Crawley Borough Council

	FIN/301	**3**

Report to Overview and Scrutiny Commission

8 July 2013

Report to Cabinet

10 July 2013

Treasury Management Outturn for 2012/2013

1. Key Points

1.1 During 2012/2013, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Actual capital expenditure	273,025	14,764	11,017
Total Capital Financing Requirement: • Non-HRA • HRA • Total	 -330 260,325 259,995	 -330 261,383 261,053	 -330 260,283 259,953
Net borrowing	176,950	184,255	165,609
External debt	260,325	261,383	260,239

Actual prudential and treasury indicators	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Investments • Longer than 1 year • Under 1 year	 22,078 61,321		 21,102 73,528
• Total	83,399	77,128	94,630

1.2 Other prudential and treasury indicators are to be found in the main body of this report. The Head of Finance, Revenues and Benefits also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

1.3 The financial year 2012/2013 continued the challenging investment environment of previous years; namely low investment returns and continued heightened levels of counterparty risk.

2. Recommendations

2.1 To the Overview & Scrutiny Commission

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

The Cabinet is asked to:

2.2.1 Approve the actual 2012/2013 Prudential and Treasury Indicators as set out in the report;

2.2.2 Recommend to Full Council that it approves the Annual Treasury Management Outturn Report for 2012/2013.

DAVE RAWLINGS
Head of Finance, Revenues and Benefits

3. Background

3.1 This report summarises:

- Capital activity during the year;
- Impact of this activity 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 the interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

4. The Council's Capital Expenditure and Financing 2012/2013

4.1 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.

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

	2011/12 Actual £'000	2012/13 Estimate £'000	2012/13 Actual £'000
Non-HRA capital expenditure	6,196	6,663	3,099
HRA capital expenditure	266,829	8,101	7,918
Total capital expenditure	**273,025**	**14,764**	**11,017**
Resourced by:			
• Capital receipts	3,297	4,646	1,583
• Capital grants	1,393	425	720
• Capital reserves	5,883	2,289	7,719
• Revenue	2,127	7,404	995
Unfinanced capital expenditure	**260,325**	**0**	**0**

5. The Council's overall borrowing need

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

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

CFR (£m): General Fund	31 March 2012 Actual	31 March 2013 Original	31 March 2013 Actual
Opening balance	-330	-330	-330
Add unfinanced capital expenditure (as above)	0	0	0
Closing balance	-330	-330	-330

CFR (£m): HRA	31 March 2012 Actual	31 March 2013 Original	31 March 2013 Actual
Opening balance	0	260,325	260,325
Add unfinanced capital expenditure (as above)	260,325	0	0
Impairment of non-dwellings	0	0	-42
Closing balance	**260,325**	260,325	**260,283**

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

5.4 **Net borrowing and the CFR** - 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.

£'000	31 March 2012 Actual	31 March 2013 Original	31 March 2013 Actual
Net borrowing position	176,950	184,255	165,609
CFR	259,995	261,053	259,953

5.5 **The authorised limit** –The "affordable borrowing limit" required by section 3 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.

5.6 **The operational boundary** – 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.

5.7 **Actual financing costs as a proportion of net revenue stream** - 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.

	2012/13
Authorised limit	271,383
Maximum gross borrowing position	260,491
Operational boundary	261,383
Average gross borrowing position	260,325
Financing costs as a proportion of net revenue stream (non-HRA)	-4.11%
Financing costs as a proportion of net revenue stream (HRA)	18.74%

6. Treasury Position as at 31 March 2013

6.1 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 position was as follows:

£'000	31 March 2012	Rate/ Return	Average Life yrs	31 March 2013	Rate/ Return	Average Life yrs
Investments:						
- in house	50,026	1.84%	1.45	60,963	1.96%	1.32
- with managers	33,373	1.58%	0.47	33,667	1.05%	0.16
Total investments	***83,399***	***1.81%***	***1.06***	***94,630***	***1.65%***	***0.90***

6.2 The maturity structure of the investment portfolio was as follows:

£'000	2011/12 Actual	2012/13 Actual
Investments		
• Longer than 1 year	22,078	21,102
• Under 1 year	61,321	73,528
• Total	83,399	94,630

6.3 The exposure to fixed and variable rates was as follows:

£'000	31 March 2012 Actual	2012/13 Original Limits	31 March 2013 Actual
Fixed rate	65,998	100,000	78,345
Variable rate	17,401	40,000	16,285

7. The Strategy for 2012/13

7.1 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.

8. The Economy and Interest Rates

8.1 The original expectation for 2012/13 was that 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 by £50bn in July to a total of £375bn. Bank Rate, therefore, ended the year unchanged at 0.5%, while 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.

