The Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director for Corporate Services
to

Cabinet

on

18th June 2013

Report prepared by:
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Annual Treasury Management Report – 2012/13

Policy and Resources Scrutiny Committee
Executive Councillor: Councillor AJ Moring

A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Annual Treasury Management Report covers the treasury activity for the period from April 2012 to March 2013, and reviews performance against the Prudential Indicators for 2012/13.

2. Recommendation

That Cabinet;

2.1 Approves the Annual Treasury Management Report for 2012/13 and the outturn Prudential Indicators for the period from April 2012 to March 2013.

2.2 Notes that the financing of capital expenditure of £60.972m has been funded in accordance with the schedule set out in Table 1 of section 4, with reduced financing required of £1.286m.

2.3 Notes that Capital Financing and Treasury Management were carried out in accordance with statutory requirements, good practice and in compliance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Prudential Code during 2012/13.

2.4 Notes the following in respect of the return on investment and borrowing;

- **The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.**

- **£0.60m of interest was earned during the whole of 2012/13 at an average rate of 0.91%. This is 0.53% over the benchmark of the 7 day LIBID (London Interbank Bid Rate) and 0.41% over bank base rate.**

- **An average of £41.9m of investments were managed in-house. These earned £0.26m of interest during the year at an average rate of 0.63%. This is 0.25% over the average 7 day LIBID and 0.13% over bank base rate.**

- **An average of £24.3m of investments were managed by fund managers. These earned £0.34m of interest during the year at an average rate of 1.39%. This is 1.01% over the average 7 day LIBID and 0.89% over bank base rate.**

- **The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) increased from £241.8m to £246.8m by the end of 2012/13 (Housing Revenue Account: £87.3m, General Fund: £159.5m).**

3. Background

3.1 The CIPFA Prudential Code requires the Council to set Prudential Indicators for its capital expenditure and treasury management activities and to report on them after the end of the financial year.

3.2 This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this Code. The Code requires the reporting of treasury management activities to:

- Review actual activity for the proceeding year (this report) ; and
- Forecast the likely activity for the forthcoming year (in the Treasury Management and Prudential Indicators Report in February).

3.3 The Prudential Code is the key element in the system of capital finance that was introduced from 1st April 2004 as set out in the Local Government Act 2003. The Code has been developed to support Local Authorities in taking capital investment decisions and to ensure that these decisions are supported by a framework which ensures affordability, prudence and sustainability.

3.4 To demonstrate compliance with these objectives of affordability, prudence and sustainability each local authority is required to produce a set of prudential indicators and to update these annually as part of setting the Council's budget.

4. Prudential Indicators

4.1 Appendix A provides a schedule of the prudential indicators.

4.2 Capital Expenditure

The first of these is the amount of capital expenditure in the year on long term assets. The table below shows this and the ways it has been financed.

Table 1: Capital Expenditure

	2012/13 Actual (£000s)	**2012/13 Revised Budget (£000s)**
Total Capital Expenditure	60,972	62,258
Financed by:		
Borrowing	32,109	35,337
Capital Receipts	2	900
Capital Grants Utilised	19,973	18,590
Revenue/Capital Reserve Contributions	526	6,062
Other Contributions	8,362	1,369
Total Financing	60,972	62,258

Under self-financing, there is currently an absolute cap on the amount that the Housing Revenue Account (HRA) can borrow, be it actual external borrowing or notional internal borrowing. For Southend that cap is £102,158k. As at 1 April 2012, actual borrowing by the HRA was £94,076k, comprising £92,908k external borrowing and £1,168k internal borrowing. This meant that there was £8,082k "headroom" for new borrowing to finance capital spend within the HRA.

The HRA can also finance its capital spend from the major repairs reserve, which itself is generated from the depreciation charge to the HRA, from grants and directly from the HRA by way of revenue contributions to capital.

The available borrowing headroom is a permissory amount, and as such could be changed by Government regulation at a future date, whereas the Council has much more control over actual monetary amounts set aside for capital such as the major repairs reserve. In financing the 2012/13 HRA capital programme therefore the current headroom has been used (after first applying the last of the decent homes grant funding) rather than the major repairs reserve. This is the key reason for the decrease in the use of 'Revenue/Capital Reserve Contributions' shown in Table 1. HRA borrowing has therefore increased by £5,982k. This has not been through raising new external borrowing; rather internal borrowing has been used. The HRA has a remaining headroom of £2,100k.

In treasury management terms, the HRA incurs interest on this new internal borrowing. However the unspent major repairs reserve generates an equal and opposite interest receipt, making this financing decision revenue neutral for the HRA.

The key reason for the increase in use of the 'Other Contributions' in Table 1 is the use of the final agreed external funding from the University of Essex and the Southend College relating to the Elmer Square Library Project. See paragraph 3.6 of the Provisional Capital Outturn 2012/13 report.

