REPORT FOR:	**Governance, Audit and Risk Management Committee (GARM)**
Date:	22 July 2013
Subject:	Treasury Management Outturn Report 2012/13
Responsible Officer:	Simon George. Director of Finance and Assurance
Portfolio Holder:	Councillor Thaya Idaikkadar (Leader and Portfolio Holder for Business Transformation and Communications, Finance, Performance, Customer Services and Corporate Services, Property and Major Contracts)
Exempt:	No
Enclosures:	Appendix 1 – Prudential Indicators Appendix 2 – Counterparty Policy *Appendix 3 – Report to Cabinet (18 July 2013) *(NB: this report was circulated with the Cabinet agenda and sent to all Members)

Section 1 – Summary and Recommendations

This report sets out the summary of Treasury Management activities for 2012/13. The report was referred to GARM Committee for scrutiny by Cabinet.

Recommendations:

The Committee is requested to review and comment on the Treasury Management Outturn.

Reason
To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

Section 2 – Report

Introduction

1. The paper that follows is due to be discussed by Cabinet on 18 July 2013. In line with GARMC's role to scrutinise treasury management activities, Cabinet has been asked to refer this report to GARMC.

2. The remainder of the report is identical to that presented to Cabinet.

3. Treasury Management is the management of the Council's investments and cash flows, its banking, money market and debt transactions together with the effective control of the risks associated with those activities.

4. The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the 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).

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

    § An annual treasury strategy in advance of the year (Council 9 February 2012).
    § A mid year treasury update report (Cabinet 13 December 2012).
    § An annual report following the year end describing the activity compared to the strategy (this report).

6. The regulatory environment places an onus on members to review and scrutinise the treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies. The additional requirements for scrutiny have been delegated to the Governance, Audit and Risk Management Committee (GARMC) and this report will be submitted to GARMC. The Treasury Management Group chaired by the Director of Finance and Assurance meets monthly to review treasury activity.

7. This annual treasury report covers

    - Overall outturn position on treasury management,
    - Council's treasury position as at 31 March 2013,
    - The economy in 2012/13,
    - Borrowing outturn for 2012/13,
    - Investment outturn for 2012/13; and
    - Compliance with treasury limits and Prudential Indicators.

Outturn Position

8. There was a favourable variance of £1.8 million on the updated capital financing budget of £19.8 million as detailed below:-

	Latest Budget	Outturn	Variation	
	£000	**£000**	**£000**	**%**
Cost of Borrowing	8,140	8,227	87	1.1%
Investment Income	-678	-1,702	-1,024	-251%
Minimum Revenue Provision	12,348	11,448	-900	-7.3%
Total	**19,810**	**17,973**	**-1,837**	**-9.3%**

9. The favourable outcome arose due to:

   (a) Borrowing – gross borrowing costs (excluding allocations) are in line with the budget. The excess costs relate to allocations to HRA, in particular Housing CFR, on which the interest allocation is calculated, is lower than was anticipated.

   (b) Income – the average of interest earned was 1.83%, which compares favourably with the prior year (1.65%) and three month Libid (0.56%). The budget was based on a rate of 1.46%. The average investment balance also exceeded the forecast - £117 million v £85 million.

   (c) MRP – The favourable variance results from project underspend and slippage on completion timetables.

Treasury Position as at 31 March 2013

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

	31st March 2013	**Average Rate**	**Average Life yrs**	31st March 2012	Average Rate	Average Life yrs
	£m	**%**	**Yrs**	£m	%	Yrs
Fixed Rate Borrowing						
Public Works Loan Board (PWLB)	218.5	4.09	38.2	218.5	4.09	39.1
Market	131.8	4.65	34.4	131.8	4.65	35.4
Total Debt	**350.3**	**4.30**	**36.8**	**350.3**	**4.30**	37.8
Investments:						
In-House	103.2	1.83	276 days	89.3	1.65	216 days
Total Investments	**103.2**			**89.3**		

The above analysis assumes loans structured as LOBOs (see paragraph 17 below for definition and further details) mature at the end of the contractual period. If the first date at which the lender can reset interest rates was used as the maturity date, the average life for market loans would be 2.3 years and for the whole debt portfolio 24.7 years.

11. Details on borrowing and investment activities follow in the report.

The Economy and Interest Rates

12. The original expectation for 2012/13 was that the 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. The 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.

13. 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.

14. 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.

15. 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 as did Fitch in May 2013.

Borrowing Outturn for 2012/13

16. Total long term debt of £350.3 million at the end of March 2013 is made up £131.8 million bank loans and £218.5 million from the PWLB.

17. There was no additional borrowing or repayments during the year. The table below sets out the borrowing maturity profile. The allocation to 5 – 10 year debt at 7.7% is below the planned range of 10 – 40%.

	31st March 2013		31st March 2012	
	£m	**%**	£m	%
Under 12 Months	10.0	2.9	0.0	0.0
12 Months and under 24 Months	6.0	1.7	10.0	2.9
24 Months and within 5 years	10.0	2.8	6.0	1.7
5 years and within 10 years	27.0	7.7	32.0	9.1
10 years and above	297.3	84.9	302.3	86.3
Total	**350.3**	**100.0**	350.8	100.0

18. The approach to funding capital expenditure as discussed in the February 2012 strategy was to use internal funds where ever possible in recognition of the unfavourable gap between investment returns and borrowing costs. Both the cost of new debt and the rates paid on deposits have declined, with the gap between the two making the carrying of excess cash increasingly expensive. Consideration was given to premature repayment of debt, which would incur a premium. This was rejected as cashflow projections indicate that any advantage would be short term with replacement debt required in later years. With expectations that gilt yields will increase in the next 2-5 years, any additional costs of carrying surplus cash in the short term will be greatly offset with longer term savings in borrowing costs.

