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Agenda Item No:

Report to: Audit Committee

Date of Meeting: 27th June 2013

Report Title: Annual Treasury Management Report 2012-13

Report By: Peter Grace
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Purpose of Report

This report provides the opportunity for the Audit Committee to scrutinise the Treasury Management activities and performance of the last financial year. A similar report will be considered by Cabinet along with any recommendations made by the Audit Committee.

Recommendation(s)

1. **To consider the report and comment on any areas that it wishes to draw to the attention of Cabinet**

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2012-13. As delegated by Council the Audit Committee is tasked with scrutinising these activities and to draw to Cabinet's attention any matters it considers important.

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 15th February 2010 and this Council fully complies with its requirements.

2. The primary requirements of the Code are as follows:

   a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

   c) Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

   d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

3. Treasury management in this context 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. "

4. The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2012-13.

5. This annual Treasury report covers

   a) capital expenditure and financing 2012-13

   b) overall borrowing need (the Capital Financing Requirement)

   c) treasury position as at 31 March 2013;

   d) performance for 2012-13;

   e) the strategy for 2012-13;

   f) the economy and interest rates in 2012-13;

   g) borrowing rates in 2012-13;

   h) the borrowing outturn for 2012-13;

   i) debt rescheduling;

j) compliance with treasury limits and Prudential Indicators;

k) investment rates in 2012-13;

l) investment outturn for 2012-13;

The Council's Capital Expenditure and Financing 2012/13

6. 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.

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

Table1: CAPITAL PROGRAMME FINANCING 2012-2013

		Outturn 2012-13 £000's
Expenditure :		3,650
Financed by :		
Borrowing		1,150
Grant - Disabled Facilities Grant	761	
Lottery Grants	10	
Local Space	731	
ESCC	9	
Regional Housing Board Grant	68	
Other Grants	228	
		1,807
Reserves		284
Capital Receipts		409
		3,650

The Council's Overall Borrowing Need

8. 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.

9. Part of the Council's treasury activities is to address the funding requirements for the Council's 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.

10. The Council's 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 borrowing need. 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.

11. 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).

12. The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2012/13 on 18/01/2012.

13. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against this scheme.

Table 2 CFR : General Fund	2011/12	2012/13	2012/13
	Actual	Estimate	Actual
	£'000	£'000	£'000
Opening balance	15,618	16,523	16,523
Add unfinanced capital expenditure (as above)	1,590	(68)	148
LAMS	1,000	1,000	1,000
Less MRP	462	496	496
Less finance lease arrangements	223	231	231
Closing balance	£16,523	£ 16,728	£16,944

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

15. 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 2012/13 and 2013/14 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.

Table 3	2011/12	2012/13	2012/13
	Actual	Estimate	Actual
	£'000	£'000	£'000
Net borrowing position	(£7,279)	(£ 6,279)	(£5,925)
CFR	£ 16,523	£ 16,728	£16,944

Treasury Position as at 31 March 2013

16. The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 4 **Debt**	31st March 2012 Principal	Rate	Maturity	31st March 2013 Principal	Rate
PWLB Loan1	£7.5m	4.80%	2033	£7.5m	4.80%
PWLB Loan 2	£1.0m	2.02%	2016	£1.0m	2.02%
PWLB Loan 4			2018	£1.0m	1.63%
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	£8.5m			£9.5m	
PWLB Loan 3	£2.0m	0.66% (Variable Rate)	2019	£2.0m	0.55% (Variable Rate)
Total Debt	£10.5m	3.75%		£11.5m	3.89%

Table 5 **Investments**	31st March 2012 Principal	31st March 2013 Principal
-In-House	£17.7m	£17.43m
Total Investments	£17.7m	£17.43m

Performance Measurement (2012-13)

17. Table 6 below compares the Estimated Interest Payable and Received and associated fees for the year 2012-13.

Table 6	2011 -12 Actual Outturn £000's	2012 -13 Revised Budget £000's	2012 -13 Actual Outturn £000's
Gross Interest Payable	373	373	370
Gross Interest Received	(229)	(293)	(306)
Fees	11	13	12
Other (e.g. PWLB Discount)	(56)	(53)	(51)
Net Cost	99*	40*	25*

* Excludes Local Authority Mortgage (LAM) scheme and interest received in 2011/12.

