Report to:

Audit and Governance Committee
Cabinet
Council

Report of: Head of Finance

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To: Audit and Corporate Governance Committee on: 23 September 2013
To: Cabinet on: 4 October 2013
To: Council on: 23 October 2013

Treasury management outturn 2012/13

That Audit and Governance Committee:

1. Notes the treasury management outturn report 2012/13 and

2. Is satisfied that the treasury activities are carried out in accordance with the treasury management strategy and policy.

3. Make any comments and recommendations to cabinet as necessary.

That Cabinet:

Considers any comments from Audit and Governance Committee and recommends Council to:

1. Approve the treasury management outturn report for 2012/13;

2. Approve the actual 2012/13 prudential indicators within the report.

Purpose of Report

1 The report fulfils the legislative requirements to ensure the adequate monitoring and reporting of the treasury management activities and that the council's prudential

indicators are reported to council at the end of the year. The report provides details of the treasury activities for the financial year 2012/13.

Strategic Objectives

2 Effective treasury management is required in order to meet our strategic objective of managing our business effectively. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that the resources are available to deliver our services and meet the council's other strategic objectives.

Background

3 The council's treasury activities are strictly regulated by legislation. The CIPFA Prudential Code and CIPFA Treasury Management Code of Practice requires a report to be provided at the end of the year. The report covers the treasury activity for 2012/13.

4 The 2012/13 treasury management strategy was approved by council on 23 February 2012. This report provides details on the treasury activity and performance for 2012/13 against the prudential indicators and benchmarks set for the year. Full council is required to approve this report.

5 An update on the economic conditions and interest rate forecasts is contained in appendix 'A'.

Icelandic bank default – Landsbanki Islands hf

6 As previously reported, the Council has an investment of £1m with Landsbanki. The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed into receivership.

7 In April 2011 the Reykjavik District Court ruled that local authorities' claims qualified for priority under Icelandic bankruptcy legislation. The decision was appealed to the Icelandic Supreme Court who affirmed the district court's ruling in October 2011. Subsequently the Reykjavik District Court recognised the council's claim at £1,004,890.41 (being the prinicipal sum plus interest due).

8 It is estimated that we will receive the full amount of the claim, although repayments will be received in stages up to 2018. The first distribution payment was made in December 2011, to date the council has received £481,311. Councillors will be periodically informed on the latest developments as they become known. In March 2012 the Winding Up Board for Landsbanki Islands hf anticipated that recovery would exceed the book value of claims and as a result the Council is eventually likely to recover 100 per cent of their deposit.

Treasury activities in 2012/13

Council investments as at 31 March 2013

9 The council's investments at 31 March 2013 were as follows:

Table 1: maturity structure of investments at 30 March 2013:	£000's	% holding
Call	10,480	46%
Money market fund	60	0%
Up to 4 months	8,000	35%
5 to 6 months	4,000	18%
6 months to 1 year	-	0%
Total investments	**22,540**	**100%**

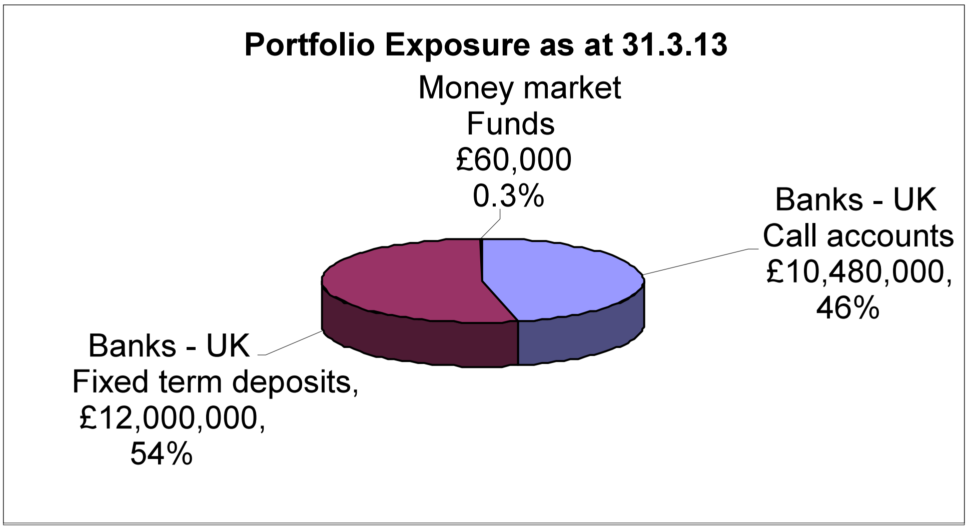
10 The majority of the funds invested are held in the form of fixed interest rate and term cash deposits. These provide some certainty over the investment return. The investment profile is organised in order to ensure sufficient liquidity for revenue and capital activities, security of investments and to manage risks within all treasury management activities.

