Report for: AUDIT COMMITTEE FOR SCRUTINY/REVIEW	
Item Number: 08	

Contains Private and Confidential Information	**YES** (Appendix 1)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
Title	Treasury Management Outturn 2012-13	
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Portfolio	Finance and Performance - Cllr Yvonne Johnson	
For Consideration By	Audit Committee	
Date to be Considered	27 June 2013	
Implementation Date if Not Called In	N/A	
Affected Wards	N/A	
Area Committees	N/A	
Keywords/Index	Treasury, Borrowing, Lending, Investments, HRA Debt, Prudential Indicators.	

Purpose of Report:
This report provides an update on the Council's borrowing and investment activities for the financial year ending 31 March 2013. This update ensures that the Council is delivering its Treasury Management service in an open and transparent manner and that the Council is fulfilling its obligations under the Local Government Act 2003 to produce an annual review of activities. The report is being submitted to the Audit Committee to enable Members to fulfil their scrutiny role of the treasury management function as per CIPFA's Treasury Management Code of Practice. In 2012-13, all treasury management activities were carried out in accordance with approved limits. The report also provides information on the economic conditions prevailing in the final quarter of 2012-13.

1. Recommendations

Members are required to:

1.1. Note the Treasury Management activities and performance against targets for the 12 months to 31 March 2013.

1.2. Note the Council's governance and reporting arrangements in line with CIPFA's best practice recommendations, as set out in paragraph 7.

1.3. Note the Council's current lending list (Appendix 1), private and confidential.

1.4. Note the Prudential indicators outturn for 2012-13 (Appendix 2).

1.5. Note that the Council continues to operate a dual Treasury Management strategy for managing the General Fund (GF) and the Housing Revenue Account (HRA) debt.

1.6. Note the position on Pension Fund investments, since Pension Fund cash is being invested separately from the Council.

2. Reason for Decision and Options Considered

2.1. This report updates on both the borrowing and investment decisions made by the Director of Corporate Finance & Audit under delegated authority in the context of the prevailing economic backdrop and considers the Treasury Management Performance measured against its benchmark.

2.2. Treasury management is the management of the council's investments and cashflows; 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.

<u>Summary</u>

2.3. The main points from this report are:

- All treasury management activities were effected by authorised officers within the parameters agreed by the Council.

- All investments were made to counterparties within the Council's approved lending list.
- The Council's remaining investment of £380k (with Glitnir Bank) which is held in an Icelandic escrow has now increased in value to £407k.
- There was no long-term borrowing raised during the year to 31 March 2013.
- Long term debt was reduced from £501.7M to £494.9M.
- The Council earned 0.609% on short term lending, outperforming the actual rolling average 7 Day libid rate of 0.394%.
- The Council currently holds no investments with overseas financial institutions (apart from the balance of £407K on the Icelandic investment).
- The HRA debt is being managed separately from General Fund debt following the revised methodology agreed for the implementation of self-financing.

2.4. A glossary of terms used is set out at the end of this report in Appendix 3.

3. Treasury Management Strategy 2012/13

3.1. The Council's Treasury Management Strategy for 2012-13 was approved on the 28th February 2012 by Full Council. The Strategy fully outlined how the treasury function would operate throughout the financial year 2012-13 and covered:

- update on Pension Fund cash/Treasury limits and current portfolio position
- treasury and prudential indicators which will limit the treasury risk and activities of the Council
- MRP Policy
- economic background and prospects for interest rates
- borrowing strategy and policy on borrowing in advance of need
- debt rescheduling
- the current treasury position
- recommendations for pooling of debt following self-financing
- annual investment strategy
- credit worthiness policy
- policy for use of external advisors
- treasury budget

3.2. The Council complied with the strategy throughout the financial year 2012-13.

Investment of Pension Fund Cash

3.3. The Council usually retains some Pension Fund cash in house. This is the excess of employers and employees contributions over the payment of pension benefit that accrue from the Pension Fund revenue account operated by the Council as administering authority for the scheme. From time to time balances are transferred to external Fund Managers to invest, but a small amount is usually retained internally to manage cashflows, or larger amounts to facilitate an asset reallocation strategy.

3.4. As agreed by Members at the Pension Fund Panel meeting on the 09 March

2011 and in accordance with regulations, the Pension fund cash has continued to be invested separately from the Council's cash in fixed term deposits and special interest bearing bank accounts throughout the financial year 2012-13. All Pension Fund transactions still flow through the Council's bank account. Usually the Pension Fund receives interest from the Council for all internally managed balances in between transfers of funds from the Council to a separate Pension Fund bank account, however, the Pension fund revenue account was cashflow negative over the financial year 2012-13, hence, no interest accrued to the Pension Fund.

