Part I – Release to Press

Meeting:	**EXECUTIVE / AUDIT COMMITTEE**	**Council Agenda Item:**	**11**
Portfolio Area:	Resources		
Date:	**3 SEPTEMBER 2013 / 9 SEPTEMBER 2013/ 9 OCTOBER 2013**		

ANNUAL TREASURY MANAGEMENT REVIEW 2012/13

NON-KEY DECISION

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1. PURPOSE

1.1 The Council is required under the Local Government Act 2003 to produce an Annual Treasury Report reviewing treasury management activities including the 2012/13 prudential and treasury indicators. 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. This report is one of three reports required under the code of practice, the other reports being :

- Annual Treasury Strategy in advance of the year (last reported 27/02/2012)
- Mid year Treasury Update report (last reported Council 5/12/2012)

2. RECOMMENDATIONS

2.1. That the Executive / Audit Committee recommends Council to approve the 2012/13 prudential and treasury indicators in this report.

3. BACKGROUND

3.1 Summary

3.1.1 It is a requirement of the Treasury Management Code of Practice (revised 2009) that Council receive an annual report on the performance of the treasury management function.

3.1.2 This report summarises:

- Capital expenditure for 2012/13;

- Impact of the expenditure on the Council's underlying indebtedness, (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 The Council's Capital Expenditure and Financing 2012/13

4.1.1 Capital expenditure is monies expended on assets with a life of more than one year, within the guidelines laid out in Accounting Practises. These costs can be financed either by capital resources the Council has on its Balance Sheet e.g. capital receipts, capital grants, revenue contributions etc. or by making a revenue contribution to capital.

4.1.2 If sufficient capital resources are not available this would give rise to a need to borrow. The actual capital expenditure for the year forms part of the required prudential indicators. Table One (shown below) summarises the actual capital expenditure and how this was financed.

Table One- 2012/13 Capital Expenditure and Financing			
	2011/12 Actual £'000	**2012/13 Estimate £'000**	**2012/13 Actual £'000**
Non-HRA Capital Expenditure	4,661	11,150	10,901
HRA Capital Expenditure	13,281	17,137	16,264
Total Capital Expenditure	**17,942**	**28,287**	**27,165**
• Capital Receipts	415	1,197	917
• Capital Grants /Contributions	2,495	7,113	6,681
• Capital Reserves	6,939	8,814	8,222
• Revenue contributions	360	2,496	2,746
Capital Programme Expenditure Requiring Borrowing	**7,733**	**8,667**	**8,599**
HRA Self Financing Settlement	**199,911**		
Expenditure Requiring Borrowing	**207,644**	**8,667**	**8,599**

4.2 The Council’s overall borrowing need

4.2.1 The Council’s underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure calculates the Council’s debt position. The CFR can be calculated by totalling the capital activity of the Council less the resources which have been used to pay for the capital spend. The CFR represents the 2012/13 and prior years unfinanced capital expenditure (see Table One), and prior years’ unfinanced capital expenditure which requires funding via borrowing or the use of internal cash balances, rather than by the application of capital resources e.g. capital receipts.

4.2.2 Part of the Council’s treasury activities is to address the funding requirements for this borrowing need. Based on the Capital Strategy, the treasury service manages the Council’s cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be 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.

4.3 The 2012/13 Capital Financing Requirement and Minimum Revenue Requirement

4.3.1 In 2012/13 the Council did not borrow to fund the General Fund capital programme, this was despite an estimate of £8,665,976 (based on the March Executive projected spend), of which £8,599,762 was actually required in 2012/13, (actual expenditure funded from borrowing). Included in this total spend was £7,039,448 relating to the town square asset purchase, (To date £4,000,000 has been borrowed to fund this asset). In 2012/13 as in previous years the Council chose to use investment balances rather borrow externally, this is because the internal borrowing rate was significantly less than the cost of borrowing from the PWLB.

4.3.2 Investment returns are extremely low reflecting the historic low rates of interest, the Council was receiving interest at only 0.78% on its investments in 2012/13, compared to borrowing costs available of around 4%.