11 Funds managed externally by Investec were brought back in-house at the end of July 2012. These funds were reinvested directly in fixed term deposits. This decision has produced annual savings in management fees of £19,000 per annum in addition to the increase in investment income for the year.

12 Money market rates in the last six months of the year have fallen significantly. One year rates have dropped by over 1.25 per cent. The governments Funding to Lending Scheme (FLS) has provided access to cheap borrowing for both banks and building societies. This has reduced the demand within the money markets significantly and had a real impact on the investment rates. It has been difficult to find re-investment opportunities which also meet the security and risk criteria.

13 The weighted average maturity period at the end of the year was 45 days.

14 The chart below shows in percentage terms how the portfolio is spread across investment types:



Investment income

15 The total investment income achieved in 2012/13 was £553,000 compared to the original budget estimate of £417,000 as shown in table 1 below:

Table 2: Investment interest earned by investment type			
Investment type	Actual Budget £000's	Actual Interest £000's	Variation £000's
Call accounts	177	67	110
Cash deposits	-	433	(433)
MMFs	-	6	(6)
Fund Manager	240	47	193
Total Interest	**417**	**553**	**(136)**

16 The actual return achieved was 33 per cent higher than the original budget. This was due to :

- The average rates achieved on internally managed investments were higher than originally forecast.
- The average maturity period for investments was extended throughout the first six months of the year.
- Average balances throughout the year have remained higher than forecast.

17 The total actual average interest rate achieved for the year was 2.04 per cent.

Performance measurement

18 A list of investments as at 31 March 2013 is shown in appendix B. The average level of investments held throughout the year was £27 million and the average return on these investments is shown below in table 3.

Table 3: investment returns achieved against benchmark				
	Benchmark return	Actual return	Growth (below)/above benchmark	Benchmarks
	%	%	%	
Bank & building society deposits - managed in house	0.39%	2.04%	1.65%	7 day LIBID
Industry average*	0.39%	1.12%	0.73%	

*Source : Sector weighted average of 6 fund managers' results covering 35 funds

19 The table shows in summary the performance of the council's investments against the benchmarks set out in the treasury management strategy. These benchmarks are used to assess and monitor the council's investment performance. The annual investment strategy set the benchmark target for internal cash invested as the 7day LIBID. The performance for the year of 2.04% exceeded the benchmark by 1.65 per cent and was 0.92 per cent above the industry average.

20 The council uses short-term investments to meet daily cash-flow requirements and has also aims to invest a proportion of the portfolio over longer dated cash deposits where possible. The weighted average life (WAL) of the council's investments has decreased to 45 days from 139 days in 2011/12. This is due to the rates we achieved on our call accounts exceeded the fixed term deposit rate for 12 month deposits and therefore investments were kept 'on call'.

External Fund Managers

21 The funds managed by Investec of £10 million, were closely monitored over a period of months in 2012. Performance did not improve significantly. As a result officers took the decision to withdraw the remaining funds at the end of July 2012.

Land and Property

22 The council holds a portfolio of non-operational assets, which includes land, offices and shops that are let on a commercial basis. These assets had a net book value of £20.8 million at 31 March 2013 (£29.4 million as at 31 March 2012) and generated income of £1.5 million (£1.4 million in 2011/12). This is equivalent to a gross return of 7.2% (2011/12, 4.7%), which excludes costs such as maintenance and management fees. Due to movement in property values and the exclusion of whole life costs, these rates of return should not be taken as a direct comparison with the treasury rates. The Economy, Leisure and Property (ELP) team manages investment property ensuring that rent is collected and rent reviews are implemented. The performance of the investment property is assessed annually to determine if assets should be retained or disposed of.

