Committee and Date	Item
Cabinet 18 September 2013 Audit Committee 19 September 2013 Council 26 September 2013	**11** Public

ANNUAL TREASURY REPORT 2012/13

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1. Summary

1.1. The report informs members of treasury activities for Shropshire Council for 2012/13, including the investment performance of the internal treasury team to 31 March 2013. The internal treasury team outperformed their investment benchmark by 0.58% in 2012/13 and performance for the last three years is 0.54% per annum above benchmark. Treasury activities during the year have been within approved prudential and treasury indicators set and have complied with the Treasury Strategy.

1.2. During 2012/13 the performance of the Treasury Team and reduced borrowing delivered an under spend of £1.637 million compared to budget as highlighted in paragraph 10.7 of this report. This under-spend reduced the overall overspend of the Council at the end of the financial year.

1.3. Members will be aware that Bridgnorth District Council had £1 million invested in the Icelandic Bank, Landsbanki Islands. The latest position in relation to this investment is that Shropshire Council has received three distributions to date amounting to nearly 50% of the total claim. The timing of any future distributions still remains uncertain but the latest estimate is that final payment may not be received until 2018.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

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3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation, or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions result in increased or reduced income for the Council.

4.2. The 2012/13 performance is above benchmark for the reasons outlined in paragraph 10.7 of this report and has delivered additional income of £1.637 million which was reflected in the final Revenue Monitor report for 2012/13.

5. Background

5.1. The Council defines its treasury management activities as "the management of the 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".

5.2. 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 actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

5.3. Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. Minimum reporting requirements are that the Council should receive the following reports:

- An annual treasury strategy in advance of the year.
- A mid year treasury update report.
- An annual report following the year describing the activity compared to the strategy.

5.4. The CIPFA Code of Practice on Treasury Management states that these reports should be scrutinised by a nominated committee and members should be trained on treasury management activities in order to support them in their scrutiny role. These reports were scrutinised by the Audit Committee before they were reported to full Council for approval. Members also received training on treasury management issues to support their scrutiny role by completing the CIPFA treasury management self-assessment and further Member training has been scheduled for November 2013.

5.5. In addition to the minimum reporting requirements, the Director's and Cabinet also receive quarterly treasury management update reports for information.

5.6. The Treasury Strategy for 2012/13 was approved by Council in February 2012, the mid-year treasury update report was approved by Council in December 2012. This Annual Report sets out our actual treasury performance for the year and shows how the actual treasury performance varied from our estimates and planning assumptions.

6. Borrowing Strategy for 2012/13

6.1. The borrowing strategy for the year continued to be funding the Council's long term borrowing requirement at advantageous rates. Short term finance from internal balances would be used in the interim pending favourable market conditions for long term funding.

6.2. Short term Public Works Loan Board (PWLB) rates were expected to be significantly cheaper than longer term borrowing rates during the year therefore borrowing in the 10 year period early on in the financial year when rates were expected to be at their lowest would be considered. Variable rate borrowing was also expected to be cheaper than long term fixed rate borrowing throughout the year.

6.3. An alternative strategy was to defer any new borrowing as long term borrowing rates were expected to be higher than investment rates during the year. This would maximise savings in the short term and also have the added benefit of running down investments which would reduce credit risk during the continued market turmoil. Short term money market borrowing was not used during the year.

7. Borrowing outturn for 2012/13

7.1. The Treasury Team take advice from its external treasury advisor, Sector Treasury Services, on the most opportune time to borrow. Movements in rates during 2012/13 are shown in the graph at Appendix A.

7.2. Members have previously been advised of the unexpected change of policy on PWLB lending arrangements in October 2010 following the Comprehensive Spending Review. This resulted in an increase in all new borrowing rates of between 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

7.3. The table below shows PWLB borrowing rates for a selection of maturity periods. The table also shows the high and low points in rates during the year, average rates during the year and individual rates at the start and the end of the financial year.

