COUNCIL

10th September 2013

REPORT OF CABINET AND THE PORTFOLIO HOLDER FOR OPERATIONS AND ASSETS

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2012/13

EXEMPT INFORMATION

None

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2012/13, and the actual Prudential Indicators for 2012/13.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003.

RECOMMENDATIONS

That Council,

1. **Approve the actual 2012/13 Prudential Indicators within the report and shown at APPENDIX 1;**
2. **Accept the Treasury Management stewardship report for 2012/13.**

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2013 and summarises:

- the Council's Treasury position as at 31st March 2013;
- performance measurement.

The key points raised for 2012/13 are;

- The Economy and Interest Rates
- Treasury Position as at 31 March 2013
- The Strategy for 2012/13
- The Council's Borrowing Requirement and Debt
- Borrowing Rates in 2012/13
- Borrowing Outturn for 2012/13
- Investment Rates in 2012/13
- Investment Outturn for 2012/13
- Performance Measurement
- Icelandic Bank Defaults.

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- Excluding the Icelandic investments (currently identified 'at risk') the Council maintained an average investment balance externally invested of £24.49m and achieved an average return of 1.09% (budgeted at £18.4m and an average return of 1.20%).

  These results compare favourably with the Council's own Benchmarks of the average 7 day and the 3 month LIBID rates for 2012/13 of 0.42% and 0.56% respectively, and in line with the CIPFA Treasury Benchmarking Club average rate of 1.10%. This is not considered to be a poor result in light of the current financial climate, our lower levels of deposits/funds and shorter investment timelines due to Banking sector uncertainty, when compared to other Councils;
- The closing weighted average internal rate on borrowing has reduced from 6.55% to 4.47%;
- The Treasury Management Function has achieved an outturn investment income of £306k compared to a budget of £220k, the increase being due to additional balances being available to invest as a result of slippage in budgeted capital expenditure into 2013/14, and revenue underspends.

During 2012/13 the Council complied with its legislative and regulatory requirements.

The Executive Director Corporate Services confirms that no borrowing was undertaken within the year and the Authorised Limit was not breached.

At 31st March 2013, the Council's external debt was £65.060m (£65.060m at 31st March 2012) and its external investments totalled £20.338m (£15.699m at 31st March 2012) – including interest credited. This excludes £1.75m Icelandic Banking sector deposits (plus accrued interest at claim date) that were 'At Risk' at the year end (£2.335m at the 31st March 2012).

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Sector, the Council's current Treasury advisers, has proactively managed its debt and investments over this very difficult year.

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Phil Thomas Ext 709239 or email phil-thomas@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy & Prudential Indicators (Council 28th February 2012);
- Treasury Management Mid-Year Review 2012/13 (Council 13th December 2012);
- Treasury Outturn Report 2011/12 (Council 11/09/2012);
- CIPFA Treasury Benchmarking Club Report 2013.

APPENDICES

Appendix 1 - Prudential and Treasury Indicators
Appendix 2 – CIPFA Benchmarking Club Investments Performance

BACKGROUND INFORMATION

1. Introduction and Background.

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).

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 28/02/2012)
- a mid-year (minimum) Treasury update report (Council 13/12/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, the Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

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.

This Council also confirms that it has complied with the requirement under the Code to give scrutiny to all of the above Treasury Management Reports by the Audit and Governance Committee before they were reported to the full Council. Member training on Treasury Management issues was undertaken in 2010 and 2011 in order to support members' scrutiny role.

2. The Economy and Interest Rates.

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 our biggest export market - the European Union (EU). 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 followed up this warning by actually downgrading the rating to AA+ in February 2013 and

Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and 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. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing 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. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.

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 Quantitative Easing (QE) in July and widely expected further QE still to come, combined to keep Public Works Loan Board (PWLB) rates depressed for much of the year at historically very low levels.

Deposit rates. 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 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.

