

Report for:	Corporate Committee 27th June 2013	Item number	
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Title:	Treasury Management 2012/13 Outturn and Quarter 1 2013/14 update
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Report authorised by :	<i>J. Parker 18/6/13</i> Director of Corporate Resources
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Lead Officer:	Ian Talbot, Interim Head of Finance – Treasury & Pensions ian.talbot@haringey.gov.uk 020 8489 8621
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Ward(s) affected: N/A	Report for Non Key Decision
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1. Describe the issue under consideration

- 1.1 This is a report to Members on treasury management activity and performance during 2012/13 in accordance with the CIPFA Treasury Management Code of Practice. It is a requirement of the Code for this to be reported on to Council once Corporate Committee has considered it. In addition it provides an update for Members on treasury management activity during the first quarter of 2013/14.

2. Cabinet Member Introduction

- 2.1 Not applicable.

3. Recommendations

- 3.1 That Members note the treasury management activity and performance during 2012/13 and the first quarter of 2013/14; and,
- 3.2 That Members approve the amendment to the Prudential Indicators within the Treasury Management Strategy Statement 2013/14 as set out in paragraph 14.6.

4. Other options considered

- 4.1 None.

5. Background information

- 5.1 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. CIPFA has defined Treasury management as: "The management of the local 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 Code recommends that members are informed of treasury management activities at least twice a year. Formulation of treasury policy, strategy and activity is delegated to the Corporate Committee and this Committee receives reports quarterly.
- 5.3 However, overall responsibility for treasury management remains with the Council and the Council approved the Treasury Management Strategy Statement and set the Prudential Indicators for 2012/13 on 28th February 2012.
- 5.4 This outturn report is a requirement of the Code and it summarises the activity during 2012/13.
- 5.5 With regard to investments, Government guidance on local authority treasury management states that local authorities should consider the following factors in the order they are stated:

Security – Liquidity – Yield

The Treasury Management Strategy reflects these factors and is explicit that the priority for the Council is the security of its funds. However, no treasury management activity is without risk and the effective identification and management of this risk are integral to the Council's treasury management activities.

- 5.6 This report has been written in consultation with the Council's treasury management advisers, Arlingclose.

6. Comments of the Chief Financial Officer and financial implications

- 6.1 The treasury management strategy in 2012/13 was to continue to maximise internal borrowing and, therefore, to minimise cash balances. This policy not only reduced credit risk in the year but also reduced the cost of borrowing. In addition, the policy of taking short term borrowing from other local authorities instead of long term also saved interest costs during 2012/13. This active

management of the debt portfolio realised savings of £2.8m in the year.

7. Head of Legal Services and Legal Implications

7.1 The contents and recommendation of this report are in accordance the Treasury Management Strategy Statement (except for the adjustments set out in paragraph 14.6 of this report) and consistent with legislation governing the financial affairs of the Council. In considering the report Members must take into account the expert financial advice available to it and any further oral advice given at the meeting of the Committee.

7.2 Paragraph 14.6 of this report will have the effect of changing Paragraph 4.14 (Table 11: Maturity of fixed rate borrowing) of the Treasury Management Strategy 2013/14 to 2014/15. The changes are necessary because the Treasury Management Code has been revised.

8. Equalities and Community Cohesion Comments

8.1 Not applicable.

9. Head of Procurement Comments

9.1 Not applicable.

10. Policy Implications

10.1 None.

11. Use of Appendices

11.1 Appendix 1: Summary of Treasury Management activity and performance
Appendix 2: Prudential Indicators

12 Local Government (Access to Information) Act 1985

12.1 Not applicable.

13. Economic and treasury portfolio background in 2012/13

13.1 The Council's treasury management advisers have advised that some of the principal factors in relation to the UK economy were:

- The global outlook stabilised mainly due to central banks maintaining low interest rates and governments increasing

spending and reducing taxes to encourage economic growth. In the UK the Bank Base Rate remained at 0.5% throughout the financial year.

- The UK economy shrank in the first and third quarters of the financial year but registered growth of 0.9% in the second quarter and 0.3% in quarter four producing year on year growth of 0.6%.
- The UK's sovereign rating was downgraded by Moody's to Aa1. The AAA status was maintained by Fitch and S&P, albeit with a Rating Watch Negative and with a Negative Outlook respectively.

