Wiltshire Council

Cabinet

18 June 2013

Subject:	**Annual Report on Treasury Management 2012-13**
Cabinet member:	**Councillor Richard Tonge** **Finance, Performance, Risk, Procurement and Welfare Reform**
Key Decision:	**No**

Executive Summary

In accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) (the leading accountancy body for the public services) Prudential Code for Capital Finance in Local Authorities 2003 (The Prudential Code), the Council adopted a Treasury Management Strategy (TMS) for 2012-13, including a set of Prudential and Treasury Indicators (PrIs/TrIs) and an Annual Investment Strategy (AIS) at its meeting on 28 February 2012. The Strategy report can be found in the Cabinet meeting on 15th February 2012 agenda in the reports pack at the following link, http://cms.wiltshire.gov.uk/ieListDocuments.aspx?CId=141&MId=6106&Ver=4 Item 8, Page 67. This report shows how the Council has performed against the strategy.

The treasury strategy was adhered to in 2012-13; the average long term borrowing rate was 3.77%; and the return on investments was 0.80%.

Proposals

The Cabinet is asked to consider and note:

a) Prudential Indicators, Treasury Indicators and other treasury management strategies set for 2012-13 against actual positions resulting from actions within the year as detailed in Appendix A; and

c) investments during the year in the context of the Annual Investment Strategy as detailed in Appendix B.

Reasons for Proposals

To give members of the Cabinet an opportunity to consider the performance of the Council against the parameters set out in the approved Treasury Management Strategy for 2012-13.
This report is required by the Prudential Code for Capital Finance in Local Authorities and the CIPFA Code of Practice for Treasury Management in the Public Services.

Michael Hudson
Service Director, Finance

Wiltshire Council

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1. Background & Purpose of Report

1.1 In accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) (the leading accountancy body for the public services) Prudential Code for Capital Finance in Local Authorities 2003 (The Prudential Code), the Council adopted a Treasury Management Strategy (TMS) for 2012-13, including a set of Prudential and Treasury Indicators (PrIs/TrIs) and an Annual Investment Strategy (AIS) at its meeting on 28 February 2012. The Strategy report can be found in the Cabinet 15th February 2012 agenda reports pack, Item 8, Page 67 http://cms.wiltshire.gov.uk/ieListDocuments.aspx?CId=141&MId=6106&Ver=4 .

1.2 An interim report for the period from 1 April to 30 September 2012 was submitted to Cabinet on 6 November 2012, the minutes of which were received and noted by Council at its meeting on 13 November 2012. This report covers the whole financial year ended 31 March 2013.

2. <u>Main Considerations for the Cabinet</u>

2.1 This report reviews:

a) PrIs, TrIs and other treasury management strategies set for 2012-13 against actual positions resulting from actions within the year (see Appendix A); and

b) investments during the year in the context of the Annual Investment Strategy (see Appendix B).

2.2 There were no opportunities to restructure PWLB loans in 2012-13, mainly because of the continuing high level of premiums payable for early repayment, together with the availability of favourable interest rates at the appropriate maturity levels.

Review of Prudential and Treasury Indicators and Treasury Management Strategy for 2012-13

2.3 The detail of the review is given in Appendix A. The Cabinet is asked to note that:

a) all action has been within the approved PrIs and TrIs;

b) the Council has recovered a further £1.4 million from Icelandic banks during 2012-13. Total recoveries since the banks failed in 2008 now stand at approximately £8.4 million.

c) the average interest rate for long term debt has remained at 3.77%, the same as in 2011-12, rates being mainly fixed, with no significant movement in the amount of loans outstanding between 1 April 2012 and 31 March 2013;

d) short term cash deficits and surpluses were managed through temporary loans and deposits with a return on investments of 0.80% (a slight decrease from 0.86% in 2011-12, reflecting overall decreases in the market during the year). This compares with the average market rate, based on the Average 3 Month LIBID Rate for 2012-13 (London Interbank Bid Rate, i.e. the rate at which banks are prepared to borrow from other banks) of 0.56%; and

e) two mid/longer term “special tranche rate” investments were placed with National Westminster Bank (in April 2012, at 2.25%) and Lloyds Banking Group (in August 2012, at 2.85%), both, for 12 months, taking advantage of favourable rates, whilst ensuring security and liquidity. In September 2012 a further longer term investment was placed with Lloyds Banking Group, taking up available counterparty capacity, at a rate of 1.75%.