4.3 Capital Financing Requirement (CFR)

The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a measure of the Council's debt position and represents capital expenditure up to the end of 2012/13 which has not yet been charged to revenue. The process of charging the capital expenditure to revenue is a statutory requirement and is done by means of the Minimum Revenue Provision (MRP). The Council's CFR is shown in table 2 and is a key prudential indicator.

Table 2: Capital Financing Requirement (CFR)

	31st March 2013 Actual (£000s)	**31st March 2013 Revised Budget (£000s)**
Balance 1st April 2012	245,974	245,974
Plus: capital expenditure financed by borrowing	32,109	35,337
Plus: fixed assets subject to finance leases	298	298
Less: Minimum Revenue Provision	(4,973)	(4,977)
Balance 31st March 2013	273,408	276,632

The CFR is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either borrowing to the CFR, choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or borrowing for future increases in the CFR (borrowing in advance of need). The Council is currently in the second of the above CFR scenarios.

4.4 Treasury Position on Borrowing and Investments

The overall treasury position at 31 March 2013 compared with the previous year is in the table on the next page.

Table 3: Treasury Position

	31 March 2013 Actual		31 March 2013 Revised Budget
	Principal (£000s)	Average Rate (%)	Principal (£000s)
Total Debt# (excluding ECC transferred debt)	256,886	4.39	291,914
Total Investments (including cash)	68,570	0.91	63,889
Net Borrowing	188,316		228,025

This includes PWLB borrowing of £246,816k with the balance being short term borrowing for cash flow purposes and finance leases (as these are credit arrangements).

In order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, exceed the CFR for 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15. The table below shows that the Council has complied with this requirement.

Table 4: CFR compared to Net Borrowing Position

	31 March 2013 Actual (£000s)	31 March 2013 Revised Budget (£000s)
Net borrowing position	188,316	228,025
Capital Financing Requirement	273,408	276,632

4.5 Authorised Limit, Operational Boundary and Ratio of Financing Costs

In addition to ensuring that the net borrowing position is lower than the CFR, the Council is required to set gross borrowing limits. These are detailed on the next page with the actual positions during the year.

Table 5: Borrowing limits

	2012/13 (£000s)
Revised Indicator - Authorised Limit	330,000
Revised Indicator - Operational Boundary	320,000
Maximum gross borrowing position during the year	272,449
Financing costs as a proportion of net revenue stream	9.35%

The Authorised Limit is the "Affordable Borrowing Limit" required by the Local Government Act 2003. This is the outer boundary of the Council's borrowing based on a realistic assessment of the risks. The table above demonstrates that during 2012/13 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached. The Council has maintained borrowing within the boundary throughout 2012/13.

The indicator "financing costs as a proportion of net revenue stream" identifies the cost of capital (borrowing costs net of investment income) as a proportion of the Council's total budget. For the General Fund the actual figure in 2012/13 was 9.35%.

4.6 Incremental impact of capital investment decisions

This indicator identifies the budgetary requirements arising from the proposed changes to the capital programme and calculates the impact on the Band D council tax that would result. The actual figure in 2012/13 was +£0.62 and results from the required financing of the approved capital programme.

4.7 Maturity structure of fixed rate borrowing (against maximum position)

The table on the next page shows the upper limits for which the Council delegates its length of borrowing decisions to the Head of Finance and Resources/Section 151 Officer in 2011/12 and the actual maturity structure of the fixed rate borrowing as at 31st March 2013.

Table 6: Maturity Structure of Fixed Rate Borrowing

	Upper limit %	Outstanding fixed rate debt maturity at 31st March 2013 %
Under 12 months	20	4
12 months and within 24 months	40	5
24 months and within 5 years	60	4
5 years and within 10 years	80	4
10 years and within 20 years	100	40
20 years and within 30 years	100	26
30 years and above	100	17

The percentages in each category for the upper limits do not add up to 100% as they do not represent an actual allocation.

5. Treasury Management Strategy

5.1 During 2012/13 the Council complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of the Code of Practice for Treasury Management means its treasury practices demonstrate a low risk approach.

5.2 The Council is aware of the risks of passive management of the treasury portfolio and has taken steps to improve the proactive management of the debt and investments over the year with the support of its treasury management advisers.

5.3 Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

5.4 UK interest rates continued to be low throughout 2012/13. The base rate stayed at its historically low rate of 0.5% throughout the year. With on-going concerns over counterparty risk since the Icelandic banks crisis and the uncertainty in the financial markets about the future of interest rates, investments have been mainly placed in instant access accounts or at 100 days' notice at most, in line with our investment strategy. These combined circumstances have led to the investment income generated in 2012/13 being lower than anticipated.

5.5 Long term interest rates from the Public Works Loans Board (PWLB) fluctuated throughout 2012/13 in response to economic events, with 50 year PWLB rates falling to a low of 3.96% in June, reaching a high of 4.59% in February and ending the year at 4.22%.