4.3.3 The Council has HRA external borrowing with the PWLB as at 31 March 2012 of £213,915,000.

4.3.4 The HRA borrowing included £17,004,000 to fund the prior years decent homes programme of which £3,000,000 was repaid on the 28 March 2013. This debt was called ‘supported borrowing’ under the former HRA Subsidy system but now forms part of the HRA debt portfolio. and as at 31 March 2013, the HRA had £739,000 of internal borrowing. The total HRA debt cap includes this external and internal borrowing and as at the 31 March 2013 the HRA could fund a further £3,030,078 of borrowing, this being the difference between the HRA’s borrowing of £214,654,922 and the debt cap of £217,685,000.

4.3.5 In 2011/12 the Council was required to finance the payment required to central government of £199,911,000. This was financed by borrowing fixed rate debt of varying maturities and accounts for the majority of the HRA outstanding debt.

4.3.6 The Council must borrow in line with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing on either the General Fund or HRA, (see Appendix A Prudential Indicators). Statutory controls are in place to ensure that borrowing for capital assets is repaid over the life of the asset. This is done through the Minimum Revenue Requirement (MRP), which effectively equates to repaying the principal or monies borrowed, in line with how long the asset will last. The Council is required to make an annual revenue charge, or MRP, which reduces the CFR and so the underlying need to borrow. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments.

4.3.7 The statutory requirement to repay debt does not necessarily have to coincide with the physical borrowing. When borrowing interest rates are relatively high compared to investment interest earned, the Council may decide to use investment balances to finance expenditure, until rates converge and borrow at a later date.

4.3.8 The Council could reduce its CFR further 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).

4.3.9 The Council's 2012/13 MRP Policy, as required by CLG Guidance, was approved as part of the 2012/13 Treasury Management Strategy Report on 27 February 2012. The calculation of MRP is based upon the years opening borrowing requirement for the year and £151,980 was charged to the General Fund in 2012/13.

4.3.10 The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table Two CFR calculation 2010/11 and 2011/12		
CFR Calculation	**31March 2012 (£'000)**	**31 March 2013 (£'000)**
Opening Balance	**17,004**	**224,647**
Closing Capital Financing Requirement (General Fund)	6,992	15,440
Closing Capital Financing Requirement (Housing Revenue Account)	217,655	214,655
Closing Balance	**224,647**	**230,095**
Increase	**207,643**	**5,448**

4.3.11 The CFR as at 31 March 2013 has increased by a net £5,447,782. The General Fund CFR has increased by £8,447,782 which relates to the borrowing required in 2012/13 less the MRP of £151,980 paid from the General Fund. The HRA CFR has decreased by £3,000,000 being the debt repaid on the 28 March 2013.

4.4 Other indicators

4.4.1 The net borrowing position of the Council as at 31 March 2013 was £202,355,000 borrowing. This was total borrowings or loans of £213,915,000 less total investments held of £11,650,000. The Council had lower investment balances than originally planned, as it was more financially beneficial to use investment balances to finance the capital programme, than to undertake borrowing.

4.4.2 The authorised limit and operational boundary is the limit at which the Council can borrow up to, a breach of the authorised limit would require a report to Council. The limits for 2012/13 were based on the borrowing need identified in the January 2013 Executive Capital report plus an additional £5Million. This was to allow for any short term cash flow needs that might arise during the course of the year or the ability to borrow (up to the limit) to cover any additional capital needs that might arise and be approved as part of the Capital Strategy.

4.4.3 The ratio of financing costs to net revenue stream, this is the interest costs divided by the General Fund net requirement. The 2012/13 indicator is lower than estimated, this is because the Council reduced its investment balances to support its borrowing requirement, rather than take more expensive external borrowing. There was also slippage on the capital programme which reduced the ratio.

4.4.4 An updated list of all Treasury Prudential Indicators is shown at Appendix A as a result of the 2012/13 actuals. All Prudential Indicators will be further reviewed and updated at a later date, taking into account approved changes to the capital programme, and borrowing and debt projections.

4.5 Treasury Position 31 March 2013

4.5.1 The Council's debt and investment position is organised by the Treasury Management section, in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risk.

