Audit Committee – 27 June 2013

# 6. 2012/13 Treasury Management Activity Report



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## Purpose of Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the 2012/13 financial year as prescribed by the revised CIPFA Code of Practice and in accordance with the Council's Treasury Strategy and Annual Investment Policy and Treasury Management Practices.

## Recommendations

2. The Audit Committee are requested to:

   - Note the Treasury Management Activity for the 2012/13 financial year;
   - Note the position of the individual prudential indicators for the 2012/13 financial year;
   - Note the outlook for the investment performance in 2013/14.

## Background

3. 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. The Council reports six monthly to Full Council against the strategy approved for the year. The scrutiny of treasury management policy, strategy and activity is delegated to the Audit Committee.

4. Treasury management in this context is defined as:

   "The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

5. 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.

## Summary of Investment Strategy for 2012/13

6. The Council's strategy for investments was based upon minimising risk and safeguarding the capital sum. With short term interest rates remaining lower for longer than anticipated, the investment strategy resulted in the lengthening of investment periods, where cash flow permits, in order to lock into higher rates of

acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

7. In order to diversify the authority's investment portfolio which is largely invested in cash, investments have been placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return.

8. Money Market Funds (MMFs) are being utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority utilises more than one MMF to diversify the exposure. The Authority restricted its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In the case of Government MMFs the Council ensured exposure to each Fund did not exceed 2% of the net asset value of the Fund.

9. Security of capital has remained the Council's main objective. This has been maintained by following the Council's counterparty policy as set out in the Treasury Management Strategy Statement for 2012/13. New investments could be made with the following institutions:

    - Other Local Authorities;
    - AAA-rated Money Market Funds;
    - Certificates of Deposit (CDs) and Term Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australian, Canadian and American);
    - T-Bills and DMADF (Debt Management Office);
    - Bonds issued by Multilateral Development Banks, such as the European Investment Bank;
    - Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.

10. The minimum long-term counterparty credit rating determined for the 2012/13 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's. Throughout the year none of the ratings that were on the Council's lending list fell below the Council's A-/A3 credit rating threshold.

11. The Council considered an appropriate risk management response to uncertain and deteriorating credit conditions in Europe was to shorten maturities for new investments. This has had an impact on investment income.

**Interest Rates 2012/13**

12. Base rate began the financial year at 0.5% and this has been maintained throughout 2012/13.

13. Our advisors are forecasting that the outlook is for official interest rates to remain low for an extended period, as shown below:

| | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | | | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Downside risk | | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 |

**Investment Portfolio**

14. The table below shows the Council's portfolio of investments at the start and end of the 2012/13 financial year:

| | Value of Investments at 01.04.12 £ | Value of Investments at 31.03.13 £ | Fixed/ Variable Rate |
|---|---|---|---|
| **Investments advised by Arlingclose** | | | |
| Euro Sterling Bonds | 4,182,407 | 0 | Fixed |
| Certificates of Deposit | 0 | 8,501,524 | Fixed |
| World Bonds | 3,035,190 | 3,028,271 | Fixed |
| Treasury Bills | 0 | 0 | Variable |
| Euro Sterling Bonds | 5,985,000 | 5,985,000 | Variable |
| Total | **13,202,597** | **17,514,795** | |
| **Internal Investments** | | | |
| Short Term Deposits (Banks) | 8,000,000 | 12,000,000 | Variable |
| Short Term Deposits (Other LAs) | 14,000,000 | 5,000,000 | Variable |
| Short Term Deposits (DMADF) | 0 | 0 | Variable |
| Money Market Funds & Business Reserve Accounts | 3,710,000 | 4,810,000 | Variable |
| Total | **25,710,000** | **21,810,000** | |
| **TOTAL INVESTMENTS** | **38,912,597** | **39,324,795** | |

