	- other long term liabilities	*£16,445*	*£463*
	Operational boundary, comprising	£55,000	£40,463
	- borrowing	*£49,555*	*£40,000*
	- other long term liabilities	*£5,445*	*£463*
Aff.5	***Affordability Measure: Capital Financing Requirement (CFR) (£'000s)***	£51,338	£51,051
	General Fund CFR closing balance in the year	-£2,754	-£2,754
	HRA CFR closing balance in the year	£54,092	£53,805
Pru.1	***Prudence Measure: Gross Debt and Capital Financing Requirement (CFR) (£'000s)***		
	Gross Debt	£42,471	£41,839
	CFR (for last, current and next 2 years)	£204,204	£204,204
	Has measure been achieved?	Achieved	Achieved
	Memorandum Item : Prudence margin	£161,733	£162,365
Pru.2	***Prudence Measure: Adoption of the CIPFA Treasury Management Code of Practice***		
	Has the Code been adopted in its entirety?	Yes	Yes
Pru.3	***Prudence Measure: Upper Limits to fixed and variable interest rate exposure***		
	Upper limit to variable interest rate exposures	25%	25%
	Upper limit to fixed interest rate exposures	100%	100%
Pru.4	***Prudence Measure: Maturity structure of borrowing***	Upper Limit	
	Loans maturing within 1 year	25%	£40m long term loans from PWLB
	Loans maturing within 1 - 2 years	25%	
	Loans maturing within 2 - 5 years	25%	
	Loans maturing within 5 - 10 years	50%	
	Loans maturing in over 10 years	100%	
Pru.5	***Prudence Measure: Total Principal sums invested for periods of more than 364 days (£'000s)***		
	Upper Investment Limit for the year	£12,000	£0

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