3.5. The Pension Fund invests its surplus cash in accordance with the Council's Treasury Management strategy agreed by Full Council on the 28th February 2012, which is delegated to the Director of Corporate Finance and Audit to manage within set parameters. The Treasury Management Strategy is reviewed on a monthly basis at the Treasury Risk & Investment Board (TRIB) a meeting consisting of Corporate Finance officers and chaired by the Executive Director of Corporate Resources. The Pensions Fund Panel is updated on pension fund investment activity and the Chair of the Pension Fund Panel (PFP) is briefed regularly.

4. Economic Background

- In summary during the last quarter of financial year 2012-13: -
    - Economic Indicators appeared to point to an economy that was close to a second consecutive quarter of negative growth in GDP, however, the UK actually returned GDP growth of 0.3% in the first quarter of 2013.
    - Household spending strengthened, both on and off the high-street;
    - Unemployment rose for the first time for a year;
    - Inflation pressures remained with rates being above the MPC's 2% target;
    - In spite of stubborn inflation three members of the MPC including Mervyn King voted for further QE;
    - UK equity prices rose and sterling fell;
    - The US economy continued to rebound.

The UK economy returned a GDP growth rate of 0.3% in the first quarter of 2013. This growth was largely attributable to the services, transport and communications sector. The unusually bad weather at the end of the quarter does not appear to have depressed activity in certain sectors, such as retail and there are no special factors like the Olympics to be ascribed to the flattering activity levels.

Household spending appears to have started the year on a stronger footing. The 2.1% monthly rise in retail sales in February more than offset January's 0.7% fall. Non-high street spending has been robust too, with new car registrations up by 7.9% in the year to February.

The latest data tentatively suggested that the labour market's recent resilience is coming to an end.

Elsewhere, the housing market has been revived a bit by the Bank of England's Funding for Lending Scheme (FLS) initiative which saw mortgage rates on fixed products reduce.

On the fiscal front, the public borrowing figures for this year have been improved by a number of one-offs, including the transfer of the Royal Mail pension fund and the revenues of interest generated by the Bank of England's Asset Purchase Facility. On an underlying basis, however, the OBR forecast net borrowing of £121.9bn

Inflation, meanwhile, remained high, with the CPI measure rising from 2.7% to 2.8% in February mostly driven by energy prices which the MPC have chosen to ignore in determining its asset buying programme.

Turning to the markets, both UK and global equity prices have rallied since the start of the year, with the FTSE 100 rising from 5,897 to 6,400. Gilt prices were volatile over the quarter, with the yield on 10-year gilts hitting 2.2% in early March, before falling back to 1.72% at the end of the quarter.

The Eurozone crisis flared up again at the end of the quarter, after it was agreed that bank deposits could be subject to a "haircut" as part of an international bail-out package for Cyprus. While a bailout package agreed by European Finance Ministers should avert disaster, the episode has raised fears about the safety of bank deposits in other periphery countries.

5. Overall Treasury Cash Flow Position as at 31 March 2013

5.1. The Council's temporary borrowing and lending activity (that is 364 days or less) during the financial year 2012-13 is set out below.

Description	**Temporary (Short Term) Borrowing £M**	**Lending £M**	**Net Position £M**
Outstanding at 1st April 2012	**0**	**-276.86**	**-276.86**
Raised/ (lent) during period	19.50	-10,691.55	-10,672.05
Repayments during period	-19.50	10,716.33	10,696.83

Outstanding 31 March 2013	**0**	**-252.08**	**-252.08**

**DMO investments were high as the Council's daily cash balances were placed here.*

5.2. Over the 12 months to 31 March 2013, the Council's cashflows were maintained through borrowing and lending activities on the wholesale money market and the net position outstanding at 31 March 2013 is temporary lending of £252.08M

5.3. £19.5M of short term borrowing (less than 21 days) was raised from other Local Authorities during the year to 31 March 2013. The option was taken at 0.27% as it was cheaper than drawing from a special interest account earning 0.65%.

6.0 The Strategy for 2012/13

6.1 The Council's Annual Investment Strategy outlines the Council's investment priorities as follows (in order of priorities):