18. The investment interest received was in excess of budget due the use of internal borrowing to finance capital expenditure resulting in less external interest payments and also due to a higher level of funds to invest in the year.

19. The net interest on the LAM scheme (as below) has been transferred into the mortgage reserve.

Table 7	2011 -12 Actual Outturn £000's	2012 -13 Revised Budget £000's	2012 -13 Actual Outturn £000's
Gross Interest Payable	5	27	20
Gross Interest Received	(10)	(45)	(45)
Net Surplus	(5)	(18)	(25)

20. The Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources are detailed below, and were in line with budget expectations.

Table 8 Balance Sheet	31st March 2012	31st March 2013
	£'000	£'000
Balances	500	500
Earmarked Reserves	14,845	15,848
Usable capital receipts	4	0
Capital grants unapplied	562	478
Total	£15,911	£16,326

The Strategy for 2012-13

21. The expectation for interest rates within the strategy for 2012/13 was for them to remain unchanged until quarter 2 of 2013 and then to increase steadily from thereon. Variable or short-term rates were expected to be the cheaper form of borrowing over the period and this was indeed the case. 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.

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

The Economy and Interest Rates

23. During the quarter ended 31 March: -

24. It remained touch-and-go whether the UK economy contracted again in the first quarter: data suggests a triple-dip recession has been avoided. On the basis of past form business surveys point to next to no growth in the first quarter of 2013.

25. The latest data tentatively suggested that the labour market's recent resilience is coming to an end. Employment continued to grow, by 131,000 in the three months to January, but this was slower than the 175,000 gain seen in the fourth quarter.

26. Elsewhere, the housing market has been revived a bit by the Bank of England's Funding for Lending Scheme (FLS) which helped to bring down some mortgage rates, primarily on fixed products. This is helping to support house prices.

27. On the fiscal front, the public borrowing figures for this year have been flattered by a number of one-offs, including the transfer of the Royal Mail pension fund and the revenues of interest generated by the Bank of England's Asset Purchase Facility. On an underlying basis, however, the forecast net borrowing of £121.9bn in 2012/13, is basically unchanged from the outturn seen in the last financial year. Underlying borrowing is now not forecast to fall substantially until 2014/15.

28. This year's Budget contained a number of individual measures, but they were on a small scale and their overall effect was fiscally neutral. The further 1p cut in corporation tax and the "employment allowance", which helps to reduce employers' national insurance contributions, were welcome moves that should help business. But giveaways were matched by further cuts, including a further 1% reduction in departmental spending in the next two fiscal years.

29. The Budget also contained a reaffirmation of the Monetary Policy Committee's (MPC's) 2% inflation target along with some minor tweaks to the MPC's remit, which will allow the MPC more flexibility in the communication of its policy. This fell short of speculation that the government could suspend, or even scrap entirely, the 2% inflation target.

30. Inflation, meanwhile, remained high, with the CPI measure rising from 2.7% to 2.8% in February. The rises having been driven, mainly, by higher energy prices.

31. The MPC has said that it would “look through” the latest energy driven price rises when setting monetary policy. Indeed, the minutes of February’s meeting showed that three members of the MPC, including Governor, Mervyn King, voted for further quantitative easing. The size of the Bank’s asset purchase programme has remained at £375bn since November.

