Brent	**Executive** 15 July 2013 **Report from the Deputy Director of Finance**
	Wards Affected: ALL
2012/13 Treasury Management Outturn Report	

1. SUMMARY

1.1 This report updates members on recent Treasury Management activity. The Council can confirm that it has complied with its Prudential Indicators for 2012/13. Details can be found in Appendix 1.

2. RECOMMENDATION

2.1 The Executive is asked to note the 2012/13 Treasury Management outturn report as also submitted to the Council and Audit Committee.

3. DETAIL

3.1 BACKGROUND

3.1.1 The Council's Treasury Management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of Treasury Management activities at least twice a year. A strategy is approved by the Council with the Budget and the outturn is reported as soon as possible after the end of the year and progress is reported half way through the year. Reports are scrutinised by the Audit Committee.

3.1.2 Treasury Management 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."

3.1.3 Overall responsibility for Treasury Management remains with the Council. No Treasury Management activity is without risk; the effective identification and management of risk are integral to the Council's Treasury Management objectives.

3.2 Economic Background

3.2.1 The global outlook stabilised mainly due to central banks maintaining low interest rates and expansionary monetary policy for an extended period. Equity market assets recovered sharply with the FTSE 100 registering a 9.1% increase over the year. This was despite economic growth in G-7 nations being either muted or disappointing.

3.2.2 In the UK the economy shrank in the first, second and fourth quarters of calendar 2012. It was the 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012. The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy. Avoiding a 'triple-dip' recession became contingent on upbeat services sector surveys translating into sufficient economic activity to overhaul contractions in the struggling manufacturing and construction sectors.

3.2.3 Household financial conditions and purchasing power were constrained as wage growth remained subdued at 1.2% and was outstripped by inflation. Annual Consumer Price Index (CPI) dipped below 3%, falling to 2.4% in June 2012 before rising to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.

3.2.4 The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases as part of its Quatitative Easing (QE) programme in July, taking total QE to £375 billion. The possibility of a rate cut was discussed at some of the Bank's Monetary Policy Committee meetings, but was not implemented as the potential drawbacks outweighed the benefits. In the March Budget the Bank's policy was revised to include the 2% CPI inflation remit alongside the flexibility to commit to intermediate targets.

3.2.5 The labour market was surpisingly resilient, with the unemployment rate falling to 7.8%. Many of the gains in employment were through an increase in self-employment and part time working.

3.2.6 The Chancellor largely stuck to his fiscal plans with the austerity drive extending into 2018. In March the Office for Budgetary Responsibility (OBR) halved its forecast growth in 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The government is now expected to borrow an additional £146bn and sees gross debt rising above 100% of GDP by 2015-16. The fall in debt as a percentage of GDP, which the coalition had targeted for 2015-16, was deferred by two years. With the national debt metrics inconsistent with a triple-A rating, it was not surprising that the UK's sovereign rating was downgraded by Moody's to Aa1. The AAA status was maintained by Fitch and S&P, albeit with a Rating Watch Negative and with a Negative Outlook respectively.

3.2.7 Gilt Yields and Money Market Rates: Gilt yields ended the year lower than the start in April. 10-year yields fell by nearly 0.5% ending the year at 1.72%. The reduction was less pronounced at the longer end; 30-year yields ended the year at 3.11%, around 25bp lower than in April.

3.2.8 The Funding for Lending Scheme caused a sharp drop in rates at which banks borrowed from local government. 3-month, 6-month and 12-month Libid rates which were 1%, 1.33% and 1.84% at the beginning of the financial year fell to 0.44%, 0.51% and 0.75% respectively.

3.3 THE BORROWING REQUIREMENT AND DEBT MANAGEMENT

PWLB Certainty Rate

3.3.1 The Certainty Rate was introduced by the PWLB in November 2012, allowing the authority to borrow at a reduction of 20bps on the Standard Rate.