13.2 The "Funding for Lending Scheme," whereby the Bank of England provides funds for the banks at a very low interest rate means that they are not so reliant on the wholesale market resulting in short term investment rates falling below the Bank Rate for much of the year.

13.3 The position of the treasury portfolio at the end of the financial year compared to the previous financial year end is shown in the table below. This shows a net reduction of £12.3m in long term PWLB borrowing and £20m in short term borrowing from other local authorities arising from the repayment of maturing debt and further use of cash balances in lieu of borrowing. The sections which follow describe the activity in the borrowing and investment portfolios in more detail.

Treasury Portfolio	Position at 31/03/12 £'000	Position at 31/03/13 £'000
<u>Borrowing</u>		
PWLB fixed maturity	201,544	192,178
PWLB fixed EIP	9,682	7,746
PWLB variable EIP	7,746	6,778
Market loans	125,000	125,000
Other local authorities	50,000	30,000
Total External Borrowing	393,972	361,702
<u>Investments</u>		
Fixed term deposits	0	7,100
Money market funds	5,470	7,095
Total Investments	5,470	14,195

14. Borrowing

14.1 During the year the Council continued its policy of undertaking limited external long term borrowing and maximising the use of internal balances in lieu. The reason for this was to continue to minimise the "cost of carry" associated with external borrowing and

thus to reduce overall borrowing costs. The cost of carry is the difference between the interest rate paid for long term borrowing and the rate of interest which can be earned from temporarily investing the funds borrowed which has amounted to 2-3% over the last year. As a result, of the £22.3m repaid for maturing loans and principal repayments only £10m was replaced by new borrowing.

- 14.2 The "Certainty Rate" was introduced by the PWLB in November 2012, allowing local authorities to borrow at a reduction of 0.20% on the Standard Rate and the Council's borrowing of £10m was taken on this basis.
- 14.3 Short term borrowing from other local authorities at £50m, was artificially high at the end of 2011-12 in order to maximise the benefits from the Government's repayment of PWLB debt as part of housing reform. The in-year borrowing of £30m is due to the large differential between short and longer term interest rates which is likely to remain a feature for some time in the future. This differential is kept under constant review and the borrowing strategy adjusted accordingly.
- 14.4 To minimise the risks associated with interest rate changes, 98% of the Council's loans portfolio is held at fixed rates.
- 14.5 The Council has £125m of market loans which are LOBO loans (Lender's Options Borrower's Option) and all of them were in their call period during 2012/13. A LOBO is called when the lender exercises its right to amend the interest rate on the loan at which point the borrower can accept the revised terms or reject them and repay the loan without penalty. Whilst none of the LOBOs were called during 2012/13 they do represent a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion. Any LOBO called will be discussed with the Council's treasury advisers prior to the acceptance of any revised terms.
- 14.6 The Treasury Management Code has recently been revised and now requires the Prudential Indicator relating to the Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment. This is in effect a technicality but should nevertheless be adjusted going forward and it is recommended, therefore, that the Prudential Indicators be adjusted as follows:

Maturity structure of borrowing (U: upper; L: lower)	Existing L	Existing U	Revised U
Under 12 months	0%	40%	55%
12 months and within 2 years	0%	35%	40%
2 years and within 5 years	0%	35%	40%
5 years and within 10 years	0%	35%	35%
10 years and within 20 years	0%	35%	35%
20 years and within 30 years	0%	35%	35%
30 years and within 40 years	0%	35%	35%
40 years and within 50 years	0%	50%	50%
50 years and above	0%	50%	50%

14.7 The table below summarises the transactions undertaken during the year:

	1/4/12 £'000	Maturing loans £'000	New loans £'000	31/3/13 £'000
PWLB fixed maturity	201,544	(19,366)	10,000	192,178
PWLB fixed EIP	9,682	(1,936)	0	7,746
PWLB variable EIP	7,746	(968)	0	6,778
Market loans	125,000	0	0	125,000
Other local authorities	50,000	(50,000)	30,000	30,000
Total borrowing	393,972	(72,270)	40,000	361,702

14.8 At the end of the financial year the average interest payable on the borrowing portfolio had fallen to 5.38% from 5.87% at 1 April 2012.