	4.5 – 5yrs	**9.5 – 10yrs**	**24.5 – 25 yrs**	**49.5 – 50 yrs**
01/04/2012 31/03/2013	2.07% 1.75%	3.25% 2.84%	4.37% 4.07%	4.41% 4.22%
High	2.15%	3.29%	4.44%	4.59%
Low	1.52%	2.52%	3.81%	3.96%
Average	1.85%	2.87%	4.09%	4.25%
High date	20/04/2012	20/02/2013	20/02/2013	20/02/2013
Low date	23/07/2012	23/07/2012	18/07/2012	01/06/2012

7.4. Following discussions with Sector, as general fund borrowing rates were significantly higher than investment rates during the year it was agreed that borrowing would be deferred in order to maximise savings in the short term and reduce credit risk by reducing investments.

7.5. The Council's total debt portfolio at 31 March 2013 is set out below:-

Type of Debt	Balance £m	Average Borrowing Rate 2012/2013
General Fund Fixed rate – PWLB	220.12	5.64%
HRA Fixed rate - PWLB	83.35	3.51%
Fixed rate – Market	49.20	4.10%
Variable rate	0	N/A

7.6. The average borrowing rate for the total portfolio (PWLB and Market) has increased from 5.4% in 2011/12 to 5.5% in 2012/13 due to a loan at a lower interest rate (2.06%) maturing during the year and being repaid. The maturity profile of the debt is evenly spread to avoid large repayments in any one financial year. The average debt period for PWLB loans is 22 years, market loans have an average debt period of 56 years. The total debt portfolio has a maturity range from 1 year to 65 years.

7.7. The Treasury Strategy allows up to 15% of the total outstanding debt to mature in any one year. It is prudent to have the Council's debt maturing over many years so as to minimise the risk of having to re-finance when interest rates may be high. The actual debt maturity profile is within these limits (Appendix B).

8. Debt rescheduling

8.1. No debt restructuring was undertaken during 2012/13. The introduction of a differential in PWLB rates on the 1 November 2007, which was compounded further since a policy change in October 2010 as outlined above, has meant that large premiums would be incurred if debt restructuring was undertaken which cannot be justified on value for money grounds.

8.2. Although these changes have restricted debt restructuring, the current debt portfolio is continually monitored in conjunction with external advisers in the light of changing economic and market conditions to identify opportunities for debt rescheduling. Debt rescheduling will only be undertaken:

- To generate cash savings at minimum risk.
- To help fulfil the Treasury Strategy.
- To enhance the balance of the long term portfolio by amending the maturity profile and/or volatility of the portfolio.

9. Investment Strategy for 2012/13

9.1. Our treasury advisor originally felt when the strategy was approved by Council in February 2012 that the bank rate would rise from 0.50% to 0.75% in September 2013 before rising again in December 2013 and March 2014 to reach 1.25% by the end of the financial year. During the year their interest rate forecast was reviewed and their updated forecast was approved by Council in December 2012 as part of the mid year report. Their revised forecast was that the bank rate would remain at 0.50% for the remainder of the financial year.

9.2. In 2012/13 investment of surplus cash was managed by the internal treasury team. The strategy for the in-house team was influenced by the need to keep funds relatively short for cash flow purposes. Lending continued to be restricted to UK banks, One Building Society, Nationalised and Part Nationalised Banks, UK Government and other Local Authorities in line with the Council's policy on creditworthiness which was approved in the Annual Investment Strategy.

10. Investment outturn 2012/13

10.1 The tight monetary conditions following the 2008 financial crisis continued through 2012/13 with little material movement in shorter term deposit rates. Bank rate remained at its historical low of 0.5% throughout the year and has now remained unchanged for four years. Market expectations of the start of monetary tightening were pushed back during the year to early 2015 at the earliest. The Government's Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.

10.2 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. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375 billion. 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% and still being 2.8% in March however, it is forecast to fall to 2% in three years' time.

10.3 The EU sovereign debt crisis was an on-going 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. 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. In February 2013 one of the credit rating agencies followed up this warning by downgrading the rating to AA+.