Review of Investment Strategy

2.4 This review is detailed in Appendix B. The Cabinet is asked to note that:

a) the tight monetary conditions following the 2008 financial crisis continued through 2012-13 with little material movement in the shorter term deposit rates, average movement being on the downside.

b) overlaying the relatively poor investment returns was the continued counterparty concerns, including Euro zone sovereign debt, together with the US ‘fiscal cliff’, the Italian elections, concerns in respect of the Cyprus ‘bail-in’ and the downgrading of the UK (AAA) credit rating by two of the main rating agencies. Although the latter passed without any significant impact.

c) during the financial year the Council was able to take the opportunity presented by longer term (four to 12 months) investment rates to invest surplus cash balances at optimum rates, whilst maintaining its approved strategy, including security and liquidity and credit rating criteria.

3. Environmental and Climate Change Considerations

3.1 None have been identified as arising directly from this report.

4. Equalities Impact of the Proposal

4.1 None have been identified as arising directly from this report.

5. Risks Assessment and Financial Implications

5.1 The primary treasury management risks to which the Council is exposed are adverse movements in interest rates and the credit risk of counterparties.

5.2 Investment counterparty risk is controlled by assessing and monitoring the credit risk of borrowers as authorised by the Annual Investment Strategy. Appendix B of this report details action taken in 2012-13.

5.3 At 31 March 2013, the Council's average interest rate in respect of long term debt was 3.77%, which remains relatively low, when compared with other local authorities.

5.4 It is also considered important to ensure that there is an even spread of loans to avoid the prospect of a number of high value loans maturing in any one year, which may need to be re-financed at a time when interest rates are high. A summary of the present loan maturity profile is shown in Appendix C (i).

5.5 Returns on short term investments have not moved significantly, mainly as a result of the volatility of the market following the 'credit crunch' starting in October 2008 and are likely to continue at near current levels for some time yet. The costs of borrowing for this Council have remained at similar levels because the loan profile is almost entirely at fixed maturity rates (despite the unexpected change of policy on PWLB lending arrangements in October 2010, when new borrowing rates increased by 0.75% to 0.85%, without an associated increase in early redemption rates). The investment rate of return for the year was 0.80%, against the average borrowing rate of 3.77%.

6. Legal Implications

6.1 None have been identified as arising directly from this report.

7. Options Considered

7.1 Mid/longer term investment rates, although lower than rates available in 2011/12, provided an opportunity to reinvest at special (attractive) deposit rates over four to 12 months. Other cash surpluses that arose were mainly placed in money market funds offering competitive rates when compared with market rates, with the advantage of being highly liquid, whilst being within the Councils approved creditworthiness criteria. In the first six to nine months of the financial year other investments were placed on the money market. In the prevailing economic climate at that time it was decided to continue to keep investments short (three months maximum), pending further certainty in the financial markets.

7.2 Due to the improvement in the market outlook later in the financial year, the Council's treasury advisers (Sector Treasury Services Ltd) took the view that the three month maximum duration limit could be lifted and durations returned to those indicated by their creditworthiness model (without adjustment). This is, however, subject to a proviso that investments should only be placed with strong counterparties and that the decision will be reviewed, should market conditions change in the future.

7.3 This market improvement, although in its relatively early stages, and the consequent changes to counterparty duration limits have enabled the Council to increase potential optimum rates with longer dated deposits, whilst maintaining/ensuring the security and liquidity of investments.

7.4 The latest forecast anticipates that Bank Rate will not start to rise until quarter one of 2015 and move steadily further during 2015. PWLB rates are also expected to rise steadily over the next three years as the UK economy improves.