**Returns for 2012/13**

15. The returns to 31st March 2013 are shown in the table below:

| | Actual Income £'000 | % Rate of Return |
|---|---|---|
| **Investments advised by Arlingclose** | | |
| Euro Sterling Bonds (Fixed) | 24 | |
| Payden Money Market Fund (VNAV) | 5 | |
| World Bonds | 23 | |
| Certificates of Deposit | 37 | |
| Euro Sterling Bonds (Variable) | 49 | |
| Total | **138** | **0.8%** |
| **Internal Investments** | | |
| Short Term Deposits | 226 | |
| Money Market Funds (CNAV) & Business Reserve Accounts | 45 | |
| Total | **271** | **0.76%** |

| | | |
|---|---|---|
| **Other Interest** | | |
| Miscellaneous Loans | 16 | |
| Total | **16** | |
| **TOTAL INCOME TO 31st MARCH 2013** | **425** | **0.77%** |
| **PROFILED BUDGETED INCOME** | **507** | |
| **DEFICIT** | **82** | |

16. The table above shows investment income for the year compared to the profiled budget. The annual budget was set at £507,030. The figures show a deficit under budget of £81,823.

17. The outturn position was affected by the interest rate set by the Bank of England. Balances were affected by the timing of capital expenditure and the collection of council tax and business rates. Investment periods were shortened due to the conditions in Europe.

18. The actual interest rate received for the year was 0.77% compared to a benchmark rate of return of 0.43%.

**Investments**

19. The graph shown in appendix B shows the performance of the in-house Treasury team in respect of all investments for the quarter ending 31st March 2013 in comparison to all other clients of Arlingclose.

20. The graph shows that SSDC is in a very good position in terms of the risk taken against the return on investments.

**Borrowing**

21. An actual overall borrowing requirement (CFR) of £9.4 million was identified at the beginning of 2012/13. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st March 2013 the Council had no external borrowing.

**Prudential Indicators – 2012/13**

**Background:**

22. In March 2012, Full Council approved the indicators for 2012/13, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allows local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

**Prudential Indicator 1 - Capital Expenditure:**

23. The actual capital expenditure incurred for 2012/13 compared to the original estimate is:

| | 2011/12 Outturn £'000 | 2012/13 Original Estimate £'000 | 2012/13 Outturn £'000 | 2012/13 Variance £'000 | Reason for Variance |
|---|---|---|---|---|---|
| Approved capital schemes | 3,837 | 4,059 | 3,078 | (981) | The variance is due to slippage within the capital programme from 2012/13 to future years. The 6 largest projects being: Birchfield Sewer Pollution Easement Works (£178k) and New Car Parks (£720k) |
| Reserve Schemes | 0 | 1,279 | 0 | (1,279) | Variance is due to slippage. |
| **Total Expenditure** | **3,837** | **5,338** | **3,078** | **(2,260)** | |

The figures in brackets reflect that actual expenditure was less than budgeted.

**Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:**

24. A comparison needs to be made between financing capital costs and the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

| Portfolio | 2011/12 Outturn £'000 | 2012/13 Original Estimate £'000 | 2012/13 Outturn £'000 | 2012/13 Variance £'000 | Reason for Variance |
|---|---|---|---|---|---|
| Financing Costs | (801) | (397) | (277) | 120 | Decreased income on investments. |
| Net Revenue Stream | 17,861 | 16,577 | 17,102 | 525 | Carry Forwards approved from 2011/12 and incorporated within the budget for 2012/13 |
| **%** | **(4.5)** | **(2.4)** | **(1.6)** | **0.8** | |

25. The financing costs include interest payable and notional amounts set aside to repay debt less interest on investment income. The figure in brackets is due to investment income outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