15. Investments – activity and performance

15.1 The Council held average cash balances of £22.3m during the year. The balances represented working cash balances and the Council's reserves. The Council invested these funds in accordance with the Treasury Management Strategy Statement agreed for 2012/13. All investments made during the year complied with the Council's agreed Treasury Management Strategy and Treasury Management Practices. Maturing investments were repaid to the Council in full and in a timely manner.

15.2 Credit Risk

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long term counterparty rating of A- Fitch, Standard and Poors and Moody's); credit default swaps; any potential support mechanisms from the UK Government and share price. The Council has sought to minimise its security risks by setting limits on each institution on the lending list. The Council has complied with all these limits during 2012/13.

In June Moody's downgraded a number of banks with global capital market operations, including the UK banks on the Council's lending list - Barclays, HSBC, Royal Bank of Scotland/Natwest, and Lloyds TSB Bank/Bank of Scotland. Although the only effect of this action was to remove RBS/NatWest from the Council's approved list (due only to their short term rating) this confirmed the Council's strategy of investing only in instant access AAA rated Money Market Funds and the Government guaranteed Debt Management Office.

The table below shows the investments outstanding at 31 March 2013:

Institution	Long term credit rating	Amount (£m)	% of total deposits
Deutsche MMF	AAA	1.400	9.9
RBS MMF	AAA	0.840	5.9
JP Morgan MMF	AAA	1.350	9.5
Invesco MMF	AAA	1.320	9.3
Goldman Sachs MMF	AAA	1.305	9.2
BlackRock MMF	AAA	0.880	6.2
Debt Management Office	AA+	7.100	50.0
TOTAL		14.195	100.0

The Debt Management Office does not have a credit rating, therefore the UK sovereign rating is used.

Throughout 2012-13 credit risk scores have been reported to Committee based on a methodology devised by Arlingclose. The scores show credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0-2
Target score	AA to A+	Score 3-5
Below target	Below A+	Score over 5

The scores during 2012-13 are shown below and evidence the impact of investing only in AAA rated Money Market Funds and the Debt Management Office:

	Quarter 1 2012/13	Quarter 2 2012/13	Quarter 3 2012/13	Quarter 4 2012/13
Value weighted	1.0	1.0	2.4	2.5
Time weighted	1.0	1.0	1.9	2.9

The significant changes during the year have arisen from a change in the methodology for valuing money market funds.

15.3 Liquidity

In keeping with the Government's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and Debt Management Office investments which operate on an instant access basis. The weighted average maturity of the investment portfolio was, therefore, one day.

15.4 Yield

The Council sought to optimise returns commensurate with its objectives of security and liquidity. £0.08m was earned on the Council's investments during 2012/13 at an average rate of 0.36%, 0.14% below the Bank of England Base Rate.

16. Update on Investments with Icelandic Banks

16.1 In December 2011, the Courts determined that local authority deposits with Glitnir and Landsbanki qualified for priority status. Securing priority creditor status means that deposits with Glitnir are set to recover 100%, whilst Landsbanki deposits are estimated to recover 98% and Heritable 88%.

16.2 Distributions received by the Council to date total £24.5m, 66% of the original investment of £36.9m.

17. Compliance with Prudential Code indicators

17.1 The Council set prudential indicators for 2012/13 in February 2012. The set of indicators is made up of those which provide an indication of the

likely impact of the planned capital programme and those which are limits set on treasury management activity. Appendix 2 sets out the approved indicators for 2012/13 and the final position for each of the capital indicators and the year end position on each of the treasury management limits.

- 17.2 Borrowing is well within the operational and authorised limits, as the peak of borrowing was £394m in April 2012. The continued policy of using internal cash balances to fund the capital programme ensured this was the case.

18. 2013/14 quarter 1 update

- 18.1 During the quarter to date £25m of local authority borrowing has matured. Due to the pattern of the Council's cash flow where a high proportion of payments arrive early in the year it has not yet been necessary to carry out any re-financing.

- 18.2 The table below shows the Council's investments as at 13 June 2013.