- Security of Capital
- Liquidity
- Yield

Long Term Borrowing Requirement and Debt

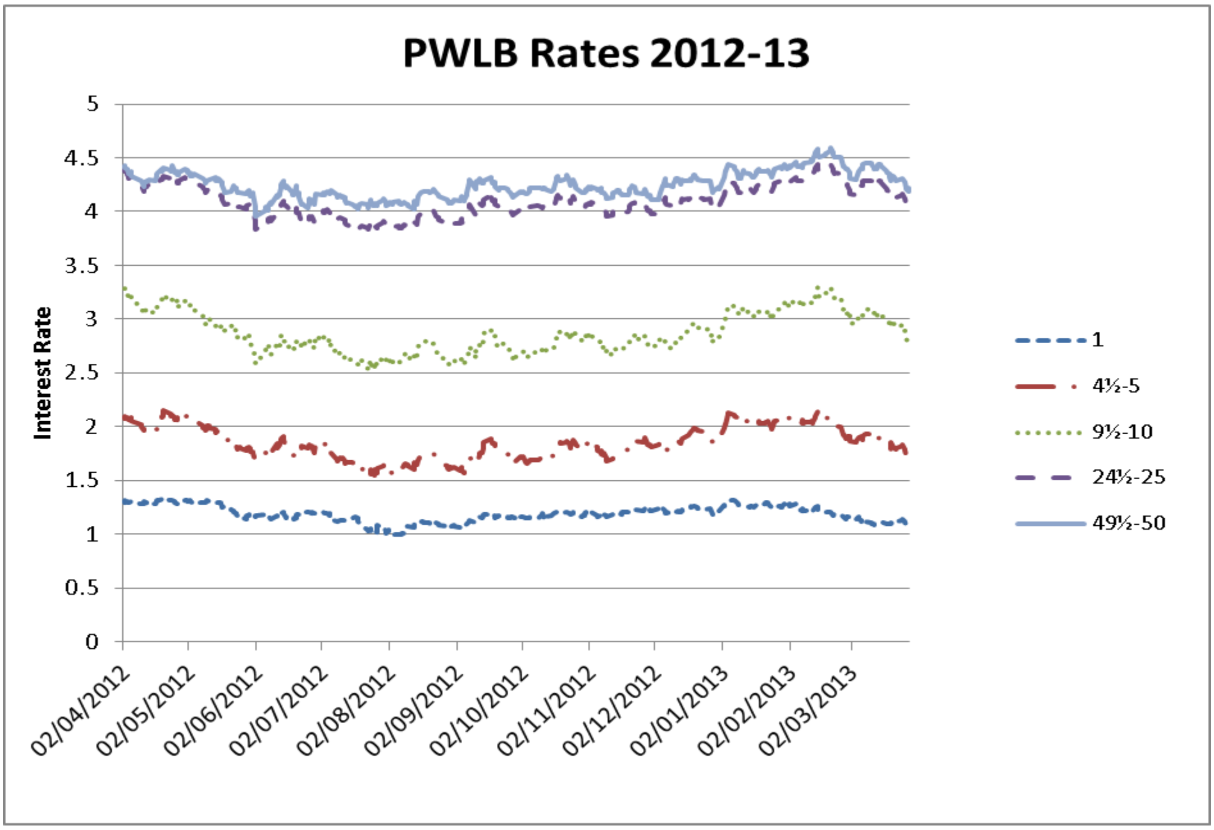
HRA Self Financing

6.2 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

The Council operates a dual Treasury Management strategy for managing the General Fund (GF) and the Housing Revenue Account (HRA) debt, following the implementation of housing finance reform at the end of last financial year which resulted in the abolition of the housing subsidy system.

Capital Financing Requirement	**2011/12 Actual £m**	**2012/13 Actual £m**	**2013/14 Estimate £m**
CFR – non housing	345	371	403
CFR – housing	148	146	146
Total CFR	**493**	**517**	**549**

6.3 Longer term borrowing rates were budgeted on a 5.00% average borrowing rate. The graph below shows a summary of PWLB rate during the financial year 2012/13.:



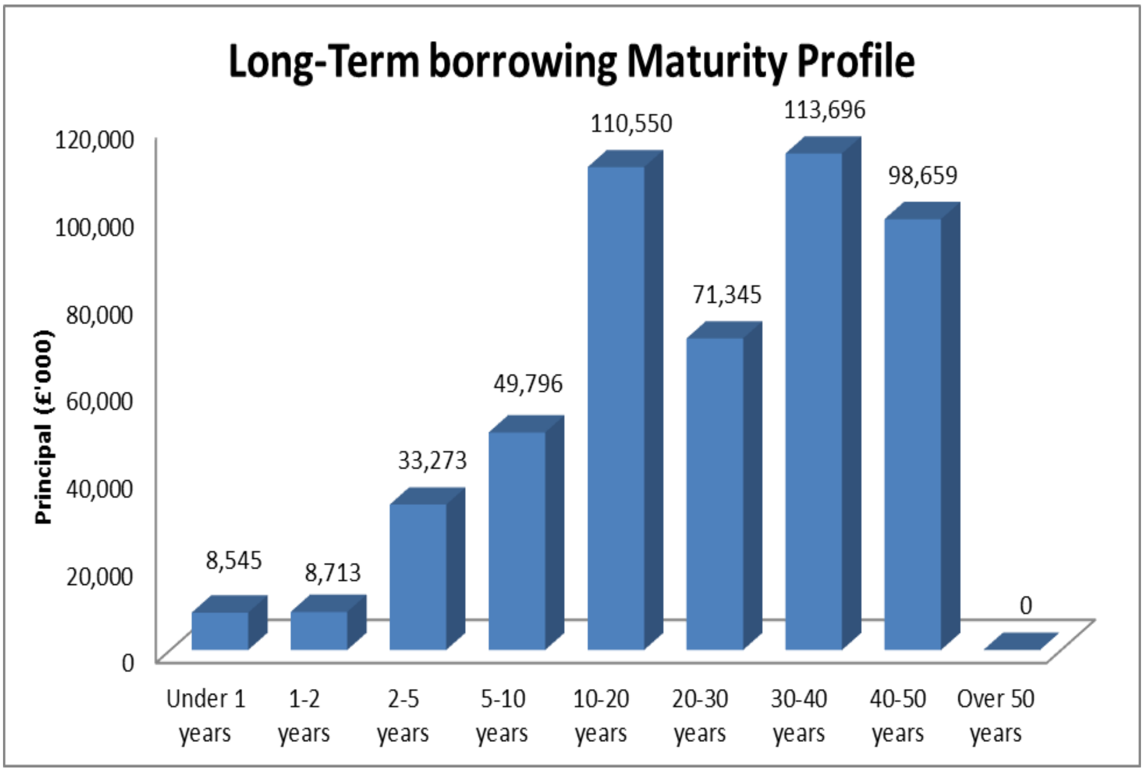
The second quarter of 2012-13 saw a downward shift in gilt yields as a result of the flight to safety following escalation of the euro-zone crisis. This resulted in PWLB rates falling across all durations. However, there has been a slight upward movement since Q2, as a result of re risking of capital markets which consequently resulted in increase in PWLB rate.

6.4 Total long term borrowing stood at £494.9M (including the Council's borrowing from Mortlake crematorium) on the 31st March 2013. The table below shows the split between General Fund and HRA, and that overall debt fell by £6.83M from £501.73.

Source	**Debt 01.04.12 £M GF**	**HRA**	**Loans raised £M**	**Loans repaid £M**	**Debt 31.03.13 £M**
PWLB :GF	291.05		0.0	4.25	286.80
:HRA		121.56	0.0	1.78	119.78
Market debt :GF	62.07		0.0	0.0	62.07
:HRA		25.93	0.0	0.0	25.93
Mortlake Crematorium	1.12	0.0	0.0	0.80	0.32
TOTAL	**354.24**	**147.49**	**0.000**	**6.83**	**494.90**

6.5 The Council's actual borrowing of £494.9M at the end of the financial year was below the anticipated year end Capital Financing Requirement (CFR) of £516.6M. No borrowing was raised in the financial year in view of the level of investments held which has allowed the Council to internally borrow in the interim hence actual borrowing was behind the Council's CFR.

This position is prudent as investment returns are low, counterparty risk is relatively high and there was no need to externally borrow. Officers will continue to monitor PWLB rates to determine the optimum time to externally borrow.



- The above graph does not include the Mortlake loan of £323k.

<u>Debt Rescheduling</u>

6.6 Movements in interest rates over time can produce dislocations, which can present opportunities for the Council to replace existing loans with new loans at lower rates. This is known as debt rescheduling. The Council can also repay existing loans early without necessarily replacing the loans. These activities will attract a discount or premium depending on the prevailing market conditions.

6.7 No debt rescheduling opportunities have arisen during the year, as the cost of premium to repay debt outweighs savings that could be achieved from the lower PWLB borrowing rates.

PWLB Certainty Rate

6.8 A discounted rate on loans from the government was launched as part of the Budget in March 2012. Cheaper borrowing rates are now available from the Public Works Loans Board for councils that can provide improved information on borrowing plans.