**Prudential Indicator 3 - Capital Financing Requirement:**

26. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The year-end capital financing requirement for the council is shown below:

| | 2011/12 Outturn £'000 | 2012/13 Original Estimate £'000 | 2012/13 Outturn £'000 | 2012/13 Variance £'000 | Reason for Variance |
|---|---|---|---|---|---|
| Opening CFR | 9,415 | 9,503 | 9,503 | 0 | |
| Capital Expenditure | 3,834 | 4,059 | 3,078 | (981) | See Prudential Indicator 1 above. |
| Capital Receipts* | (2,706) | (3,650) | (1,605) | 2,045 | Due to the reduction in capital spend in 2012/13, financing through capital receipts was reduced. |
| Grants/Contributions* | (1,131) | (409) | (1,448) | 1,039 | |
| Minimum Revenue Position (MRP) | (177) | (125) | (148) | (23) | Additional leases have incurred additional MRP |
| Additional Leases taken on during the year | 268 | 0 | 276 | 276 | New leases relating to 1 x chipper, 3 x vans, 4 x ride on mowers and 3 x Tippers (Vehicles) |
| **Closing CFR** | **9,503** | **9,378** | **9,656** | **278** | |

*Figures in brackets denote income through receipts or reserves

**Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:**

27. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

| | 2011/12 Outturn £'000 | 2012/13 Revised Estimate £'000 | 2012/13 Outturn £'000 | 2012/13 Variance £'000 | Reason for Variance |
|---|---|---|---|---|---|
| Net Borrowing | (39,551) | (36,014) | (38,939) | (2,925) | The estimate was a prediction of the year end balance based on a forecast usage of capital resources. There was slippage on the capital budget. |
| CFR | 9,503 | 9,378 | 9,656 | 278 | See explanations for indicator 3 above |

28. The figures above in brackets described as net borrowing actually represent net investments. Our net borrowing is forecast to remain as net investment for the foreseeable future and therefore will not at any time be in excess of the capital financing requirement.

**Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:**

29. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

| | **2011/12 Actual %** | **2012/13 % Limit** | **2012/13 Actual %** | **2012/13 Variance %** | **Reason for Variance** |
|---|---|---|---|---|---|
| Fixed | 18.6 | 80 | 7.7 | (72.3) | Within limit |
| Variable | 81.4 | 100 | 92.3 | (7.7) | Within limit |

30. The Council must also set limits to reflect any borrowing we may undertake.

| | **2011/12 Actual %** | **2012/13 % Limit** | **2012/13 Actual %** | **2012/13 Variance %** | **Reason for Variance** |
|---|---|---|---|---|---|
| Fixed | 0 | 100 | 0 | 100 | SSDC currently has no borrowing |
| Variable | 0 | 100 | 0 | 100 | SSDC currently has no borrowing |

31. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

**Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:**

32. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSDC, at any time, has sufficient liquidity to meet all of its financial commitments. The following table summarises the position:

| **Upper Limit for total principal sums invested over 364 days** | **2011/12 Actual £'000** | **2012/13 Maximum Limit £'000** | **2012/13 Actual £'000** | **Variance £'000** | **Reason for Variance** |
|---|---|---|---|---|---|
| Between 1-2 years | 9,020 | 25,000 | | (25,000) | Within limit |
| Between 2-3 years | | 20,000 | | (20,000) | Within limit |
| Between 3-4 years | | 10,000 | | (10,000) | Within limit |
| Between 4-5 years | | 10,000 | | (10,000) | Within limit |
| Over 5 years | | 5,000 | | (5,000) | Within limit |

33. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

**Prudential Indicator 7 - Actual External Debt:**

34. The purpose of this indicator is to highlight a situation where the Council is planning to. borrow in advance of need

| | 2012/13 Estimate £'000 | 2012/13 Actual £'000 | 2012/13 Variance £'000 | Reason for Variance |
|---|---|---|---|---|
| Outstanding Borrowing (at nominal value) | 0 | 0 | 0 | |
| Other long-term liabilities (at nominal value) | 196 | 386 | 190 | Additional Leases taken out since setting the budget |
| **Gross Debt** | **196** | **386** | **190** | |
| **Less: Net Investments** | **(36,014)** | **(39,325)** | **(3,311)** | |
| **Net Debt** | **(35,818)** | **(38,939)** | **(3,121)** | |

The figures above described as net debt actually represent net investments.