10.4 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.

10.5 To counter the historically low investment rates, and following advice from Sector, use was made of direct deals with main UK banks which were part nationalised for various periods from three months to one year. Direct deals offered substantially enhanced rates over the equivalent rates available through brokers. This provided opportunities to lock into higher, long term rates at times when it was thought they offered substantial enhancement over short term benchmark rates. Due to the enhanced market rates over bank rate this resulted in the total portfolio outperforming the benchmark. Continued use of an instant access account with Natwest the Council's own bankers, was also used as this account offered both instant access to funds and paid a rate which was higher than placing short term deposits through brokers.

10.6 Movements in short term rates through the year are shown in the graph at Appendix A.

10.7 Throughout the year the level of interest rates and average investment balances were higher than budgeted. This resulted in the internal treasury team achieving a higher level of interest on revenue balances than budgeted. This £716,000 surplus was in addition to an under-spend on debt charges of £921,000 due to no long term general fund borrowing being undertaken in 2012/13. The total £1.637 million under spend reduced the overall overspend of the Council at the end of the financial year.

10.8 At 31 March 2013 the allocation of the cash portfolio was as follows:

	£m
• In-house short dated deposits for cash flow management	59.4
• In-house long dated deposits (up to 1 year)	9.3
• Other Local Authorities	25.2
Total	**93.9**

10.9 The following table shows the average return on cash investments for the internal treasury team during the year and for the last 3 years to 31 March 2013. Recognising the need to manage short term cash flow requirements, the target for the internal team is the Local Authority 7 day deposit rate.

	Return 2012/13	**Return 3 years to 31 March 2013**
	%	**% p.a**
Internal Treasury Team	0.86	0.87
Benchmark (Local Authority 7 Day LIBID rate)	0.28	0.33

10.10 The conclusions to be drawn from the table are:

- During 2012/13 the internal treasury team outperformed their benchmark by 0.58%.
- Over the 3 year period the internal team’s performance has been 0.54% per annum above the benchmark.

11. Landsbanki Deposit Update

11.1 Members will be aware that Bridgnorth District Council had £1 million invested in the Icelandic Bank, Landsbanki Islands. All local authorities who placed deposits with Landsbanki submitted claims to the Landsbanki Winding up Board in October 2009. All claims submitted were accepted as priority claims by the Board and by the Icelandic courts. The latest position in relation to this investment is that Shropshire Council has received three distributions amounting to around 50% of the total claim. The timing of any future distributions still remains uncertain but the latest estimate is that the final payment may not be made until 2018.

12. Compliance with Treasury Limits and Prudential Indicators

12.1 All borrowing and lending transactions undertaken through the year have complied with the procedures and limits set out in the Council’s Treasury Management Practices and Treasury Strategy. In addition, all investments made have been within the limits set in the approved counterparty list. No institutions, in which investments were made, showed any difficulty in repaying investments and interest in full during the year.

12.2 Appendix C shows the Prudential Indicators approved by Council as part of the 2012/13 and 2013/14 (revised estimate) Treasury Strategies compared with the actual figures for 2012/13. In summary, during 2012/13 treasury activities have been within the prudential and treasury limits set in the Treasury Strategy.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 23 February 2012, Treasury Strategy 2012/13. Council, 13 December 2012, Treasury Strategy 2012/13 Mid-Year Review. Council, 28 February 2013, Treasury Strategy 2013/14. Cabinet, 01 August 2012, Treasury Management Update Quarter 1 2012/13. Cabinet, 14 November 2012, Treasury Management Update Quarter 2 2012/13. Cabinet, 20 February 2013, Treasury Management Update Quarter 3 2012/13. Cabinet, 29 May 2013, Treasury Management Update Quarter 4 2012/13.
Cabinet Member: Mike Owen, Portfolio Holder
Local Member N/A
Appendices A. Movement in Interest Rates 2012/13 B. Debt Maturity Profile as at 31 March 2013 C. Prudential Indicators 2012/13