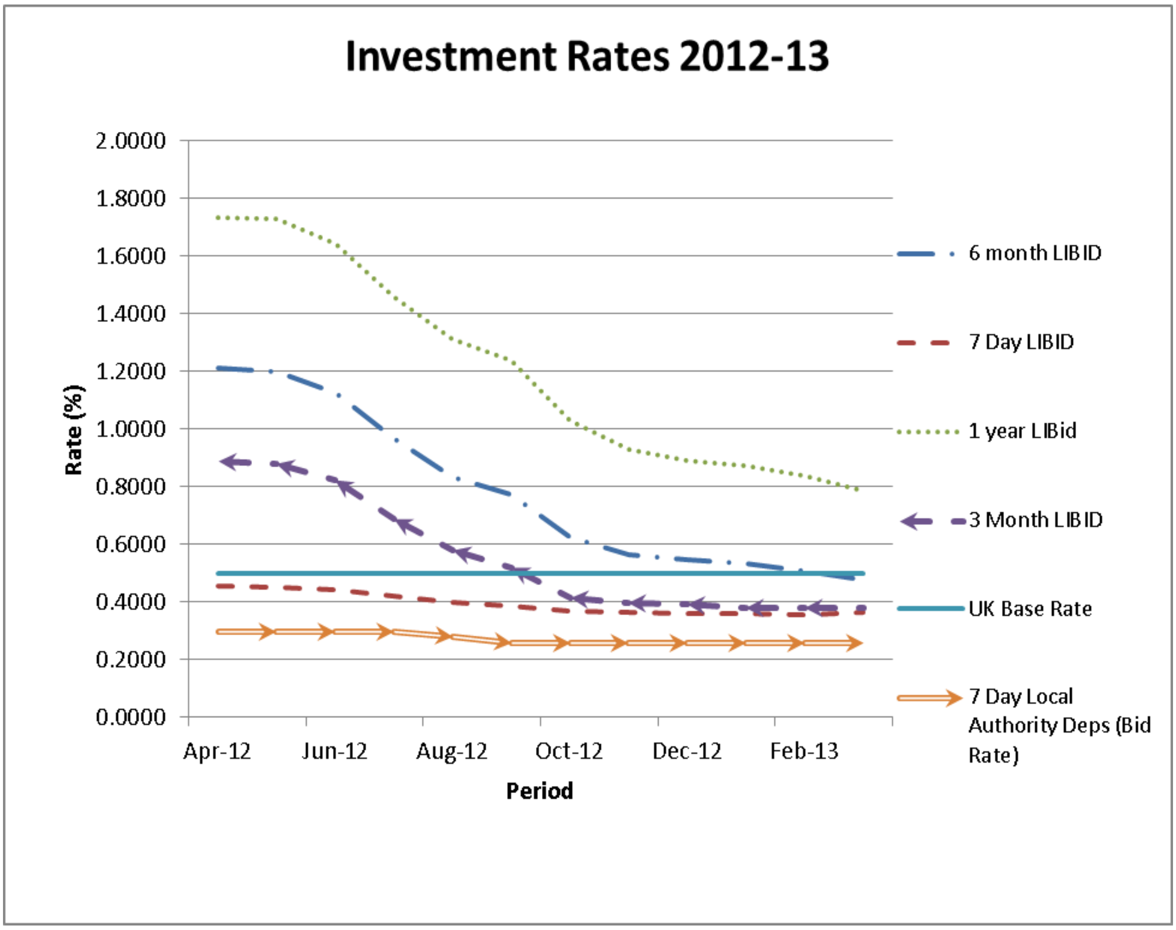
6.9 The "certainty rate" is 20 basis points (0.2%) below the PWLB's normal rate. The aim is to afford increased spending capacity from Council's who will benefit from savings accrued from interest payments.

6.10 Although there was no plan to borrow, the Council successfully applied and had since renewed its application to remain qualified to borrow at the discounted certainty rate.

Investment Rate 2012-13

6.11 The low interest rate environment brought on by the global financial crisis of 2008 has persisted. The Bank of England has maintained base rates at the historic low rate of 0.5% to stimulate recovery.

The graph below illustrates how investment rates fell to a historically very low level during the year.



Investment Outturn

6.12 The low investment returns were as a result of the continued counterparty concerns generated by the Euro zone sovereign debt crisis. The Council's aim was to achieve the optimum return on investments commensurate with the proper levels of security and liquidity.

6.13 The Council managed its investments in-house and invested with institutions on the Council's approved lending list. Due to the ongoing volatile economic outlook, the Council operated a restricted lending list throughout the year, mainly investing in the UK Government, other Local Authorities and a handful of financial institutions. The approved list of investment counterparties remains subject to ongoing review by the

Treasury Risk and Investment Board which meets monthly.

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

Investments held by the Council

6.15 The Council maintained an average of £290M of internally managed funds and an outstanding balance of £252M as at 31 March 2013. The internally managed funds earned an average rate of return of 0.609%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.394%. A budget of £1.73M was included in the 2012-13 strategy for investment income, but the Council achieved a marginally higher budget outturn for investment income of £1.77M. The key driver behind investment remained the prudent approach to investments taken by the Council and an investment emphasis on security and return of capital and liquidity ahead of yield.

6.16 The uncertain economic backdrop during the year constrained the Council to placing most new investments in shorter term deposits and with high quality counterparties such as the DMO and other local authorities. The outcome of such a policy of course was a continuous reduction in the investment income received by the Council compared to previous year.

6.17 Slippage on the capital programme contributed to the higher cash balances in 2012-13. Slippage by its nature is not possible to forecast at the beginning of the financial year.

