REPORT FOR DECISION

Agenda Item	

MEETING:	**CABINET** **OVERVIEW & SCRUTINY COMMITTEE** **COUNCIL**
DATE:	**10 JULY 2013** **4 SEPTEMBER 2013** **11 SEPTEMBER 2013**
SUBJECT:	**2012/13 TREASURY MANAGEMENT ANNUAL REPORT**
REPORT FROM:	**DEPUTY LEADER AND CABINET MEMBER FOR FINANCE & CORPORATE AFFAIRS**
CONTACT OFFICER:	**STEVE KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)** **ANDREW BALDWIN, HEAD OF FINANCIAL MANAGEMENT**

TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	This paper is within the public domain

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SUMMARY:

PURPOSE/SUMMARY:

The Council undertakes Treasury Management Activities in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, which requires that the Council receives an annual strategy report by 31 March for the year ahead and an annual review report of the previous year by 30 September. This report is the review of Treasury Management activities during 2012/13.

OPTIONS & RECOMMENDED OPTION

It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

IMPLICATIONS:

Corporate Aims/Policy Do the proposals accord with the Policy

Framework:	Framework? Yes
Statement by Executive Director of Resources:	As set out in the report and the comment of the Assistant Director of Resources (Finance and Efficiency) below.
Statement by Assistant Director of Resources (Finance and Efficiency):	This report provides information on the Council's debt, borrowing, and investment activity for the financial year ending on 31st March 2013 in conformity with the CIPFA Code of Practice for Treasury Management. The successful management of the Council's borrowing and investments is central to the Council's financial strategy, both in the short term and in ensuring a balanced debt profile over the next 25 to 60 years. The overall strategy for 2012/13 was to finance capital expenditure by taking out short term temporary borrowing rather than more expensive long term loans. The taking out of longer term loans (1 to 10 years) to finance capital spending will only then be considered if required by the Council's underlying cash flow needs. With the reduction of cash balances the level of short term investments will fall. Debt decreased by £1.927m during the year, to £203.694 million at 31st March 2013 compared to £205.621 million at 31st March 2012. The average borrowing rate fell from 4.56% to 4.43% due to fall out of high coupon rate debt and new short term loans. Investments at 31 March 2013 stood at £17.456 million, compared to £23.881 million the previous year. The average rate of return on investments was 1.67% in 2012/13 compared to 1.39% in 2011/12.
Equality/Diversity implications:	No - (see paragraph 8.1, page 9)
Considered by Monitoring Officer:	Yes. The presentation of an annual report on Treasury Management by 30th September of the following financial year is a requirement of the Council's Financial Regulations 5.7, as part of the Council's Financial Procedure Rules and Budget and Policy framework, relating to Risk Management and Control of Resources: Treasury Management.
Are there any legal implications?	No
Staffing/ICT/Property:	There are no direct staffing, ICT or property implications arising from this report.

Wards Affected: All

Scrutiny Interest: Overview & Scrutiny Committee

TRACKING/PROCESS DIRECTOR: MIKE OWEN

Chief Executive/ Strategic Leadership Team	Cabinet Member/Chair	Ward Members	Partners
	Yes 10/7/13		
Overview & Scrutiny Committee		Committee	Council
4/9/13			11/9/13

1.0 BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council on 24 February 2010 and this Council fully complies with its requirements. The primary requirements of the Code are the: -

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local authority's 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. "

1.3 This **Annual Treasury Report** covers:

- the Council's current treasury position;
- overview of the 2012/13 strategy;
- economic review for 2012/13
- borrowing outturn for 2012/13
- investment outturn for 2012/13
- compliance with treasury limits and Prudential Indicators;

2.0 CURRENT TREASURY POSITION

2.1 The Council's debt and investment position at nominal values for the beginning and the end of 2012/13 was as follows:

	31st March 2012 Principal £'000	Average Interest Rate	31st March 2013 Principal £'000	Average Interest Rate
Fixed Rate Funding:				
- PWLB	161,362		153,862	
- Market	39,000		39,000	
- Local Bonds	3		3	
Variable Rate Funding:				
- Temporary Loans	0		6,000	
- PWLB	0		0	
- Market	0		0	
Bury MBC Debt	200,365		198,865	
Airport Debt	5,256		4,829	
Total Debt	**205,621**	**4.56%**	**203,694**	**4.43%**
Total Investments	**23,881**	**1.39%**	**17,456**	**1.67%**

3.0 OVERVIEW OF THE STRATEGY FOR 2012/13

3.1 The strategy for 2012/13 was to finance capital expenditure by taking out temporary loans at lower rates of interest than more expensive long term loans. These loans would be postponed as long as it is prudent to do so. One PWLB loan of £7.5m was repaid in the year and, in line with the strategy, has not yet been replaced. All other borrowing in the year comprised temporary short term loans. As investment returns were low during 2012/13, savings were made by running down investments to finance capital expenditure.

3.2 As a result of 3.1 above, the Council was able to lower the average interest rate on debt from 4.56% to 4.43% and was able to achieve an average interest rate on investments of 1.67% for 2012-13 (which compares with Sector's target rate of 0.90%).

3.3 Due to poor investment returns, investment balances were kept low during the year and consequently there was a reduction in exposure to counterparty and interest rate risk on the investment portfolio.

4.0 ECONOMIC REVIEW FOR 2012/13

4.1 The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 of 2014. However, economic growth in the UK was flat during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the EU. The UK coalition government maintained it's policy stance against a background of warnings from two credit rating agencies that the UK could lose it's AAA credit rating. Moody's followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation fell from 3% at the start of the year to end at 2.8% in March, with projections of a fall to below 2% pushed back to quarter 1 of 2016. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.

4.2 **Gilt yields** oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically very low levels.

4.3 **Investment rates.** The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July 2012 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.

5.0 BORROWING OUTTURN FOR 2012/13

5.1 The Council's ability to borrow is determined by the cumulative capital financing requirement (CFR). When the cumulative CFR is compared to outstanding debt the difference is the amount of headroom still available to borrow. At the end of 2012/13 debt stood at £203.694m and the CFR at £250.017m. Therefore, in theory, further borrowing of £46.323 could be taken to finance past and present capital expenditure.

5.2 An analysis of movements at nominal values on loans during the year is shown below:

	Balance at	**Loans**	**Loans**	**Balance**
	31.3.12	**Raised**	**Repaid**	**31.03.13**
	£000s	**£000s**	**£000s**	**£000s**
PWLB	161,362	0	(7,500)	153,862
Market	39,000	0	0	39,000
Temporary Loans	0	8,000	(2,000)	6,000
Other loans	3	0	0	3
Bury MBC Debt	**200,365**	**8,000**	**(9,500)**	**198,865**
Airport PWLB Debt	**5,256**	**0**	**(427)**	**4,829**
Total Debt	**205,621**	**8,000**	**(9,927)**	**203,694**

5.3 The approach during 2012/13 was to take advantage of rates when they were at their lowest and identify debt rescheduling opportunities. Unfortunately, there were no opportunities to make savings through debt rescheduling in 2012/13.

5.4 In line with the strategy, the Council delayed borrowing as long as possible by running down short term investments. When it was time to borrow, temporary short term loans were taken in preference to more expensive long term loans. One PWLB loan was repaid in the year, and, in line with the strategy, has not yet been replaced. By maintaining borrowing at short term rates, the Council was able to minimise any corresponding risk from holding short term investments. As the year progressed further borrowing was kept to a minimum and cash balances were used to finance new capital expenditure. Therefore counterparty risk incurred on investments was minimised. This also maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