Treasury management limits on activity

23 The council is required by the Prudential Code to report on the limits set each year in the treasury management strategy. The purpose of these limits is to ensure that the activity of the treasury function remains within certain parameters, thereby mitigating risk and reducing the impact of an adverse movement in interest rates. However, if these limits are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. During the year none of these limits were exceeded. These limits are shown in appendix C.

Liquidity and yield

24 The benchmarks for liquidity are set to ensure that sufficient funds can be accessed at short notice. These are targets and not limits. The weighted average life (WAL) in days sets a benchmark for how long investments should be made and the maximum benchmark is a target set to ensure that investments are not made for too long. For example the amount to be maintained for liquidity was £10m and the actual of £11m was above the benchmark. The actual year end position for the WAL of 45 days was lower than the benchmark of 91 days and did not exceed the maximum of 360 days. This reduction was due to longer dated deposits maturing towards the end of 2013, and a lack of new opportunities to reinvest in deposits of a similar maturity length.

25 The year end position against the original benchmarks approved in February 2012 is shown below:

	2012/13 Benchmark £m	**2012/13 Actual £m**
Bank overdraft	0.5	0
Short term deposits - minimum available within 1 week	10	11
	2012/13 Benchmark	**2012/13 Actual**
Weighted average life (days)	91.0	45.0
Weighted average life - maximum	360.0	45.0

Debt activity during 2012/13

26 During 2012/13 there has been no need for the council to borrow. The council will continue to take a prudent approach to its debt strategy. The prudential indicators and limits set out in appendix C provide the scope and flexibility for the council to borrow in the short-term up to the maximum limits, if such a need arose within the cash flow management activities of the authority, for the achievement of its service objectives.

Financial implications

27 A year ago, forecasts were that inflationary pressures would mean that interest rates would have to start rising towards the end of 2012. This has not happened and the current outlook for growth in the UK economy means interest rates are very low and are likely to remain so. The investments made in 2012/13 ensured that the council earned interest of £553,000, however from 2013, income is anticipated to reduce until

market rates rise. This will be reflected in the council's 2014/15 budget and its medium term financial plan.

Legal implications

28 There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the DCLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

29 As at 31 March 2013, the council's financial investments had a cost value of approximately £22.5 million. As a result of proactive management of investments held, and despite a fall in market interest rates, during 2012/13 investments generated £553,000 in investment income, which was £136,000 above the £417,000 original budgeted estimate. Officers identified mid year that the external funds were under performing and took steps to bring back a portion of these funds and re-invest in fixed term deposits at higher rates.

30 The financial year 2012/13 provided volatile conditions with regard to treasury management. Concerns for counterparty risk continue to present the council with a difficult environment to invest in. The main implications of these factors were:

- low investment returns and difficulty to forecast;
- increased counterparty risk – reduced choice of counterparties
- Interest rate exposure risk – due to investments held in short-term maturity periods.

31 Despite the continued uncertainty the overall investment performance was above the industry average for 2012/13. Investments were made in the year that provided a good return whilst maintaining security and liquidity.

Background papers

- Chartered Institute of Public Finance and Accounting (CIPFA) code of practice for treasury management in the public sector.
- CIPFA treasury management in the public services code of practice and cross sectoral guidance notes
- Treasury Management Strategy 2012/13 – Council 23 February 2012.

Appendices

A – Economic update and interest rates
B – List of investments as at 31 March 2013
C – Prudential indicators
D – Glossary of terms

Appendix A

Economic Update and interest rates as at August 2013

A1. Growth in the UK economy remains weak. National debt is expected to rise above 100 per cent of GDP by 2015-16 and this resulted in the UK losing its AAA rating.

A2. Household financial conditions remain subdued. Job fears, inflation eroding disposable incomes, small or no pay increases are all factors contributing to consumers ability to spend and overall living standards have fallen in real terms due to the sharp price rises relative to wages. Average real wages have fallen every month since June 2008. The squeeze on households' income will remain a critical factor in the economy over the next few years. Inflation is the main cause and will continue to have the greatest impact on living standards as real income will continue to decline. The slow recovery has meant that social security payments remain high and tax income is low.

A3. The Euro region suffered a further period of stress with Spain forced to officially ask for a bailout of its domestic banks. However, the ECB declared it would do whatever it takes to stabilise the Eurozone.