4.6 Borrowing and Investment Position

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

Table Three Treasury Position as at 31 March 2013

	31 March 2012 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2013 Principal £'000s	Rate / Return %	Average Life (Yrs)
Fixed rate funding - PWLB*	216,915	3.77	20.93	213,915	3.31	20.20
CFR	224,647			230,095		
Over/(under) borrowing	(7,732)	(3.4)		(16,180)	(7.0)	
Investments – In house	11,560	0.85		11,650	0.78	

**All borrowing taken out was fixed rate.*

4.6.2 The maturity structure of debt portfolio was as follows (see also Appendix B):

Table Four Maturity of Debt Portfolio for 2011/12 and 2012/13		
Time to maturity	**31 March 2012 Actual**	**31 March 2013 Actual**
Maturing within one year	3,000	2,000
1 year or more and less than 2 years	2,000	0
2 years or more and less than 5 years	5,500	8,000
5 years or more and less than 10 years	3,741	1,241
10 years or more	202,674	202,674
Total	**216,915**	**213,915**

4.6.3 All the Council's investments at both 31 March 2012 and 2013, were due or mature within one year. A summary of the Council's exposure to fixed and variable rate principal is shown below in table, (see also Appendix B).

Table Five Fixed and Variable Rate Investment Totals for 2011/12 and 2012/13		
	31 March 2012 Actual	**31 March 2013 Actual**
Fixed rate principal	0	0
Variable rate principal	11,560	11,650

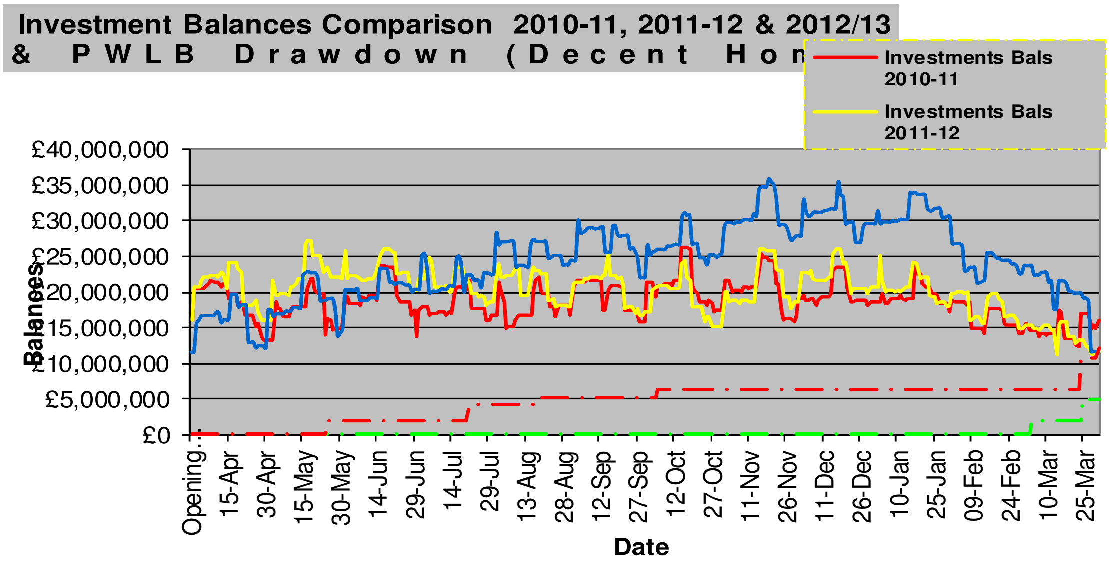
4.7 The Strategy for 2012/13:

4.7.1 The outturn against the revised 2012/13 Strategy has changed in terms of capital expenditure due to scheme slippage and underspends .The actual capital expenditure was £872,788 lower of which £66,214 related to schemes funded from prudential borrowing.