3. Overall Treasury Position as at 31 March 2013.

At the beginning and the end of 2012/13 the Council's Treasury position was as follows*:

GENERAL FUND	31st March 2012 Principal £m	Rate/ Return %	Average Life Years	31st March 2013 Principal £m	Rate/ Return %	Average Life Years
Total debt	-	-	-	-	-	-
CFR	*1.606*	-	-	*1.525*	-	-
Over / (under) borrowing	*(1.606)*	-	-	*(1.525)*	-	-
Total investments	*12.048*	*1.25*	*0.22*	*12.179*	*1.10*	*0.29*
Net debt	*(12.048)*	-	-	*(12.179)*	-	-

HOUSING REVENUE ACCOUNT	31st March 2012 Principal £m	Rate/ Return %	Average Life Years	31st March 2013 Principal £m	Rate/ Return %	Average Life Years
Total debt	*65.060*	*6.55*	*37.44*	*65.060*	*4.47*	*36.43*
CFR	*68.063*	-	-	*68.054*	-	-
Over / (under) borrowing	*(3.003)*	-	-	*(2.994)*	-	-
Total investments	*5.145*	*1.25*	*0.22*	*9.589*	*1.10*	*0.29*
Net debt	*59.915*	-	-	*55.471*	-	-

*As a result of adopting the two pool financing option of the Housing Self Financing Reform, the Council is required to separate the General Fund and HRA financing.

In terms of its Capital Financing Requirement (CFR) the Council has maintained the split as determined by the Local Government Act 2003, however, external borrowing (some of which was taken in the early 1990s) and external investments have not been 'earmarked' against one fund or the other, but pooled in line with the previous capital financing code.

Under the new arrangements, it was determined that the Council's existing external debt of £20.392m would be all classified as HRA debt and would be added to the £44.668m new borrowing undertaken as part of the new financing structure. This means that although General Fund has a small CFR of £1.525m, this is financed notionally from internal resources and is not earmarked against any specific external borrowing. With regard to investments, by identifying the value of each fund's balances, reserves etc, at the year end, this will provide a basis of a notional split of investments for calculation purposes.

4. The Strategy for 2012/13.

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

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.

The actual movement in gilt yields meant that PWLB rates fell 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 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. 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.

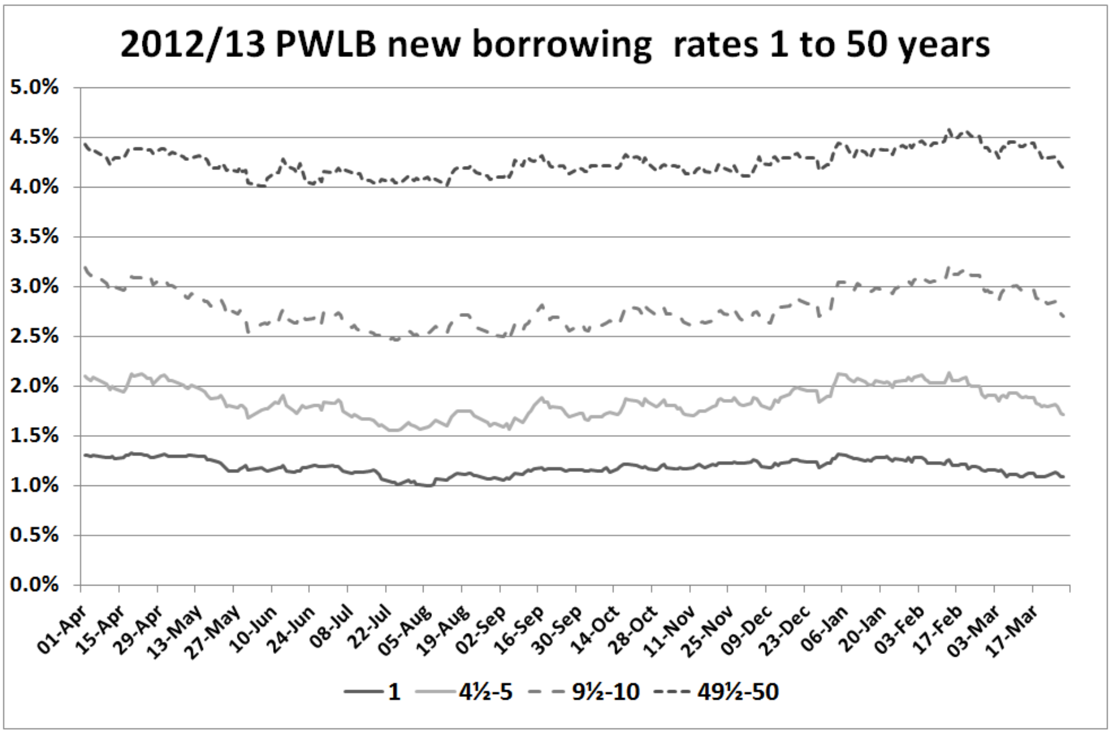
5. The Borrowing Requirement and Debt.