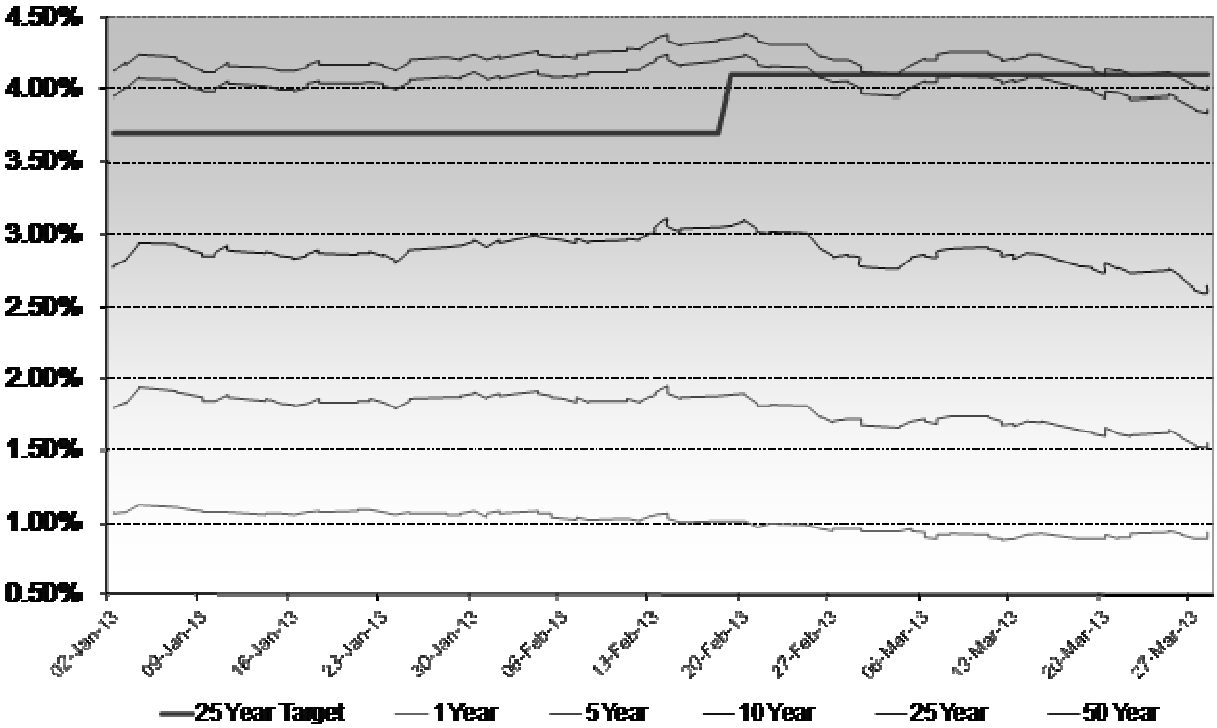
32. Internationally, the economic recovery in the US appeared to gather momentum over the first quarter.

Borrowing Rates in 2012-13

33. PWLB 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.

34. PWLB rates 2012-13 were:-

Table 9: PWLB rates



PWLB certainty rates quarter ended 31.3.2013

Table 10	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.88%	1.51%	2.59%	3.84%	3.99%
Date	12/03/13	28/03/13	28/03/13	28/03/13	28/03/13
High	1.12%	1.94%	3.10%	4.24%	4.39%
Date	04/01/13	14/02/13	14/02/13	14/02/13	20/02/13
Average	1.00%	1.78%	2.87%	4.05%	4.20%

35. The graph and table above highlight the fluctuation in borrowing rates throughout the year for different borrowing periods (in years). Members are able to scrutinise the timing of any borrowing decisions with this information.

Borrowing Outturn for 2012/13

36. Treasury Borrowing - a £1million maturity loan from the PWLB was drawn to fund the expenditure in respect of the Local Authority Mortgage Scheme .This was borrowed in March 2013 at a rate of 1.63%.

Debt Rescheduling

37. The Council examined the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. No rescheduling was done during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Compliance with Treasury Limits

38. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

Investment Rates in 2012-13

39. The Eurozone crisis flared up again, after it was agreed that bank deposits could be subject to a "haircut" as part of an international bail-out package for Cyprus. While a bailout package agreed by European Finance Ministers should avert disaster, the episode has raised fears about the safety of bank deposits in other periphery countries.