8. Conclusion

8.1 Cabinet is asked to note the report.

Michael Hudson
Service Director, Finance

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Background Papers

The following unpublished documents have been relied on in the preparation of this Report: NONE

Appendices

Appendix A	Review of Prudential and Treasury Indicators for 2012-13
Appendix B	Investment Strategy for 2012-13
Appendix C	Summary of Long Term Loans, Temporary Loans and Deposits for 2012-13

APPENDIX A

REVIEW OF PRUDENTIAL AND TREASURY INDICATORS FOR 2012-13

1. Where appropriate the figures shown in this report are consistent with the PrI and TrI estimates in the Strategy for the next three years, as reviewed and reported as part of the 2012-13 budget process.

Prudential Indicators

PrI 1 - Capital Expenditure

2. The table below shows the original and revised estimate of capital expenditure against the actual for the year 2012-13:

	2012-13 Original Estimate £ million	2012-13 Revised Estimate £ million	2012-13 Actual Outturn £ million
General Fund	113.9	87.3	67.3
Housing Revenue Account	9.4	5.5	4.5

3. The Capital Programme has been actively managed throughout the year and the revised capital budget (capital outturn position for 2012-13) is £81.9 million. Further breakdown of these figures will be presented in the capital outturn report, which will be taken to the Cabinet Capital Assets Committee at its meeting on 23 July 2013.

PrI 2 – Ratio of Financing Costs to Net Revenue Stream

4. PrI 2 expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers (General Fund) and rents receivable (HRA). The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments.

	2012-13 Original Estimate	2012-13 Revised Estimate	2012-13 Actual
General Fund	8.2%	6.4%	6.5%
Housing Revenue Account	19.9%	15.4%	15.9%

5. In terms of the General Fund slight differences between budgeted and actual costs led to a minor increase in actual ratio when compared with the revised estimate.

PrI 3 – Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

6. This indicator is only relevant during budget setting, as it reflects the impact on the Band D Council Tax, or average weekly housing rents in respect of the HRA, caused by any agreed changes in the capital budget.

PrI 4 – Net Borrowing and the Capital Financing Requirement

7. PrI 4 measures the so called "Golden Rule" which ensures that net borrowing is only for capital purposes. The table below shows the original and revised estimate for 2012-13 compared with the actual position at the year end.

	2012-13 Original Estimate £ million	**2012-13 Revised Estimate £ million**	**2012-13 Actual £ million**
CFR – General Fund	389.3	393.5	341.9
CFR – HRA	122.6	122.6	122.6
Net Borrowing – Gen Fund	268.2	187.2	177.8
Net Borrowing – HRA	118.8	118.8	118.8
CFR not funded by net borrowing – Gen Fund	**121.1**	**206.3**	**164.1**
CFR not funded by net borrowing – HRA	**3.8**	**3.8**	**3.8**

8. The Capital Financing Requirement (CFR) increases whenever capital expenditure is incurred. If resourced immediately (from capital receipts, direct revenue contributions or capital grant/contributions) the CFR will reduce at the same time that the capital expenditure is incurred, with no net increase in CFR.

9. Where capital expenditure is not resourced immediately, there is a net increase in CFR, represented by an underlying need to borrow for capital purposes, whether or not external borrowing actually occurs. The CFR may then reduce over time by future applications of capital receipts, capital grants/contributions or further charges to revenue.

10. This PrI is necessary, because under an integrated treasury management strategy (in accordance with best practice under the CIPFA Code of Practice on Treasury Management in the Public Services), borrowing is not associated with particular items or types of expenditure, whether revenue or capital

11. Net Borrowing is the Council's total external debt less its short term cash investments.

PrI 5 – Compliance with CIPFA Code of Practice for Treasury Management in the Public Services ("The Code")

In the past year the Council was, and is expected to continue to be, fully compliant with the CIPFA Code of Practice for Treasury Management in the Public Services.

12. This Code of Practice has been complied with during 2012-13.

Treasury Management Indicators within the Prudential Code

TrI 1 – Authorised Limit for External Debt

Authorised Limit	2012-13 £ million	2013-14 £ million	2014-15 £ million	2015-16 £ million
Borrowing – General Fund	418.5	436.0	450.3	451.9
Borrowing – HRA	123.2	123.2	123.2	123.2
Total Borrowing	**541.7**	**559.2**	**573.5**	**575.1**
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**541.9**	**559.4**	**573.7**	**575.3**

13. This Authorised Limit was not exceeded at any time during the year, as maximum borrowing was below the lower Operational Boundary.