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31st March 2012 Actual £m	31st March 2013 Original £m	31st March 2013 Actual £m
CFR General Fund	1.606	0.412	1.525
CFR HRA	68.063	68.063	68.054
Total CFR	69.669	68.475	69.579

6. Borrowing Rates in 2012/13.

PWLB borrowing rates - the graph below shows how PWLB rates fell to historically very low levels during the year.



7. Borrowing Outturn for 2012/13

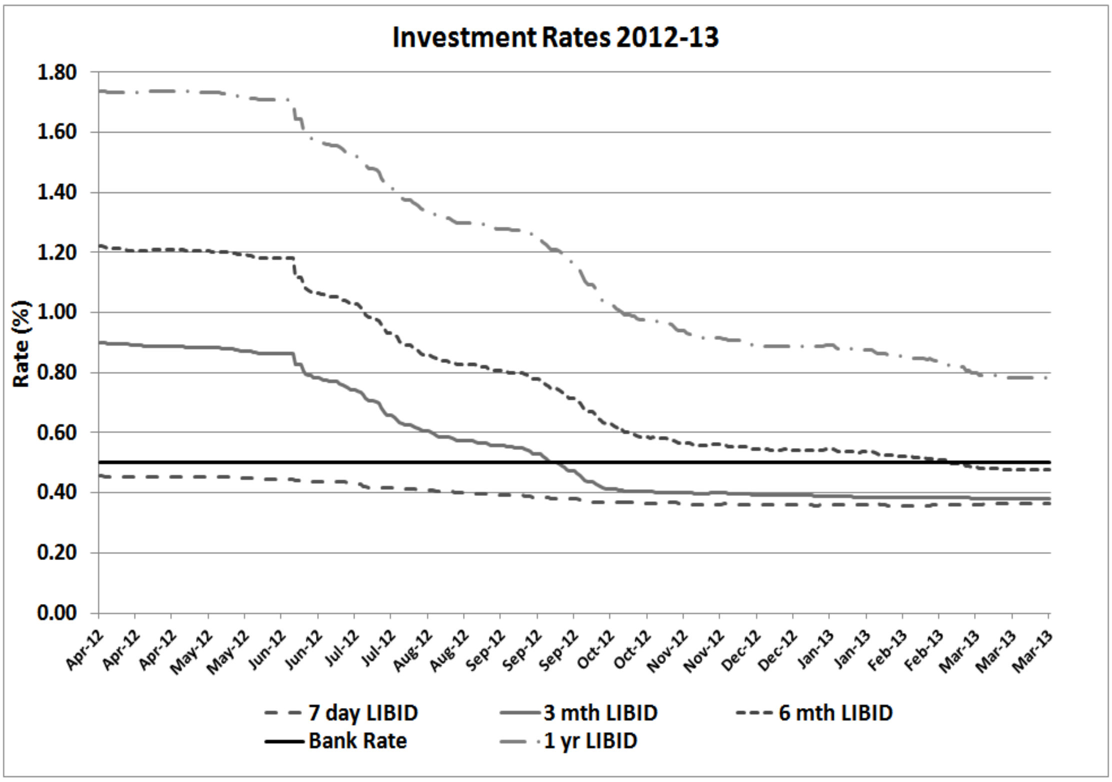
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8. Investment Rates in 2012/13

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.