Counterparty	Long Term Credit Rating	Period to Maturity (days)	Amount (£k)	% of Total Deposits
Debt Management Office	AA+	5	3,200	5.7
Debt Management Office	AA+	7	5,000	8.9
Debt Management Office	AA+	5	3,600	6.4
Debt Management Office	AA+	1	8,200	14.7
Debt Management Office	AA+	1	1,700	3.0
Debt Management Office	AA+	1	7,300	13.0
Debt Management Office	AA+	14	5,000	8.9
Debt Management Office	AA+	11	3,250	5.8
Nat West Call Account	A	1	5,400	9.6
Goldman Sachs MMF	AAA	1	3,750	6.7
Deutsche MMF	AAA	1	1,160	2.1
RBS MMF	AAA	1	2,900	5.2
JP Morgan MMF	AAA	1	0.535	1.0
Invesco MMF	AAA	1	1.320	2.4
BlackRock MMF	AAA	1	3,700	6.6
TOTAL			56,015	100.0

The Debt Management Office does not have a credit rating therefore the UK sovereign rating is used

Appendix 1: Summary of Treasury Management Activity and Performance

1. Treasury Portfolio

	Position at Q4 2012/13 £000	Position at Q3 2012/13 £000	Position at Q2 2012/13 £000	Position at Q1 2012/13 £000
Long Term Borrowing PWLB	206,702	208,155	205,901	218,972
Long Term Borrowing Market	125,000	125,000	125,000	125,000
Short Term Borrowing	30,000	20,000	23,000	35,000
Total Borrowing	361,702	353,155	353,901	378,972
Investments: Council	14,195	20,950	15,580	19,795
Investments: Icelandic deposits in default	12,455	12,995	13,918	14,485
Total Investments	26,650	33,945	29,498	34,280
Net Borrowing position	335,052	319,210	324,403	344,692

2. Security measure

	Quarter 4 2012/13	Quarter 3 2012/13	Quarter 2 2012/13	Quarter 1 2012/13
Credit score – Value weighted	1.6	1.0	1.0	1.0
Credit score – Time weighted	1.9	1.0	1.0	1.0

3. Liquidity measure

	Quarter 4 2012/13	Quarter 3 2012/13	Quarter 2 2012/13	Quarter 1 2012/13
Weighted average maturity: deposits (days)	4.00	8.36	4.21	2.37
Weighted average maturity: borrowing (years)	27.74	27.20	28.50	25.60

4. Yield measure

	Quarter 4 2012/13	Quarter 3 2012/13	Quarter 2 2012/13	Quarter 1 2012/13
Interest rate earned	0.31%	0.36%	0.33%	0.45%
Interest rate payable	5.38%	5.46%	5.47%	5.44%

Appendix 2: Prudential Indicators

	Prudential Indicator	2012/13 Original Indicator	2012/13 Position/Actual at 31/3/2013
CAPITAL INDICATORS			
1	Capital Expenditure	£k	£k
	General Fund	44,350	41,317
	HRA	43,514	40,673
	TOTAL	87,864	81,990
2	Ratio of financing costs to net revenue stream	%	%
	General Fund	2.70	2.78%
	HRA	15.35	13.18%
3	Capital Financing Requirement	£k	£k
	General Fund	298,901	277,726
	HRA	272,854	271,096
	TOTAL	571,755	548,822
4	Incremental impact of capital investment decisions	£	£
	Band D Council Tax	1.31	0.41
	Weekly Housing rents	0.20	0.09

	Prudential Indicator	2012/13 Original Indicator	2012/13 Position/Actual at 31/3/2013
TREASURY MANAGEMENT LIMITS			
5	Borrowing Limits	£k	£k
	Authorised Limit	788,917	393,972
	Operational Boundary	638,545	393,972
6	HRA Debt Cap	£k	£k
	Headroom	54,684	54,894
7	Net debt to gross debt	£k	£k
	Limit on proportion of net debt to gross debt	531,755	422,331
8	Upper limit – fixed rate exposure	100%	98.13%
	Upper limit – variable rate exposure	40%	1.87%
9	Maturity structure of borrowing (U: upper, L: lower)	L	U
	under 12 months	0%	40%
	12 months & within 2 years	0%	35%
	2 years & within 5 years	0%	35%
	5 years & within 10 years	0%	35%
	10 yrs & within 20 yrs	0%	35%
	20 yrs & within 30 yrs	0%	35%
	30 yrs & within 40 yrs	0%	35%
	40 yrs & within 50 yrs	0%	50%
	50 yrs & above	0%	50%
10	Sums invested for more than 364 days	£0	£0
11	Adoption of CIPFA Treasury Management Code of Practice	√	√