19. In aggregate there is £83.8 million of Lender Option Borrower Option (LOBO) structured loans shown in the table above as having maturities of between 38 and 66 years. The lenders are permitted to reset interest rates five years after the loan is drawn and either semi-annually or annually thereafter. Should interest rates on these loans increase, the Council is able to repay at no cost. The table below restates the maturity profile by including LOBO loans at their first interest reset date. With PWLB borrowing rates close to historic lows, there could be a saving if any of the LOBO loans had to be repaid or replaced in the next 12 months.

	31st March 2013	
	£m	**%**
Under 12 Months	43.8	12.5
12 Months and under 24 Months	36.0	10.3
24 Months and within 5 years	30.0	8.6
5 years and within 10 years	27.0	7.7
10 years and above	213.5	60.9
Total	**350.3**	**100.0**

Investment Outturn for 2012/13

20. The Bank of England base rate has remained at 0.5% since March 2009 while 7 day and 3 month Libid rates continued to decline ending the year at 0.37% and 0.38% respectively making investing over short horizons unattractive. Despite these headwinds the investment portfolio achieved an average return of 1.83% in the year through concentrating investments with the two part UK Government owned banks that offered superior returns, particularly in the first half of the year.

21. The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The treasury strategy permits investments for a range of periods from overnight to three years (historically up to five years), dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Further details of the credit quality of counterparties are given in appendix 2.

22. The investment portfolio is mostly (95%) invested with two banks, Lloyds / HBOS (50%) and RBS (45%). The counterparty policy at the start of the year permitted 30% to be invested in each of these banks and this was revised in October after discussion with GARMC to 50% with each bank. The change was based on the

additional assurance from part ownership by the UK Government, which is reflected in the maximum maturity of 3 years with these two banks, compared with three months for the other approved counterparties.

23. Full advantage has been taken of the available limits with Lloyds and RBS. Not only did they offer higher interest rates than the other UK banks but the longer permitted maturity also enhanced revenue.

24. As at 31st March 2013 the investment portfolio is invested over a spread of maturities up to three years. At the year end £25 million matures in more than 12 months taking advantage of the longer tern rates available. This is the maximum permitted by the strategy. These deposits yield between 1.4% and 3.6%, considerably greater than three month deposits which yield less than 1%. A listing of new investments of 3 months or more in the year is included in appendix 2.

25. The returns from the investment portfolio are benchmarked by the treasury advisor, Sector, and in the year the weighted average return calculated by Sector of 1.90% exceeded both their risk adjusted model portfolio (1.57%) and the average of other London Boroughs (1.21%).

26. The table below sets out the investment balances as at 31 March 2013.

	31st March 2013		31st March 2012	
	£m	**%**	£m	%
Specified Investments				
Banks & Building Societies	0.1	0.1	0.1	0.1
Money Market Funds	0.0	0.0	5.7	6.4
Non –Specified Investments				
Banks & Building Soc.	103.1	99.9	83.5	93.5
Total	**103.2**	**100.0**	89.3	100.0

27. Included in the above balances are funds of £4.4 million invested on behalf of the West London Waste Authority and Pension Fund balances of £2.7 million. Most pension fund cash balances are held in separate banks accounts in the name of the fund (£19.6 million as at 31st March 2013). In aggregate 23% of interest earned is allocated both to the WLWA and to internal funds (schools, housing, insurance etc).

Compliance with Treasury Limits

28. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The prudential system provides a flexible framework approach within which capital assets can be procured, managed, maintained and developed. Under this framework, individual authorities are responsible for deciding the level of their affordable borrowing for the Council's capital investment plans that is demonstrated to be affordable, prudent and sustainable.

29. The Act and the supporting regulations require the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years. The indicators for 2012/13 were approved by the Cabinet in February 2012. During the financial year the Council operated within the treasury limits and Prudential Indicators

as shown in Appendix 1, apart from the matter referred to in paragraph 28 below. Appendix 1 also comments on the outturn compared with the strategy.

30. At the year end the investment with Lloyds Bank represented 50.4% of aggregate balances, marginally in excess of the 50% limit. Cash balances at the year end are at their lowest level and were below the level anticipated when dealing in early March. The Lloyds position returned to below 50% on the first working day of April 2013.

Minimum Revenue Provision (MRP)

31. Under the statutory regulations a Minimum Revenue Provision is made each year to repay the outstanding debt on assets. This is calculated by spreading the capital expenditure over the useful life of the asset as detailed in the strategy.

Financial Implications

32. Financial matters are integral to the report.

Environmental Impact

33. There are no direct environmental impacts.

Performance Issues

34. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function

Risk Management Implications

35. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

Risk included on Directorate risk register? Yes
Separate risk register in place? No

Equalities Implications

36. There is no direct equalities impact.

Corporate Priorities

37. This report deals with the Treasury Management Strategy which is a key to delivering the Council's corporate priorities.

Legal Implications

38. The report has been reviewed by the Legal Department and comments received are incorporated into the report.

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 17 June 2013	√	Chief Financial Officer
Name: Matthew Adams Date: 24 June 2013	√	on behalf of the Monitoring Officer

Section 6 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager, Finance & Procurement) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: N/A