9. Investment Outturn for 2012/13.

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 22nd February 2011. 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).

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

The Council maintained an average balance of £24.49m of internally managed funds which earned an average rate of return of 1.09%.

This compares with a budget assumption of interest earned of £220k based on average investment balances of £18.4m at 1.20% investment return

Performance Management;

This service had set the following local performance indicators:

- *To Maximise investment returns by ensuring that the average balance held in the Council's current accounts (non-interest earning) is maintained below £5,000*;

  The actual average balance held in the current accounts for 2012/13 was £15,713 cr (in hand) (£2,219 cr (in hand) in 2011/12);

  The net loss of interest for 2012/13 (loss of investment interest on un-invested balances less any overdraft interest incurred) was £21 compared to £64 for 2011/12 (approximately 6p per day);

- *Average external interest receivable in excess of 3 month LIBID rate;*

  Whilst the assumed benchmark for local authorities is the 7 day LIBID rate, a higher target is set for internal performance.

  The actual return of 1.09% compared to the average 3 month LIBID of 0.56% (0.53% above target).

CIPFA Benchmarking Club

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance for the year against other members. Our average return for the year (as mentioned above) was 1.09% compared to the group average of 1.10% (information from CIPFA Benchmarking Report 2012/13) Combined In-House Investments excluding the impaired investments in Icelandic banks.

This can be analysed further into the following categories:

	Average Balance Invested £ m		**Average Rates Received %**	
Category	Tamworth Borough Council	CIPFA Benchmarking Club	Tamworth Borough Council	CIPFA Benchmarking Club
Investments < 365 days Managed in-house	10.4	54.8	1.68	1.34
Investments > 365 days Managed in-house	-	18.3	-	2.59
Notice Accounts	5.5	30.7	0.93	0.82
DMADF	-	9.4	0.25	0.25
CD's Gilts and Bonds	0.05	10.8	0.18	0.91
Callable and Structured Deposits	-	20.2	-	2.16
Money Market Funds	8.5	30.0	0.49	0.52
All Investments Managed in-house	**24.5**	**125.3**	**1.09**	**1.10**

The data above displays that despite the Council being a small investor in the markets, performance is only slightly lower when compared with other members of the benchmarking club.

The graphs reproduced at **APPENDIX 2** highlights the Council's investment performance compared to other members of the benchmarking club.

10. Icelandic Bank Defaults

The Council currently has the following investments 'at risk' in Icelandic banks;

Bank	Original Deposit £m	Accrued Interest £m	Total Claim £m	Reduction due to Exchange rate fluctuations £m	Repayments Received @ 31/03/2013 £m	Balance Outstanding £m	Anticipated Total Recovery %
Glitnir	3.000	0.232	3.232	(0.034)	2.554	0.644	100
Kaupthing Singer & Friedlander	3.000	0.175	3.175	-	2.413	0.762	85.25
Heritable	1.500	0.005	1.505	-	1.163	0.342	88.08
TOTALS	7.500	0.412	7.912	(0.034)	6.131	1.747	-

At the current time, the process of recovering assets is still ongoing with the administrators. In the cases of Heritable Bank plc and Kaupthing, Singer and Friedlander Ltd, the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2013/14 and 2014/15.

Investments outstanding with the Iceland domiciled bank Glitnir Bank hf have been subject to decisions of the Icelandic Courts.

Following the successful outcome of legal test cases in the Icelandic Supreme Court, the Administrators have committed to a full repayment and the authority received a significant sum in late March 2012. However, due to Icelandic currency restrictions, elements of our deposits which are held in Icelandic Krone have been held back pending changes to Icelandic law. This sum has been placed in an interest bearing account and negotiations are continuing for their early release.

Members will be periodically updated on the latest developments of these efforts.

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