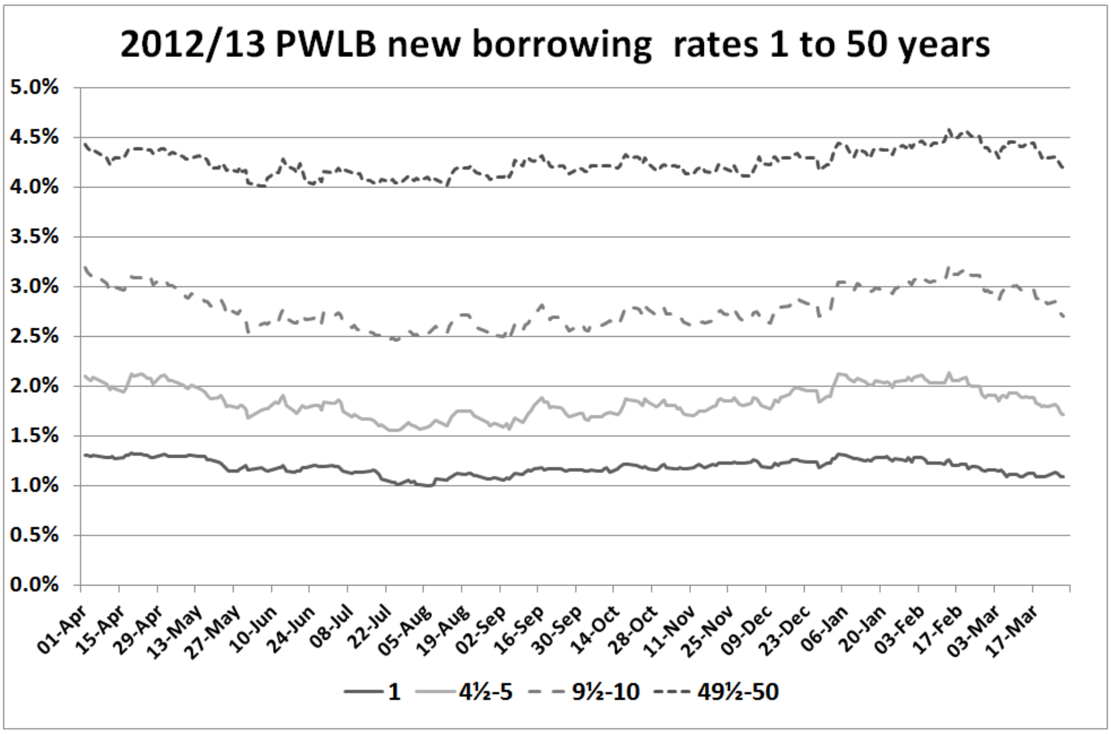
5.5 The active monitoring of the debt portfolio, the full year effect of previous rescheduling of loans, and the taking of new loans at historically low rates, have decreased the average Interest rate on the debt held over time:

Year	06/07	07/08	08/09	09/10	10/11	11/12	12/13
Average Interest Rate on Debt	5.50%	5.40%	5.33%	4.98%	4.81%	4.56%	4.43%

5.6 From 2006/07 the average interest rate falls over time due to rescheduling of loans to lower interest rates and the borrowing of new loans at historically low levels.

5.7 The Council's policy on the fall out of debt has been to establish a debt profile where the amount of debt due to be refinanced each year is stable and large scale financing in any one year avoided. Market LOBO (Lenders Option Borrower's Option) loans are recorded in accordance with the regulations set down in the Prudential Code which states "the maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment".

5.8 PWLB borrowing rates - the graph overleaf shows how PWLB rates remained close to historically very low levels during the year.



6.0 INVESTMENT OUTTURN FOR 2012/13

6.1 The Council manages its investments in-house (with advice from Sector) with the overall objective to balance risk with return and the overriding consideration being the security of the available funds.

6.2 Surplus funds have been invested with institutions listed in the Council's approved lending list. When making investment decisions, the Council has regard to the Guidance on Local Government Investments issued by the DCLG and CIPFA's Treasury Management Code of Practice.

6.3 Institutions in which investments were made did not have any difficulty in repaying investments and interest in full during the year, reflecting the sound risk management activities undertaken by the treasury team.