Tr 2 – Operational Boundary for External Debt

Operational Boundary	2012-13 £ million	2013-14 £ million	2014-15 £ million	2015-16 £ million
Borrowing – General Fund	408.5	425.3	439.3	440.9
Borrowing – HRA	123.2	123.2	123.2	123.2
Total Borrowing	**531.7**	**548.5**	**562.5**	**564.1**
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**531.9**	**548.7**	**562.7**	**564.3**

14. This TrI is for gross borrowing and was set at a limit that would allow the Council to take its entire financing requirement as loans if this was the most cost effective alternative. The limit on HRA borrowing is capped at £123.2 million. The limits, which have not been exceeded during the period covered by this report, are set to anticipate expected expenditure. The maximum gross borrowing during the year being £364.0 million (£245.2 million on General Fund and £118.8 on HRA) at 31 March 2013.

TrI 3 – External debt

	31/3/12 Actual £ million	31/3/13 Expected £ million	31/3/13 Actual £ million
Borrowing – General Fund	245.2	245.2	245.2
Borrowing – HRA	118.8	118.8	118.8
Total Borrowing	**364.0**	**364.0**	**364.0**
Other Long Term Liabilities	£0.2	0.2	£0.2
TOTAL	**364.2**	**364.2**	**364.2**

15. This TrI shows the gross External Debt outstanding at year end. The actual borrowing figure is outstanding long term borrowing as shown in Appendix C (i). Actual borrowing was as expected at the end of 2012-13.

16. There were no long term loans taken during the year.

Treasury Management Indicators within the Treasury Management Code

TrI 4a and 4b – Upper Limit on Fixed Interest Rate Exposures and Interest Rate Exposures, respectively

The Council's upper limit for fixed interest rate exposure for the period 2012-13 to 2015-16 is 100% of net outstanding principal sums.

The Council's upper limit for variable interest rate exposure is 15% for 2012-13, 25% for 2013-14, 35% for 2014-15 and 40% for 2015-16 of net outstanding principal sums.

17. All loans and investments are at fixed rates of interest.

TrI 5 – Maturity Structure of Borrowing

Limits on the Maturity Structure of Borrowing	**Upper Limit**	**Lower Limit**	**Actuals 31/3/13**
Maturing Period:			
- under 12 months	15%	0%	0.0%
- 12 months and within 24 months	15%	0%	3.3%
- 2 years and within 5 years	45%	0%	9.4%
- 5 years and within 10 years	75%	0%	9.5%
- 10 years and above	100%	0%	77.8%

18. In addition to the main maturity indicators it is considered prudent that no more than 15% of long term loans should fall due for repayment within any one financial year. The actual maximum percentage falling due for repayment in any one year is currently 3.6% (£13 million) in both 2052-53 and 2053-54. The average interest rate on present long-term debt is 3.77%, which continues to be relatively low when compared with other local authority borrowing rates.

TrI 6 – Total Principal Sums invested for periods longer than 364 days

19. This TrI is covered by the Annual Investment Strategy, which is detailed in Appendix B.

Other Treasury Management issues

Short Term Cash Deficits and Surpluses

20. It was agreed, as per the approved Strategy, that temporary loans and deposits would be used to cover short term cash surpluses and deficits that arise during the year. Such borrowing or investments would be made to specific dates at fixed rates, with reference to cash flow requirements. Investments have also been placed in Money Market Funds during the year.

21. Any outstanding temporary loans and/or deposits are summarised in Appendix C (ii).

Icelandic Bank Deposits

22. During 2012-13 the Council received three more interim dividends from the administrators of Heritable Bank, totalling £0.842 million and two further repayments, totalling £0.542 million, from Landsbanki.

23. According to the latest available information, the Council can expect to receive a final total repayment from Heritable of between 86 and 95 pence in the pound. The Administrators have indicated that a further repayment (the fourteenth) will be paid in July 2013, but "the quantum of the dividend remains subject to the continued collection of funds through a run-off of the various loan books."

24. The Landsbanki Winding-up Board announced on March 9, 2012 that it anticipated recoveries in the administration of Landsbanki would exceed the book value of priority claims by around ISK 121bn (some 9% higher than the value of priority claims) taking account of the sale of its holding in Iceland Foods. It is now considered likely that local authorities will recover 100 per cent of their deposits.