4.7.2 During 2012/13 a number of changes were made to the Strategy:

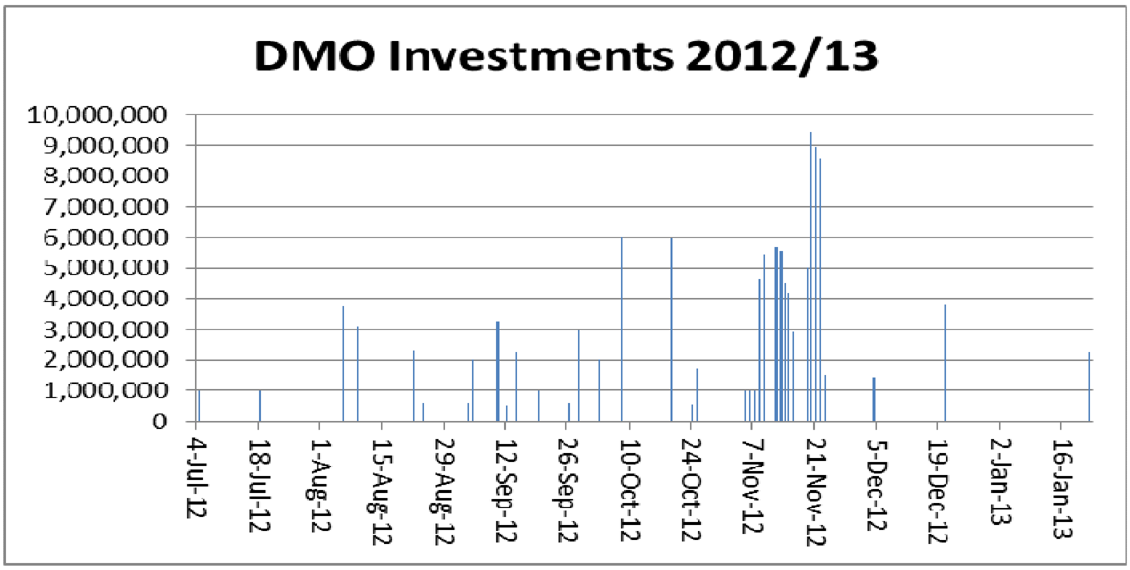
- The inclusion of money market funds in the Treasury Management Strategy (update mid- year December 2012). Approval was given for two money market funds with a maximum limit of £7million and 25% of the investment portfolio. This was subsequently increased to £15million in February 2013 as part of the 2013/14 Strategy.
- An increase in the variable rate investment interest from £25million to £35million reflecting the Council's higher cash balances and the risk associated with fixing

investments. The highest level of investments recorded in 2012/13 was £35.88million in November 2012 on four different occasions, however this included a fixed rate investment for £5million which meant the maximum variable rate investments for 2012/13 was £30.88million. Comparative cash balances for 2010/11 to 2012/13 are shown in the chart below.



- Increases in borrowing approvals relating to changes in the capital programme reported in December 2012 and February 2013.

- The use of the Debt Management Office (DMO) as a 'safe haven' and permission for unlimited deposits, (see also paragraph 4.8.1 below). The amount of investments deposited with the DMO in 2012/13 was £131million for an average of 4.4 days. The last 2012/13 investment with the DMO was in January 2013.



4.8 Compliance with Prudential Limits 2012/13

4.8.1 There was a technical breach reported in the mid -year review to Council in December 2012, where deposits exceeding £5million were placed overnight with the Government's Debt Management Office, in the absence of alternative counterparties. The Treasury Management Strategy was amended to allow unlimited deposits with the Government's Debt Management Office in recognition of its status as a safe haven.

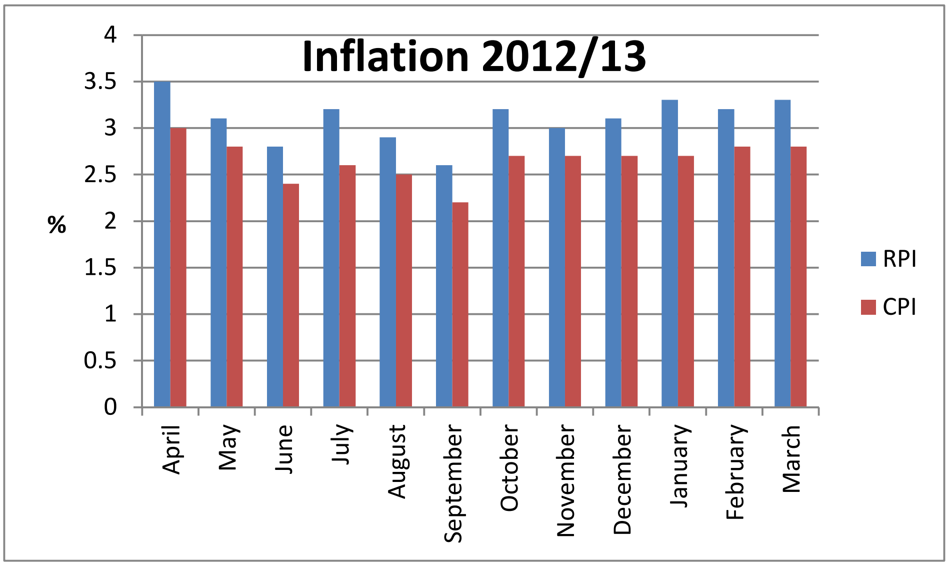
4.8.3 The full list of approved Treasury Prudential Indicators and their corresponding actual expenditure for 2012/13 are shown at Appendix A.