**Prudential Indicator 8 – Credit Risk:**

35. The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution and its sovereign
- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Economic Fundamentals, such as a country's net debt as a percentage of its GDP
- Corporate developments, news articles, markets sentiment and momentum
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

**Prudential Indicator 9 - Actual External Debt:**

36. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities (this

represents our finance leases). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

| **Actual External Debt as at 31/03/2013** | **£'000** |
|---|---|
| Borrowing | 0 |
| Other Long-term Liabilities (Finance Leases) | 386 |
| **Total** | **386** |

**Prudential Indicator 10 - Authorised Limit for External Debt:**

37. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set for each year.

| | **2011/12 Actual £'000** | **2012/13 Original Estimate £'000** | **2012/13 Actual £'000** | **2012/13 Variance £'000** | **Reason for Variance** |
|---|---|---|---|---|---|
| Borrowing | 0 | 11,000 | 0 | (11,000) | SSDC currently has no borrowing |
| Other Long-term Liabilities | 389 | 1,000 | 386 | (614) | Within limit |
| **Total** | **389** | **12,000** | **386** | **(11,614)** | |

**Prudential Indicator 11 – Operational Boundary for External Debt:**

38. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million for each of the next three years was set.

| | **2011/12 Actual £'000** | **2012/13 Original Estimate £'000** | **2012/13 Actual £'000** | **2012/13 Variance £'000** | **Reason for Variance** |
|---|---|---|---|---|---|
| Borrowing | 0 | 9,200 | 0 | (9,200) | SSDC currently has no borrowing |
| Other Long-term Liabilities | 389 | 800 | 386 | (414) | Within limit |
| **Total** | **389** | **10,000** | **386** | **(9,614)** | |

**Prudential Indicator 12 - Maturity Structure of Fixed Rate borrowing:**

39. This indicator is relevant when we borrow, then we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

| Maturity structure of fixed rate borrowing | 2012/13 Upper Limit % | 2012/13 Lower Limit % | 2012/13 Actual % | 2012/13 Variance % | Reason for Variance |
|---|---|---|---|---|---|
| Under 12 months | 100 | 0 | 0 | Not applicable | |
| 12 months and within 24 months | 100 | 0 | 0 | Not applicable | |
| 24 months and within 5 years | 100 | 0 | 0 | Not applicable | |
| 5 years and within 10 years | 100 | 0 | 0 | Not applicable | |
| 10 years and within 20 years | 100 | 0 | 0 | Not applicable | |
| 20 years and within 30 years | 100 | 0 | 0 | Not applicable | |
| 30 years and within 40 years | 100 | 0 | 0 | Not applicable | |
| 40 years and within 50 years | 100 | 0 | 0 | Not applicable | |
| 50 years and above | 100 | 0 | 0 | Not applicable | |

**Prudential Indicator 13 - Incremental Impact of Capital Investment Decisions:**

40. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

| Incremental Impact of Capital Investment Decisions | 2011/12 Actual £ | 2012/13 Original Estimate £ | 2012/13 Actual £ | 2012/13 Variance £ |
|---|---|---|---|---|
| Decrease in Band D Council Tax | 0.20 | 0.34 | 0.65 | 0.31 |

**Prudential Indicator 14 - Adoption of the CIPFA Treasury Management Code:**

41. This indicator demonstrates that the Council has adopted the principles of best practice.

| Adoption of the CIPFA Code of Practice in Treasury Management |
|---|
| The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18th April 2002. |

**Conclusion**

42. The council is currently within all of the Prudential Indicators.

***Background Papers:*** *Prudential Indicators Working Paper, Treasury Management Strategy Statement 2012/13*