25. The deposits outstanding with Icelandic banks are shown in Appendix C (ii) at impaired value less repayments, impairment being calculated using the latest available guidance.

26. The initial investments in Icelandic banks amounted to a total of £12 million and the Council has recovered just over £8.4 million, to date. Current indications suggest that total recoveries will be better than previously expected. The estimates for the eventual recovery rates are: from Heritable, between 86% to 90%; and 100% from Landsbanki (subject to foreign exchange rate movements). Although it is difficult to estimate the final recoverable amount precisely, the best estimate for the final recoverable amount, based on the expected recovery rates, is just over £11 million (including some interest), leaving approximately £1 million (or 8.9%) irrecoverable overall.

Longer Term Cash Balances

27. The tight monetary conditions have continued through 2012-13 with a downward trend in the deposit rates for all types of investments (short/medium and long term), particularly in the second half of the financial year. As a result opportunities for an increased return by longer term investment of the more permanent cash surpluses, such as reserves and balances have been limited.

28. During the first nine months of 2012-13 funds were mainly invested 'short' (no longer than three months), in the light of the continuing uncertainty of the financial climate, particularly the ongoing Euro zone sovereign debt issues. However, there have been opportunities to invest, within the Councils approved Treasury Management Strategy, in (UK 'Government backed') banks which have offered "special tranche rates" for twelve months.

29. Three "special tranche rate" investments were placed with National Westminster Bank (in April for 12 months at 2.25%) and Lloyds Banking Group (in August for 12 months at 2.85% and a further investment in September for five months, at a rate of 1.75% (now matured)). Further details of the first two 12 month investments are shown in Appendix C(ii).

30. On 11 January 2013 Sector, the Council's treasury advisors, issued a newsflash saying that they then believed that market conditions were such that there was no longer a need for a more stringent limit (of three months) on the maximum suggested durations with counterparties. The revised durations, based on Sector's normal creditworthiness parameters (as shown in the Investment Strategy in Appendix B below), are now reflected in the latest credit lists issued following the newsflash. Sector will, of course, continue to monitor the situation and amend the credit list and their advice accordingly.

APPENDIX B

REVIEW OF INVESTMENT STRATEGY FOR 2012-13

1. All investments of surplus cash balances were placed to ensure:

   a) the security of capital, deposits only being placed with financial institutions which met the **high credit ratings** laid down in the approved Strategy;

   b) the liquidity of investments, all deposits being placed for fixed periods at fixed rates of interest; and

   c) all such investments were in sterling and in “Specified Investments”, as prescribed in the DCLG Guidance on Local Government Investments (the “Guidance”).

2. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

3. As summarised in Appendix C (ii), 258 deposit transactions were processed during the year, with a gross value of £850.046 million. Of deposits placed, 100 were placed direct with HSBC Bank Treasury on the Council’s overnight deposit account, 1 in call accounts, 134 through money market funds and 23 were placed with other counterparties via the money markets and direct dealing. The level of deposits in money market funds and call accounts reflects both counterparty downgrading and banks moving away from instant access call accounts to notice accounts, which are sometimes not always suitable for cash flow purposes.

4. Details of the deposits outstanding at the end of the year, totalling £67.338 million, are shown in Appendix C (ii). These deposits represent the Council’s reserves both long term, such as the PFI and Insurance funds, and short term such as creditors or payments in advance and include the deposits that remain outstanding from Icelandic banks at impaired value less repayments.

5. The opportunity was taken to place a proportion of these deposits in longer term investments for 12 months, taking advantage of the improved interest rates on offer for the longer maturity period. These are shown within general deposits in Appendix C (ii).

6. The Council contracts with a treasury adviser, regularly reviewing credit ratings of potential organisations and their respective country's ratings, together with other 'tools' used to assess the credit quality of institutions such as credit default swaps. The Council uses this information to assess institutions with which it may place deposits or from which it may borrow, including interest rate forecasts for both borrowing and investment, together with setting a 'benchmark' borrowing rate. The Council's investment policy is 'aimed' at the prudent investment of surplus cash balances to optimise returns whilst ensuring the security of capital and liquidity of investments. However, the Council, like any other organisation, can be exposed to financial risk, which is negated as far as possible by the foregoing measures.