Borrowing Activity in 2012/13

	Balance on 01/04/2012 £m	Debt Maturing £m	New Borrowing £m	Balance on 31/03/2013 £m	Average Rate %
CFR	500				
Short Term Borrowing	26	96	70	0	0
Long Term Borrowing	405	3	30	432	4.69
TOTAL BORROWING	431	99	100	432	4.69

3.3.2 The Council funded £30m of its capital expenditure through new long term borrowing. The PWLB remained the Council's preferred source of borrowing given the transparency and control that its facilities continue to provide. The average rate payable on the debt is 2.49% and average maturity is 18 years, though as the loan is repayable by Equal Instalments of Principal (EIP), the balance outstanding will fall steadily over the life of the loan.

3.3.3 Given the large differential between short and longer term interest rates, which is likely to remain a feature for some time in the future, as well as the pressure on Council finances, the debt management strategy sought to lower debt costs within an acceptable level of volatility (interest rate risk). Loans that offered the best value in the prevailing interest rate environment were PWLB medium-term EIP loans and temporary borrowing from the market. Use of these instruments also involves a level of repayment every year, which offers an element of flexibility in case the level of the borrowing requirement does not continue to rise, as has been the case in the past.

Internal Borrowing

3.3.4 Given the significant cuts to local government funding putting pressure on Council finances, the strategy followed was to minimise debt interest payments without compromising the longer-term stability of the portfolio. The differential between the cost of new longer-term debt and the return generated on the Council's temporary investment returns was significant (between 2% - 3%). The use of internal resources in lieu of borrowing was judged to be the most cost effective means of funding £50m of capital expenditure. This has, for the time being, lowered overall treasury risk by reducing both external debt and temporary investments. Whilst this position is expected to continue in 2013/14, it will not be sustainable over the medium term. The Council expects it will need to borrow £120m for capital purposes by the end of 2015 - 16.

Lender's Option Borrower's Option Loans (LOBOs)

3.3.5 No lenders have excercised their options to change the terms of LOBO loans during the year

3.3.6 The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date. This change is reflected in Appendix 1, paragraph (c).

3.3.7 Changes in the debt portfolio have decreased the average life from 40 years to under 39 years but has smoothed the maturity profile somewhat and introduced an element of flexibility in case the Council's need to borrow starts to decline in the future.

3.4 INVESTMENT ACTIVITY

3.4.1 DCLG's Investment Guidance requires local authorities to focus on security and liquidity, rather than yield.

Investment Activity in 2012/13

Investments	Balance on 01/04/2012 £m	Investments Made £m	Maturities/ redemptions £m	Balance on 31/03/2013 £m	Average Rate %
Short Term Investments	34	1,840	1,826	48	0.59
Investments in Pooled Funds	10	226	220	16	0.33
TOTAL INVESTMENTS	44	2,066	2,046	64	0.59

3.4.2 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. Investments during the year included:

Deposits with other Local Authorities

Investments in AAA-rated Money Market Funds

Call accounts and deposits with UK Banks
Deposits with the Debt Management Office

Credit Risk

3.4.3 Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swaps, GDP of the country in which the institution operates and the country's net debt as a percentage of GDP, any potential support mechanisms and share price. The minimum long-term counterparty credit rating determined for the 2012/13 Treasury Management strategy was A+/A+/A1 across rating agencies Fitch, S&P and Moody's until the end of February. Following a review of the significance of credit ratings and their implications for risk, and with the advice of our advisors, Arlingclose, the Treasury Management Strategy Statement for 2013 - 14 revised the minimum ratings to A-/ A-/A3, with the proviso that institutions which met these criteria would still be subject to more wide ranging considerations to ensure that Officers were comfortable with institutions included on the Lending List.

3.4.4 In June Moody's downgraded a range of banks with global capital market operations, including the UK banks on the Council's lending list - Barclays, HSBC, Royal Bank of Scotland/Natwest, Lloyds TSB Bank/Bank of Scotland and Santander UK plc - as well as several non UK banks. These ratings fell below the Council's minimum criteria at the time and were removed from the list. Following the review, they have been reinstated.

3.4.5 Counterparty credit quality has been maintained as demonstrated by the Credit Score Analysis summarised below. The table in Appendix 2 explains the credit score.