A4. The government Funding for Lending Scheme (FLS) has been introduced to improve access to mortgages at lower rates. This has affected lenders need to borrow and money market rates have fallen considerably as a result. There will be a need to increase interest rates and reverse the government bond purchases at some stage, but it is unlikely to happen in the next 12 to 24 months.

A5. Investor demand in UK gilts as a 'safe haven' continues to keep yield increases down. Long term rates will eventually rise, mainly due to the fact that high volumes of gilts have been issued already in the UK and also in other major western countries.

A6. The interest rate forecast is based on the assumption that growth starts to recover in the next three years. If the EZ crisis worsens or low growth in the UK continues the base rate is likely to remain low for longer than this forecast.

A7. Concerns over investment counterparty risk remain because of the volatile economic conditions. However the council's current treasury management policy manages this risk down to a low level.

1. Interest rates

A8. The Bank of England changed its forecast significantly in the August Inflation report and upgraded its growth predictions to 1.4% in 2013 and 2.5% in 2014.

A9. Bank rate remained unchanged at 0.5% throughout the first half of 2012/13. The earlier forecast of a rate rise in Q4 of 2014 has been postponed until Q4 in 2016.

A10. Investment rates have remained flat with a range between 0.5 per cent to around 1.0 per cent for up to a year's maturity. This has dropped significantly as banks and building societies were offered further cheap cash supply via the FLS. The short term rates from one month to six months offer very little differential with six month rates ranging between 0.37 per cent and 0.55 per cent.

A11. Sector's forecast of the expected movement in medium term interest rates:

	NOW	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	0.50
3 month LIBID	0.39	0.40	0.40	0.40	0.40	0.40	0.40	0.40
6 month LIBID	0.47	0.50	0.50	0.50	0.50	0.50	0.50	0.50
12 month LIBID	0.74	0.80	0.80	0.80	0.80	0.80	0.80	0.80
5 yr PWLB	2.20	2.20	2.20	2.20	2.20	2.20	2.30	2.40
10 yr PWLB	3.40	3.30	3.30	3.30	3.30	3.30	3.40	3.50
25 yr PWLB	4.30	4.20	4.20	4.30	4.30	4.40	4.50	4.60
50 yr PWLB	4.30	4.30	4.30	4.40	4.40	4.50	4.60	4.70
	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3 month LIBID	0.40	0.40	0.40	0.40	0.50	0.60	0.80	1.00
6 month LIBID	0.50	0.50	0.50	0.60	0.70	0.90	1.10	1.30
12 month LIBID	0.80	0.90	1.00	1.20	1.40	1.60	1.80	2.00
5 yr PWLB	2.50	2.60	2.80	2.90	3.00	3.20	3.30	3.40
10 yr PWLB	3.60	3.80	3.90	4.10	4.20	4.30	4.40	4.50
25 yr PWLB	4.70	4.80	4.90	5.00	5.00	5.10	5.10	5.20
50 yr PWLB	4.80	4.90	5.00	5.10	5.10	5.20	5.20	5.30

Appendix B

Investments as at 31 March 2013

Counterparty	Deposit Type	Principal £	Rate
Lloyds TSB Bank Plc	Fixed	3,000,000	3.00%
Lloyds TSB Bank Plc	Fixed	2,500,000	3.00%
Lloyds TSB Bank Plc	Fixed	2,500,000	3.00%
Royal Bank of Scotland	Fixed	4,000,000	2.25%
Royal Bank of Scotland	Call	8,000,000	1.05%
Santander	Call	2,480,000	0.90%
Goldman Sachs	MMF	60,000	Variable
Total Investments		22,540,000	

Appendix C

Prudential indicators as at 31 March 2013		
	2012/13 Original estimate £m	31.03.2013 Actual £m
Authorised limit for external debt		
Borrowing	5	0
Other long term liabilities	0	0
	5	**0**
Operational boundary for external debt		
Borrowing	2	0
Other long term liabilities	0	0
	2	**0**
Investments		
Interest rate exposures		
Limits on fixed interest rates	50	23
Limits on variable interest rates	10	0
Maximum principal sums invested > 364 days		
Upper limit for principal sums invested > 364 days	20	0

Appendix D

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Base Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)

CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered british government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
LIBID	London inter-bank bid rate
LIBOR	London inter-bank offered rate

Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust, however in a MMF.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.