6.18 Investments held at 31 March 2013 are outlined below.

Counterparty Name	Total Deposited 31/03/13 (£'000)	Total Deposited 31/03/12 (£'000)
Local Authorities	116,700	159,600
Debt Management Office	13,900	24,900
Glitnir Bank HF	406	380
HSBC	30,000	30,000
Lloyds TSB Bank Call Account	30,000	34,000
Natwest SIBA	40,000	27,383
Barclays	20,000	0
Treasury Bill	499	0
Future Ealing Ltd*	600	600
TOTAL INVESTED ('000):	**252,105**	**276,863**

** Ealing's Local Education Partnership, a joint-venture company formed by the Council and Balfour Beatty Education to deliver Ealing's Building Schools for the Future programme.*

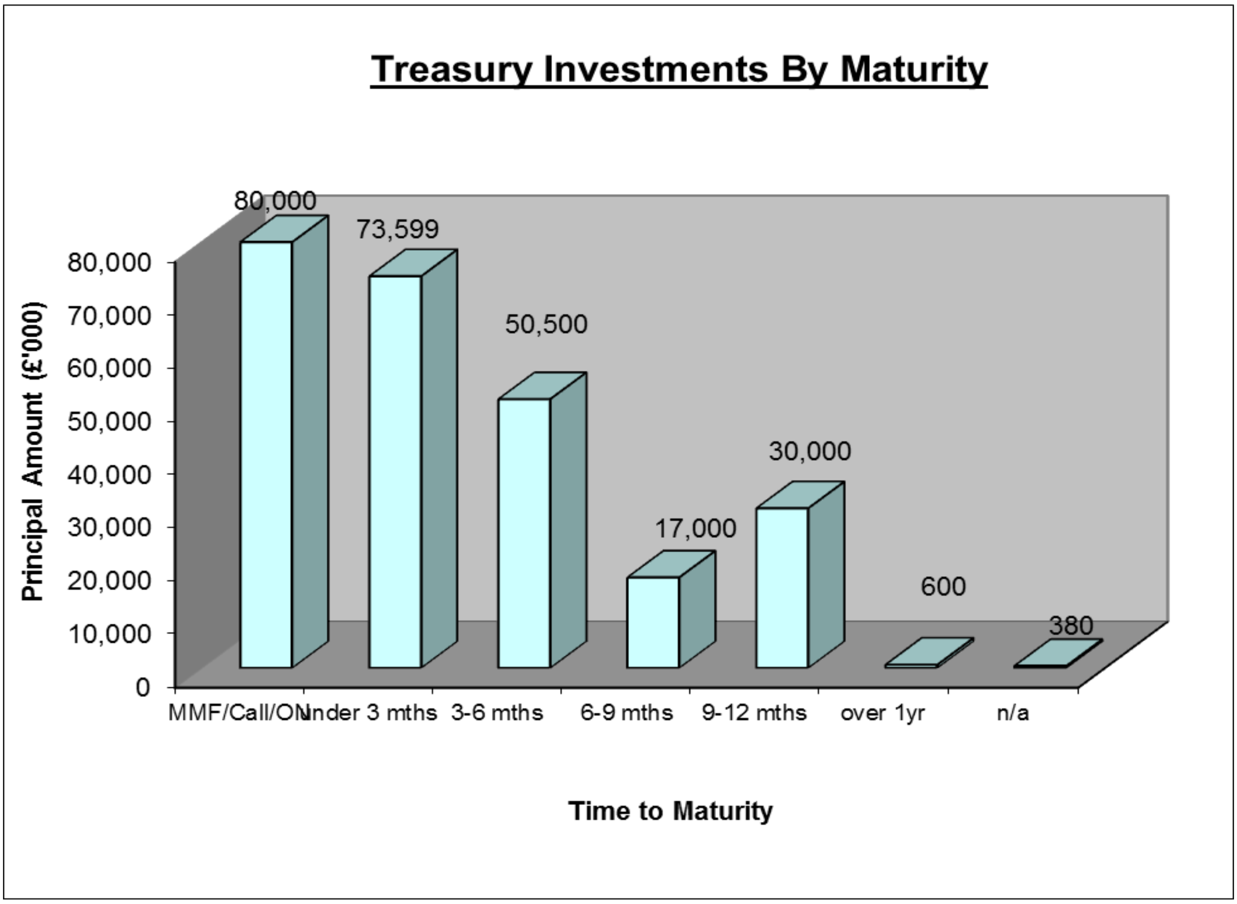
6.19 Investment in Treasury Bills was approved by TRIB during the course of 2012-13. The net return achieved on this investment after brokerage was higher than the DMO's current rate. Barclays Bank was reinstated on to the Council's lending list for a maximum duration of 31 days and funds were deposited in a relatively higher yielding call account.