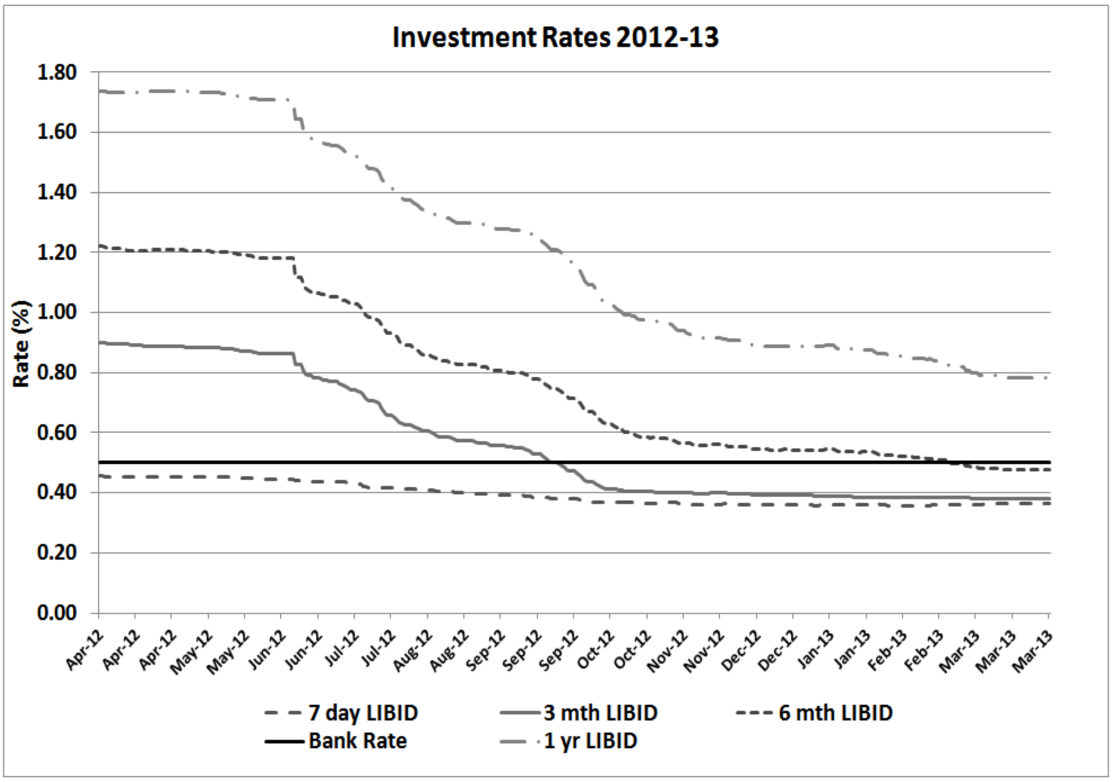
6.4 The investment strategy for 2012/13 approved by Council in February 2012 forecast the bank rate to stay flat at 0.50% throughout the year. The average rate on investments for the year was 1.39% which is significantly in excess of Sector's initial target rate of 0.90%.

6.5 The strategy also recognised that the Council's funds would be mainly cash-flow driven. The Council would seek to utilise business reserve accounts and short dated deposits in order to benefit from the compounding of interest.

6.6 Investments at 31 March 2013 stood at £17.456 (£23.881m at 31 March 2012), whilst the average for the year was £35.416m (£44.187m at 31 March 2012). The decrease in the weighted average investments from 2011/12 to 2012/13 reflects the strategy to run down investments in the second half of the year to fund capital expenditure rather than borrow to fund capital spending.

6.7 Total interest earned on investments in the financial year was £0.589m compared to £0.597m in 2011/12. This reflects the fact that investment returns were poor throughout the year. Consequently cash balances were used to finance new capital expenditure to maximise budget savings as investment rates were much lower than new borrowing rates.

6.8 In terms of investment rates in 2012/13, the Bank Rate remained at its historic low of 0.5% throughout the year and it 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 Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.



7.0 COMPLIANCE WITH TREASURY LIMITS

7.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out the Council's Treasury Policy Statement and annual Treasury Management Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

8.0 EQUALITY AND DIVERSITY

8.1 There are no specific equality and diversity implications.

9.0 FUTURE ACTIONS

9.1 Treasury Management Updates and Prudential Indicators for 2013/14 will be presented on a quarterly basis to the Cabinet and the Overview & Scrutiny Committee.

10.0 CONCLUSION

10.1 It is recommended that Members note the treasury management activity that has taken place during the financial year 2012/13.