Credit Score Analysis 2012/13

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2012	2.18	AA+	2.38	AA+	3
30/06/2012	1.99	AA+	1.75	AA+	87
30/09/2012	1.99	AA+	1.75	AA+	87
31/12/2012	2.59	AA	1.77	AA+	90
31/03/2013	4.40	AA-	4.43	AA-	233

Liquidity

3.4.6 The Council maintained a sufficient level of liquidity through the use of Money Market Funds, call accounts and short term deposits.

Yield

3.4.7 The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% throughout the year.

3.4.8 In response to uncertain and deteriorating credit conditions in Europe, the Council's Lending List was restricted and, for a time, a very narrow range of counterparties was used. With slightly improved credit conditions as winter went on, it was felt to be prudent to extend the list, though Eurozone and some other European banks are still not included, as conditions in the Eurozone are still not felt to be sufficiently predictable to make them acceptable risks.

3.4.9 The Council's budgeted investment income for the year had been estimated at £0.16m. The average cash balances representing cash available to the Council for the short term were £73m during the period and interest earned was £0.28m.

Update on Investments with Icelandic Banks

3.4.10 In December 2011, the Courts determined that local authority deposits with Glitnir qualified for priority status, which means that the Council should recover 100% of its deposit. The decision was final and there is no further right of appeal. However the final recovery will be influenced by the exchange rate when the Icelandic krona becomes convertible. About £1m remains outstanding.

3.4.11 The liquidators of Heritable expected that 88p/£ or more will be recovered overall, though some commentators feel that this is a conservative estimate. 77% has been recovered to date, and a further 5% is expected in 2013/14.

3.4.12 CIPFA has issued recently further updated guidance on the accounting treatment as LAAP 82 (update 7); this is not felt to require revision to the approach which the Council has taken up to now.

Compliance

3.4.13 in compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the Treasury Management activity during 2012/13. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

3.4.14 The Authority can confirm that during 2012/13 it complied with its Treasury Management Policy Statement and Treasury Management Practices.

BACKGROUND INFORMATION
Logotech Loans Management System.
Arlingclose reports on Treasury Management.
2012/13 Budget and Council Tax report – 27 February, 2012

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Appendix 1

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

The Deputy Director of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; borrowing at its peak was £455m.

	Operational Boundary (Approved) as at 31/03/2013 £m	Authorised Limit (Approved) as at 31/03/2013 £m	Actual External Debt as at 31/03/2013 £m
Borrowing	823	723	432

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limits for 2012/13 %	Maximum during 2012/13 /%
Upper Limit for Fixed Rate Exposure	100	100
Compliance with Limits	Yes	Yes
Upper Limit for Variable Rate Exposure	40	16
Compliance with Limits	Yes	Yes

Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Borrowing as at 31/03/2013 £m	Actual Borrowing as at 31/03/2013 %	Compliance with Set Limits?
under 12 months	40	0	50	12	Yes
12 months and within 24 months	20	0	9	2	Yes
24 months and within 5 years	20	0	48	11	Yes
5 years and within 10 years	60	0	36	8	Yes
10 years and within 20 years	100	0	9	2	Yes
20 years and within 30 years	100	0	20	5	Yes
30 years and within 40 years	100	0	76	18	Yes
40 years and above	100	0	184	42	Yes
Total			432	100	

The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date

Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2012/13 Approved £m	2012/13 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
Non-HRA	185		85	107
HRA	13		17	10
Total	198		102	117

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2012/13 Approved %	2012/13 Actual %	31/03/2014 Estimate %	31/03/15 Estimate %
Non-HRA	9.63	8.47	8.83	10.25
HRA	22.18	21.17	20.34	15.85

Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Authority adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the re-adoption of the CIPFA Treasury Management Code at its meeting on 27 February, 2012

Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2012/13 Approved £m	2012/13 Actual £m	31/03/2014 Estimate £000s	31/03/15 Estimate £000s
	20	0	0	0

HRA Limit on Indebtedness

	2012/13 Approved £m	2013/13 Actual £m	31/03/2014 Estimate £000s	31/03/15 Estimate £000s
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
HRA CFR	137	137	137	137
Difference	62	62	62	62

Appendix 2

Credit Score Analysis

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10
Not rated	11
BB	12
CCC	13
C	14
D	15

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The Council aimed to achieve a score of 7 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.