Icelandic Investment update

6.20 As reported to Members over the course of the financial year, the Council has received the bulk of its investment in Glitnir i.e. £1.7M. Due to foreign exchange controls implemented by the Icelandic government to protect capital outflows, the balance of £380K has remained in an escrow account throughout the year. This balance yielded interest of 3.65% from 01 April 2012 to 22 June 2012 and 4.2% from then to the end of the year. A currency gain of £27K was recognised at year-end, thus increasing the value of this investment to £407K. The Local Government Association (LGA) is continuing to work with local authorities to review options for repatriation of funds to the UK at the earliest opportunity.

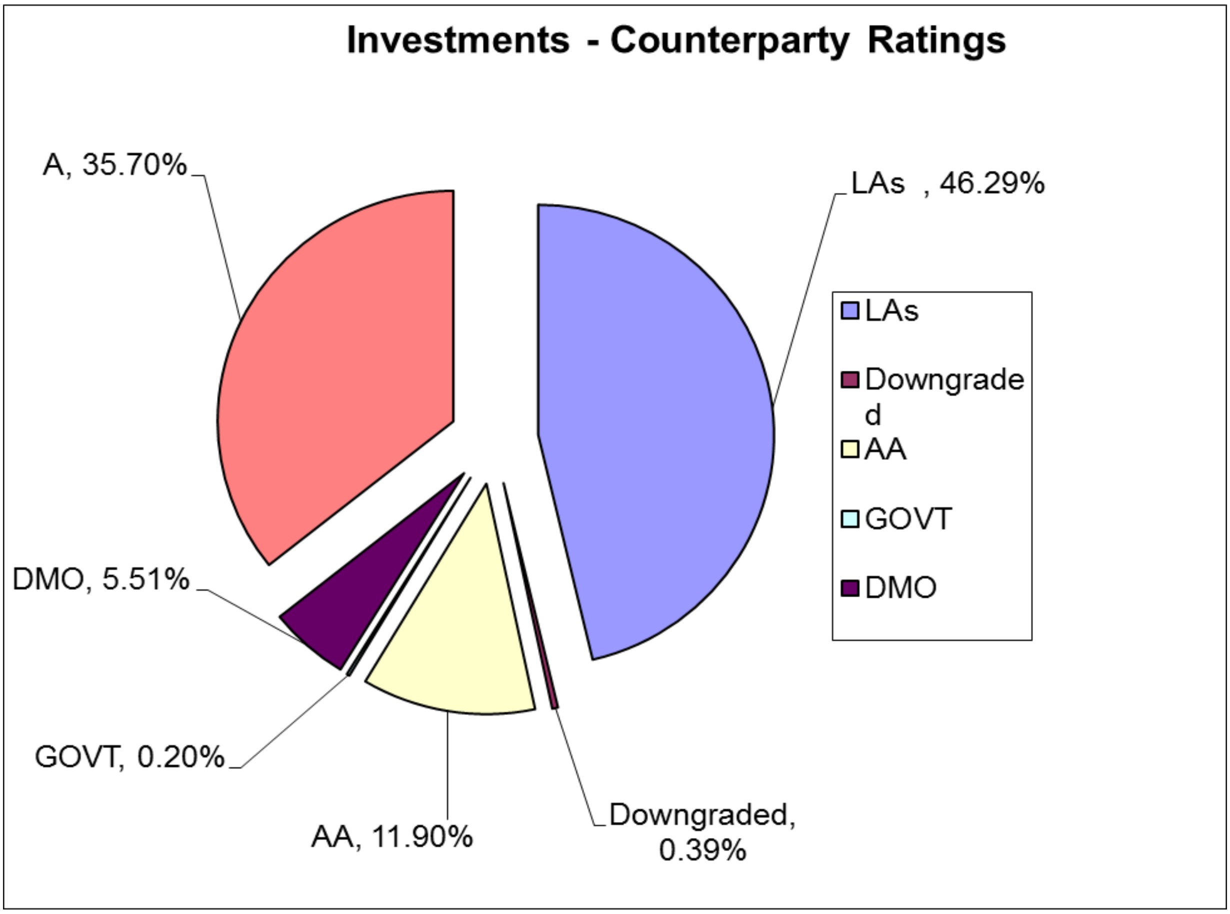
6.21 Average investment balance from 1 April 2012 to 31 March 2013 was £290M**.** The level of funds available were in the main attributable to the Council's reserve balances and slippage on the Capital Programme.

Investment Maturity Profile at 31 March 2013



- *The Council currently only has one investment that has a maturity period of over one year – Future Ealing Ltd. The graph does not incorporate the £27K gain on foreign exchange movement.*

<u>Investments by Counterparty Rating at 31 March 2013</u>



**Downgraded includes Glitnir of 0.24% and Future Ealing of 0.15%*

Temporary Borrowing

6.15 During the year, temporary borrowing of £19.5M was raised to cover short term cash flow requirements. (See para 5.3)

7 **Treasury Management Governance and Scrutiny**

7.1 The Council continues to review and ensure that it embraces best practice in the risk management, control, monitoring and reporting of its treasury management activities.