Councillor John Smith
Deputy Leader and Cabinet Member for Finance and Corporate Affairs

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Background documents:

Unaudited Final Accounts Bury MBC 2012/13
CIPFA Treasury Management Code of Practice in the Public Services
CIPFA The Prudential Code for Capital Finance in Local Authorities
Sector's Annual Treasury Management Report 2012-13
Financial markets and economic briefing papers
For further information on the details of this report and copies of the detailed variation sheets, please contact:

Mr S. Kenyon, Assistant Director of Resources (Finance and Efficiency), Tel. 0161 253 6922, E-mail: S.kenyon@bury.gov.uk, or

Mr. A Baldwin, Head of Financial Management, Tel. 0161 253 5034,
E-mail: A.Baldwin@bury.gov.uk

Prudential Indicators 2012/13 Appendix 1

The key objectives of the Prudential Indicators are to ensure that the Council's capital investment plans and treasury management decisions are affordable, prudent and sustainable or in exceptional cases to highlight if this is not achievable. The prudential indicators for 2012/13 were not breached and were kept within their limits.

The table below shows the Prudential Indicators for 2012/13.

CAPITAL EXPENDITURE	**Original Budget 2012/13**	**Actual Outturn 2012/13**	**Variance**
	£'000	**£'000**	
Estimate of Capital Expenditure			
Non-HRA	8,041	18,253	126.99%
HRA	6,905	7,156	3.64%
Housing Reform settlement	0	0	
TOTAL	**14,946**	**25,409**	
Estimate of Capital Financing Requirement (CFR)			
Non-HRA	133,705	131,233	(1.85%)
HRA existing expenditure	40,887	40,531	(0.87%)
Housing Reform settlement	79,258	78,253	(1.27%)
	253,850	**250,017**	

AFFORDABILITY	**Original Budget 2012/13**	**Actual Outturn 2012/13**	**Variance**
Estimate of incremental impact of capital investment decisions			
Increase in council tax (band D, per annum)	£1.44	£0.00	
Increase in housing rent per week	£0.00	£0.00	
Ratio of Financing Costs to net revenue stream			
Non-HRA	2.55%	3.40%	(33.33%)
HRA	6.25%	15.44%	(147.04%)
Net External Borrowing only to support the CFR in Medium Term	**£'000**	**£'000**	
Net External borrowing over medium term	217,014	203,694	
Total CFR over Medium Term	255,212	250,017	
Net External Borrowing < Total CFR	TRUE	TRUE	

EXTERNAL DEBT	**Original Budget 2012/13**	**Actual Outturn 2012/13**	**Variance**
	£'000	**£'000**	
Authorised limit of external debt			
Borrowing	214,500	214,500	0.00%
Other long term liabilities	7,400	7,400	0.00%
Housing Reform Settlement	79,300	79,258	
TOTAL	301,200	301,158	

Operational boundary			
Borrowing	189,400	189,400	0.00%
Other long term liabilities	7,400	7,400	0.00%
Housing Reform Settlement	79,300	79,258	
TOTAL	276,100	276,058	

TREASURY MANAGEMENT	**Original Budget 2012/13**	**Actual Outturn 2012/13**	**Variance**
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	140%	140%	0%
Upper limit for variable rate exposure Net principal re variable rate borrowing / investment	-40%	-40%	0%
Upper limit for total principal sums invested for 364 days	£10 m	£10 m	
Maturity structure of fixed rate borrowing 2012/13	Upper/lower limit	Actual	
Under 12 months	10% - 0%	7.00%	
12 months and within 24 months	35% - 0%	2.97%	
24 months and within 5 years	40% - 0%	6.07%	
5 years and within 10 years	50% - 0%	6.88%	
10 years and above	90% - 30%	77.08%	

The prudential indicators of affordability listed above address the revenue implications of the authority's finances since, as a fundamental principle, all borrowings are secured on the authority's future revenue income. The CIPFA Prudential Code requires the prudential indicators in respect of external debt, as above, to be set and revised taking into account their affordability. It is through this means that the objectives of sustainability and prudence are addressed each year.