40. It follows that investment rates available in the market have continued at historically low levels and have fallen further during the last quarter as a result of the Funding

for Lending Scheme. The average level of funds available for investment purposes during the last quarter was £23m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council holds approximately £15m core cash balances for investment purposes (i.e. funds available for more than one year).

41. The table below shows the bank base rate and the PWLB rates forecasts

Table 11	Jun-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%

Investment Strategy

42. There have been some changes in strategy during the year :-

(i) A minor relaxation of the investment criteria for short term deposits which aligns the criteria to those of the Council's treasury advisers (Sector).

(ii) The accommodation of an additional £1m deposit for 5 years with the Lloyds Bank group in respect of another round of the Local Authority Mortgage scheme. The deposit being made on the 26th March at a rate of 1.97%, whilst the matching £1m borrowing from the PWLB was at a rate of 1.63% - the difference being placed in a reserve to meet any costs arising from any defaults.

(iii) Investment returns to be lower for a longer than anticipated period.

Investment Outturn for 2012-13

43. Investments held by the Council - the Council maintained an average balance in the year of £22m. The average rate of return for the year was 1.33% (1.47%. including LAMS scheme deposits). The comparable performance indicator is the average 7-day LIBID rate (un-compounded), which was 0.36%.

44. Investments as at 31 March 2013: the table below provides a snapshot of the investments held at 31 March 2013.

Table12 Counter Party	Rate/ Return	Start Date	End Date	Principal	Term
Calyon CIB Credit Agricole	0.52%	5/1/13	15/04/13	£3.0m	Fixed
Nat. West (12 month unbreakable)	2.4%	22/8/12	21/8/13	£5.0m	Fixed
Credit Industriel et Commercial	0.505%	15/1/13	15/4/13	£2.0m	Fixed
Barclays Bank plc	0.65%			£2.425m	On Call
Lloyds TSB Group	3.0%	16/4/12	11/4/13	£5.0m	Fixed
Total				£17.425	

45. No institutions in which investments were made during 2012/13 had any difficulty in repaying investments and interest in full during the year.

Financial Implications

46. The security of the Council's monies remains the top priority within the strategy. The past year has seen the continuing historically low level of interest rates available to investors.

47. However, the return on investments achieved by the Council was greater than 2012/13 budget expectations (a 1.33% return achieved).

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No

Background Information

Treasury Management and Annual Investment Strategy 2012/13, Cabinet, 20 February 2012
CIPFA - Treasury Management Code of Practice (revised 2009)
CIPFA - The Prudential Code (revised 2009)

Officer to Contact

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Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2011/12	2012/13	2012/13
(1). EXTRACT FROM BUDGET	Actual	Estimate	Actual
	£'000	£'000	£'000
Capital Expenditure	£3,774	£3,826	£3,650
Ratio of financing costs to net revenue stream	0.53%	0.63%	0.34%
Net borrowing requirement	£ 590	£ 0	£ 150
Capital Financing Requirement as at 31 March	£16,523	£16,728	£16,944
Annual change in Capital Financing Requirement	£905	£ 205	£421
Incremental impact of capital investment decisions			
Increase in council tax (band D) per annum	£0.51	£0.0	£0.0

Please note: the CFR figures have been updated to reflect the notional charge for MRP which is now accounted for following the implementation of the new International Financial Reporting Standards

Appendix 2: Treasury Management Indicators

TREASURY MANAGEMENT INDICATORS	2011/12	2012/13	2012/13
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000
Operational Boundary for external debt -			
borrowing	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000
Actual external debt	£10,500	£11,500	£11,500
Other long term liabilities	£ 376		£
TOTAL	£10,876	£11,500	£11,500
Upper limit for total principal sums invested for over 364 days	£1,000	£2,000	£2,000

The limits set for exposure to fixed and variable rates of interest in respect of both investments and borrowing were 100%.

Maturity structure of fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%