7.2 The Council's Treasury Management Strategy is approved annually by Full Council and there is also at a minimum a mid-year report which goes to Full Council. All reports to Full Council also go to Audit Committee which undertakes the scrutiny role for the Treasury Management function. Audit Committee receive quarterly Treasury Management Update Reports.

7.3 In addition there is regular monitoring of Treasury Management activities by Management, the portfolio holder for Finance and the Treasury Risk and Investment Board.

7.4 The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the Treasury Management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regards to delegation and reporting.

Training

7.5 Members received refresher training on Treasury management at the Audit Committee meeting in March 2013, this was to ensure they maintain the relevant knowledge and skills required to fulfil their scrutiny role in the most effective manner.

7.6 The Council has adopted the following reporting structure:

Report	**Full Council / Cabinet**	**Audit Committee**	**Director of Finance (Treasury, Risk & Investment Board)**
Annual Treasury Strategy (Feb/March)	☐		
Mid Year Treasury Strategy update	☐		
Treasury Strategy updates or revisions required at other times	☐	☐	
Annual Scrutiny of Treasury Management Strategy (February)		☐	
Treasury Management Performance Q1		☐	
Treasury Management Performance Q2 (Mid- year report)	☐	☐	
Treasury Management Performance Q3		☐	
Treasury Outturn	☐	☐	
Day to Day Treasury Oversight			☐

8 Financial implications

Budget 2012/13 £'000s	Outturn 2012/13 £'000s	Variance 2012/13 £'000s
34,243	32,209	(2,034)

8.1 The outturn Treasury Management position shows an underspend of £2,034K after a contribution of £3.4M towards direct revenue funding of capital schemes. This underspend is largely attributable to savings achieved from interest on borrowing since no borrowing was raised during the course of 2012-13.

9 Prudential Indicators

9.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

9.2 Ealing's Treasury Management Prudential Indicators outturns for the period 2012-13 are attached as appendix 2. They show the Council operated within approved limits. For example the Council operated within its authorised limit for external debt.

9.3 The benefit of the indicators will be derived from monitoring them over time rather than from the absolute value of each. The indicators are not intended to be used as comparators between councils. A reporting process has been established, with a half-yearly report to Cabinet that highlights any significant deviations from expectations. Once determined, the indicators can be amended, subject to reporting to Council for approval

10 Legal

10.1 Lending of surplus funds must comply with the Local Authorities (Capital Finance) (Approved investments) Regulation 1990, as amended from time to time by the Government.

10.2 To comply with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 requires full Council to approve an Annual Statement of Minimum Revenue Provision.

11 Value For Money

11.1 Assessment of value for money is achieved through:

- Monitoring against benchmarks
- Operating within budget

11.2 For example, internally managed investment returns exceeded the LIBID benchmark for the year 2012-13 and PWLB borrowing was monitored throughout the year, the budgeted target rate was 5.00%. In addition, the treasury function operated within budget in 2012-13.

12 Risk Management

12.1 No treasury management activity is without risk. Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. Risk management always remains the priority over returns. The adoption of the CIPFA Code for Treasury Management in Public Services in September 2002, the use of a Lending List and receiving advice from Sector Treasury Services mitigates some of the risk associated with optimising performance returns. Security of capital remains the priority in the Council's investment with counterparties. The Treasury Team continue to be alert to concerns about the current volatility in financial markets and the uncertain economic outlook and this is reflected in the Council's approach to investments and ultimately its Lending List.

13 Community Safety

13.1 None

14 Links to Strategic Objectives

14.1 Proper and effective management of the Treasury Management function is an essential element of the financial administration process within the Council. Income generated from this source makes a significant contribution to the resources available to fund the Councils strategic objectives.

15 Equalities and Community Cohesion

15.1 None

16 Staffing /Workforce and Accommodation Implications

16.1 None

17 Any Other Implications

17.1 None

18 Consultation

18.1 See attached consultation

19 Timetable for implementation

19.1 Not applicable

BACKGROUND INFORMATION

Lending and borrowing investments files kept on the 5th floor Perceval House. Cash fund manager reports.

<u>Consultation</u>

Name of consultee	Department	Date sent to consultee	Date response received	Comments appear in report para:
Nigel Watson	Assistant Director of corporate Finance	12-06-2013	13-06-2013	Throughout
Mathew Bunyon	Head of Financial Planning & Investments	12-06-2013		

Helen Harris	Head of Legal	12-06-2013		
Cllr Mik Sabiers	Chair of the Audit Committee			

Report History

Decision type: For Action/Information	**Urgency item? No**

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	07 Jun 2013	18 Jun 2013	17 Jun 2013

Report no.:	Report author and contact for queries:
	Bridget Uku, Treasury & Investments Manager, ext 5981