4.9 2012/13 Economic & Interest Rate Review

4.9.1 As has become usual, the Bank of England February Inflation Report downgraded its forecasts for growth and the rate at which inflation will fall back towards the target rate of 2% and pushed back the timing of economic recovery. The Bank has raised its forecasts for inflation (peaking at 3.2% in Quarter three 2013/14) and pushed back the timing of when inflation would fall back to the 2% target rate by eighteen months, to Quarter one 2016. The Bank has, therefore, continued its trend of correcting it's repeated over optimism on the speed and strength of recovery and it is now forecasting growth reaching about 1.9% in two years time.

4.9.2 In both the Chancellor's Autumn Statement, and then his March budget, he again extended the timetable for reducing the annual budget deficit and total outstanding debt due to weak growth depressing tax revenues and increasing benefit payments. The one slightly more optimistic area has been the housing market, as the Funding for Lending Scheme is reported as having a positive effect in improving the supply of credit via mortgages.

4.9.3 The Bank Rate ended the year unchanged at 0.5% while CPI inflation peaked in April at 3%, finishing at 2.7% in March.



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

4.9.5 Equity prices have rallied since the start of the year, with the FTSE 100 rising from 5,897 to 6,400. Gilt prices were volatile over the last quarter of 2012/13 quarter, with the yield on 10-year gilts hitting 2.2% in early March, before falling back to 1.72% at the end of the quarter, similar to the level seen at the start of the year. Meanwhile, the pound fell fallen sharply against the dollar, from $1.63 to $1.51. Sterling was slightly weaker against the euro, too, slipping from €1.23 to €1.19.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2012/13 financial year any consequential financial impacts of the Strategy have been reflected in the July Capital Strategy update and the 4th Quarter 2012/13 budget monitoring report.

5.2 Legal Implications

5.1.2 Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Risk Implications

5.1.3 The table below identifies the risks if the recommendations are agreed. The risks have been assessed in accordance with the Council's risk management strategy.

	Description of risk	Mitigation	Residual Risk Level
1.	Investment balances increase and monies placed with banking groups exceed approved Counter Party Limits	The Treasury Team would actively seek to find alternative Counter Parties to lend to, or seek Council approval to increase the Counter Party Limits	M
2.	There is an increase in the capital programme which cannot be resourced from available resources.	If the CFR increased in 2012/13 because the Council needed to borrow additional funds this would have to be in excess of the current headroom in the operational boundary limit	L
3	The Council is unable to defer spend within the General Fund capital programme in future years or identify resources to fund the unsupported borrowing in the Capital Strategy.	This would increase the cost of borrowing to the General Fund and would require funding.	M
4	The Council invests funds with a bank which is unable to meet the repayment.	The Counter Party ratings are reviewed on a weekly basis and should prevent placing funds with banks at risk. The Council has a very strict lending criteria.	L

5.4 Equalities and Diversity Implications

5.4.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

BACKGROUND DOCUMENTS

- BD1 - Treasury Management Strategy Statement and Annual Investment Strategy- Mid Year Review (5 December 2012 Council) http://www.stevenage.gov.uk/content/committees/55185/55202/55205/Council-5-December-2012-Item12.pdf

- BD2 - Prudential Code Indicators and Treasury Management Strategy 2013/14 (Council February 2013) http://www.stevenage.gov.uk/content/committees/55185/55202/55205/Council-27-February-2013-Item13.pdf

APPENDICES

- Appendix A – Prudential Indicators
- Appendix B – Investment Portfolio Q4