8.2 **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 at historically low levels.

8.3 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 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.

8.4 **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 in March.

9. Investment Outturn for 2012/2013

9.1 **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 29 February 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.).

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

9.3 **Investments held by Fund Managers** – the Council uses an external fund manager to invest part of its cash balances. The performance of the manager against the benchmark return was:

Fund Manager	Investments Held £’000	Net Return	Benchmark
Investec	33,667	1.05%	0.43%

9.4 This compares with a budget assumption of average investment balances of £32.8m at 2.00% investment return.

9.5 Investments held by the Council - the Council maintained an average balance of £66.5m of internally managed funds. The internally managed funds earned an average rate of return of 1.96%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.39%. This compares with a budget assumption of £51.6m investment balances earning an average rate of 2.62%.

10. Performance Measurement

10.1 One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. The following performance indicators were set out in the Annual Treasury:

10.2 **Security** - the Council's maximum security risk benchmark for the current portfolio, when compared to historic levels of default, is:

- 0.15% historic risk of default when compared to the whole portfolio.

10.3 The security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.03%	0.22%	0.40%	0.56%	0.74%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

10.4 **Liquidity** – in respect of this area the Council seeks to maintain:

- Bank overdraft - £0.1m
- Liquid short term deposits of at least £2m available with a week's notice.
- Weighted Average Life benchmark is expected to be 1.20 years, with a maximum of 1.50 years.

10.5 **Yield** - Local measures of yield benchmarks are:

- Investments – Internal returns 0.2% above the 7 day LIBID rate
- Investments – External fund managers - returns 10% in excess of 7 day LIBID.

10.6 These performance indicators are monitored throughout the year and reported to the Leader each quarter. The position at 31 March 2013 has been included in Appendix 1.

11. Staffing, Equalities, Financial and Legal Implications/Powers

11.1 The financial and legal implications are addressed throughout this report.

12. Risk Implications

12.1 Section 10 addresses the risk to security, liquidity and yield of the Council's investment strategy.

13. Environmental Impacts

13.1 None.

14. Reason for the Recommendations

14.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an Annual Treasury Report reviewing treasury management activities and the actual prudential and treasury indicators for 2012/2013. 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).

15. Background Papers

Treasury Management Strategy for 2012/2013 – Cabinet, 08 February 2012 [FIN/256 refers]

Treasury Management Mid-Year Review 2012/2013 – Cabinet, 28 November 2012 [FIN/285 refers]

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Appendix 1

Treasury Report for 31 March 2013

The following table shows the position at 31 March 2013 against the benchmarks set in the 2012/13 Treasury Strategy.

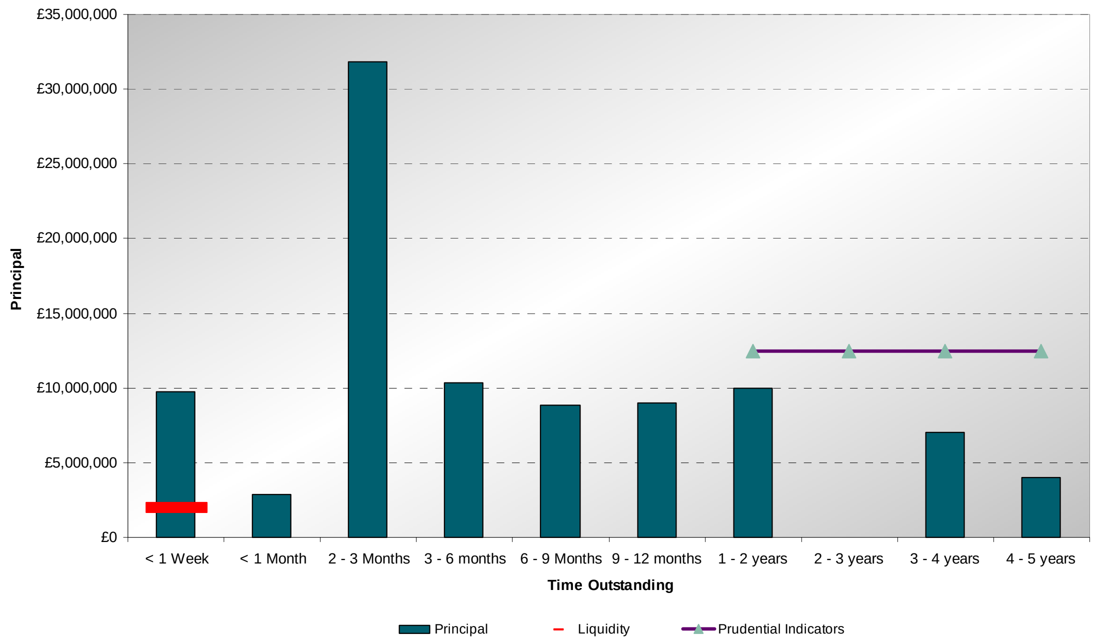
	Benchmark		Actual
Liquidity			
Weighted Average Life (years)	Avg 1.20	Max 1.50	0.90
Short-term deposits (<1 week's notice)	>£2m		£9.7m
Max sums invested >365 days	£50m		£21.1m
Security			
Overall risk of default	0.15%		0.065%
1 year	0.03%		0.010%
2 years	0.22%		0.097%
3 years	0.40%		0.000%
4 years	0.56%		0.537%
5 years	0.74%		0.155%
Non-specified investments	70%		50%
Yield			
In-house (annualised)	0.39%		1.96%
Investec (cumulative)	0.43%		1.05%
Other			
Limit on fixed rate investments	£100m		£78.3m
Limit on variable rate investments	£40m		£16.3m
Limits to Borrowing Activity			
Operational Boundary	£261.38m		£260.32m
Authorised Limit	£271.38m		£260.49m