Appendix C (i)

SUMMARY OF LONG TERM BORROWING 1 APRIL 2012 - 31 MARCH 2013

LOANS RAISED During the Period

Date raised	Lender	Amount (£m)	Type	Interest rate (%)	Maturity date	No. of years
No Loans Raised During the Financial Year						
	Total	0.000				

Average period to maturity (years) **N/A**

Average interest rate (%) **N/A**

Maturity Profile at 31 March 2013

Year	Amount (£m)	%age	Average rate (%)
1 to 5 years	46.049	12.7	3.501
6 to 15 years	84.933	23.3	2.873
16 to 25 years	93.500	25.7	3.836
26 to 50 years	123.500	33.9	4.380
Over 50 years	16.000	4.4	4.298
Totals	363.982	100.0	3.774

Average period to maturity (years) **24.53**

SUMMARY OF TEMPORARY LOANS AND DEPOSITS 1 April 2012 - 31 March 2013

Deposits Outstanding at 31 March 2013

Borrower	Amount £m	Terms		Interest rate(%)
National Westminster Bank	8.000	Fixed to	05-Apr	2.25
Lloyds TSB Bank	5.000	Fixed to	09-Aug	2.85
National Bank of Abu Dhabi	8.000	Fixed to	15-Jul	0.65
National Australia Bank	8.000	Fixed to	15-Jul	0.43
Nationwide Building Society	8.000	Fixed to	16-Apr	0.44
Barclays Bank	8.000	Fixed to	16-Apr	0.45
Svenska Handelsbanken AB	0.017	No fixed maturity date		0.40
Ignis Money Market Fund	14.202	No fixed maturity date		0.44
JP Morgan Money Market Funds	0.022	No fixed maturity date		0.28
Prime Rate Money Market Fund	5.853	No fixed maturity date		0.45
Goldman Sachs Money Market Fund	0.002	No fixed maturity date		0.37
Heritable Bank	0.312	Est Recoverable Amount		6.00
Heritable Bank	0.208	Est Recoverable Amount		6.00
Heritable Bank	0.312	Est Recoverable Amount		6.00
Heritable Bank	0.104	Est Recoverable Amount		5.42
Landsbanki	1.285	Est Recoverable Amount		6.10
Landsbanki	0.021	Est Recoverable Amount		4.17
Total	67.338			

Outstanding deposits with Icelandic Banks are shown at the estimated recoverable amount, which takes account of estimated impairments and any repayments received to date. The last entry relates to the amount paid out in ISK by the Winding-up Board of Landsbanki and is currently held in Iceland in an interest bearing escrow account, which is accounted for as a "new" investment. Interest rates shown against the other Icelandic deposits are the original rates at acquisition date.

There were no temporary loans taken out in 2012/13

Transactions During the Period

Type	Balance 1 Apr 12 £m	Raised Value £m	Raised No.	Repaid Value £m	Repaid No.	Balance 31 Mar 13 £m	Interest Variance * High/Low(%)
Temporary loans							
- General	0.000	0.000	0	0.000	0	0.000	
Total	**0.000**	**0.000**	**0**	**0.000**	**0**	**0.000**	
Temporary deposits							
- General	24.507	176.119	23	153.384	20	47.242	2.85/0.35
- HSBC Overnight	0.000	216.570	100	216.570	103	0.000	0.25/0.20
- Call Accounts	0.026	7.541	1	7.550	1	0.017	0.75/0.40
- Money Market Funds	25.132	449.816	134	454.869	145	20.079	0.76/0.28
Total	**49.665**	**850.046**	**258**	**832.373**	**269**	**67.338**	

* Interest variance is the highest/lowest interest rate for transactions during the period.

* With the exception of the HSBC Overnight Account, interest rates have decreased (relatively) markedly over the year, hence the gap between the higher and lower rates achieved.

* In terms of general deposits, the high of 2.85% was obtained on a special 12 month deposit.

General deposits include impaired Icelandic investments less any repayments that have been received, to date.