Detailed holdings at 31 March 2013

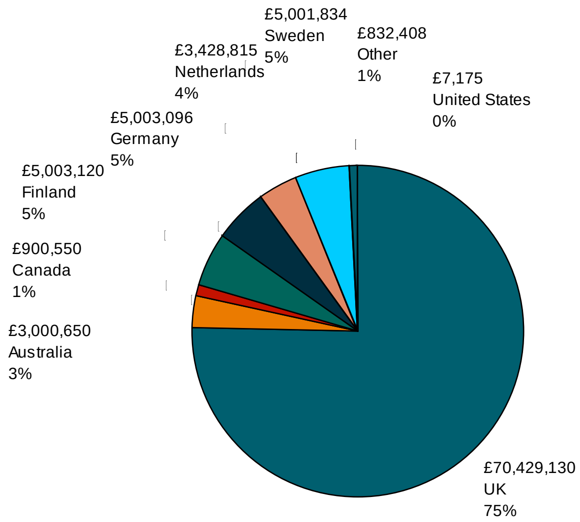
	Investec	In-House	Total	Limit	Rating
UK Banks					
Barclays Bank	£3.30m	£7.72m	£11.02m		A
HSBC Bank plc	£2.70m	£5.02m	£7.72m	£15.00m	AA-
Lloyds Banking Group		£7.03m	£7.03m	£15.00m	A
Royal Bank of Scotland		£5.01m	£5.01m	£10.00m	A
Santander		£2.10m	£2.10m		A
Standard Chartered Bank		£3.03m	£3.03m	£10.00m	AA-
UK Building Societies					
Coventry Building Society		£1.00m	£1.00m	£3.00m	A
Leeds Building Society		£2.00m	£2.00m	£3.00m	A-
Nationwide Building Society	£1.20m	£4.01m	£5.21m	£10.00m	A+
Nottingham Building Society		£2.00m	£2.00m	£3.00m	BB
Local Authorities					
Aberdeen City Coucil		£3.01m	£3.01m	£15.00m	AAA
Birmingham County Council		£10.01m	£10.01m	£15.00m	AAA
Lancashire County Council		£2.01m	£2.01m	£15.00m	AAA
Midlothian Council		£3.01m	£3.01m	£15.00m	AAA
Peterborough City Council		£4.00m	£4.00m	£15.00m	AAA
Money Market Funds					
Investec Liquidity Funds	£3.29m		£3.29m	£15.00m	AAA
Overseas Banks					
Bank of Nova Scotia	£0.99m		£0.99m	£10.00m	AA-
Citibank NA	£0.01m		£0.01m		A
Deutsche Bank AG	£5.00m		£5.00m		A+
National Australia Bank	£3.00m		£3.00m	£15.00m	AA-
Nordea Group	£5.02m		£5.02m	£15.00m	AA-
Rabobank	£3.33m		£3.33m	£15.00m	AA
Svenska Handelsbanken	£5.00m		£5.00m	£15.00m	AA-
Supranationals Bonds					
European Bank for Reconstruction	£0.83m		£0.83m	£15.00m	AAA
	£33.67m	£60.96m	£94.63m		

The current full counterparty report, with lending limits is included in Appendix 2.

Compliance with Liquidity and Prudential Indicator Limits



Country Limits



These charts include investments made by Investec.

Sector Diversification