6. Borrowing

6.1 The table below summarises the PWLB borrowing activities during the year 2012/13:

Table 7: PWLB borrowing

Quarter	Borrowing at beginning of quarter (£m)	New Borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2012	241.8	0	0	(10)	231.8
July to September 2012	231.8	0	0	(0)	231.8
October to December 2012	231.8	7	18	(10)	246.8
January to March 2013	246.8	0	0	(0)	246.8

£25m of new loans were taken out for a period of between 18 and 21 years and £20m was repaid on maturity.

6.2 The Council's outstanding PWLB borrowing as at 31st March 2013 was:

- Southend-on-Sea Borough Council £246.816m*
- ECC transferred debt £15.079m

* £159.5m General Fund and £87.3m Housing Revenue Account.

6.3 Repayments in 2012/13 were:

- Southend-on-Sea Borough Council £20.0m
- ECC transferred debt £0.65m

6.4 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1st April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County.

6.5 The table below summarises our borrowing position as at the end of 2012/13:

Table 8: Debt position

	31 March 2013		31 March 2012	
	Principal (£000s)	Average Rate (%)	Principal (£000s)	Average Rate (%)
-PWLB – Fixed	236,816	4.52	231,816	4.51
-PWLB – Variable	10,000	1.53	10,000	1.63
Sub-total for SBC:	**246,816**		**241,816**	
-ECC Transferred Debt	15,079	2.62	15,730	2.58

6.6 Some of the Council's borrowings are at a higher interest rate than the current rate of borrowing. To redeem these loans before their maturity date (i.e. to redeem them early) the Council would be required to pay a premium (this is like paying to redeem a mortgage early except the amount of the penalty depends on the prevailing rate of interest). New loans could then be taken out at the current rate.

6.7 In November 2007 the PWLB changed its structure of interest rates so that any early repayment of PWLB debt has a higher repayment rate applied. Then in October 2010, as part of the Spending Review interest rates for PWLB borrowing were increased by 1%. No PWLB restructuring was carried out in 2012/13 due to the higher cost of PWLB repayments making it uneconomical and giving no benefit to the Council.

6.8 On 1st November 2012 HM Treasury implemented a 'certainty rate' at a discount on that level of 0.2% on loans for those local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. This Council provided the necessary information and is therefore eligible for this 'certainty rate'.

6.9 The total interest payments during the year were £10.4m, compared to the original budget of £11.5m. The original budget assumed that the Council would take out £41m of new loans during 2012/13. Instead £25m of new loans were taken out in the year which led to an underspend on the interest payments against the original budget.

6.10 In addition, short term borrowing that was undertaken during the 2012/13 financial year for cash flow purposes. The average rate paid in 2012/13 was 0.30% and the details of the loans are shown in the table on the next page:

Table 9: Short term borrowing

Counterparty	Amount of loan (£m)	Period of loan (days)	Return date
Kirklees Council	3m	10	01/11/2012
Shropshire County Council	5m	21	09/11/2012
Leicester City Council #	5m	37	05/04/2013
Caerphilly County Council #	5m	42	08/04/2013

For these loans only part of the period of the loan falls into the 2012/13 financial year.

6.11 The Council undertakes benchmarking with other Local Authorities as part of the CIPFA benchmarking club for Treasury Management. Each year we benchmark our performance against other club members across England and Wales. For 2012/13, the level of our total borrowing was in line with the average of the comparator authorities (46 in 2012/13).

7. Investments

7.1 The table below summarises the Council's investment position at the end of 2012/13:

Table 10: Investment position

	31 March 2013		31 March 2012	
	Principal (£000s)	Average Rate (%)	Principal (£000s)	Average Rate (%)
Variable rate investments managed in-house	27,500	0.63	11,000	0.75
Investments managed by fund managers	24,440	1.39	24,103	1.23*
Total investments	51,940	0.91	35,103	0.98

* Includes interest earned from two fund managers for part of the year

7.2 The actual rate on investments earned in 2012/13 was 0.91% as opposed to a forecast of 1.31% which was included in the budget. This forecast was based on the best estimates of future interest rates at the time the budget was set.

7.3 The Council earned a total of £0.60m of interest through the investment of surplus funds both in-house and with the fund managers. The interest earned was £0.28m lower than the budgeted figure of £0.88m. This reduced level of interest was due to achieving a lower than forecast interest rate. The average balance of cash was £66m which was similar to the budgeted figure of £64m.

These forecasts were based on the best estimates at the time the budget was set.

7.4 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector, which has been implemented in the Annual Investment Strategy approved by the Council on 1st March 2012. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

7.5 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the year monies were placed 32 times for periods of one year or less. In the light of the Icelandic Banks collapse and the prevailing financial market conditions there has been greater emphasis on counterparty risk and the security of the principal sums invested. The table below shows the most used counterparties overall and the countries in which they are based. All deals are in sterling despite the country the counterparties are based in.

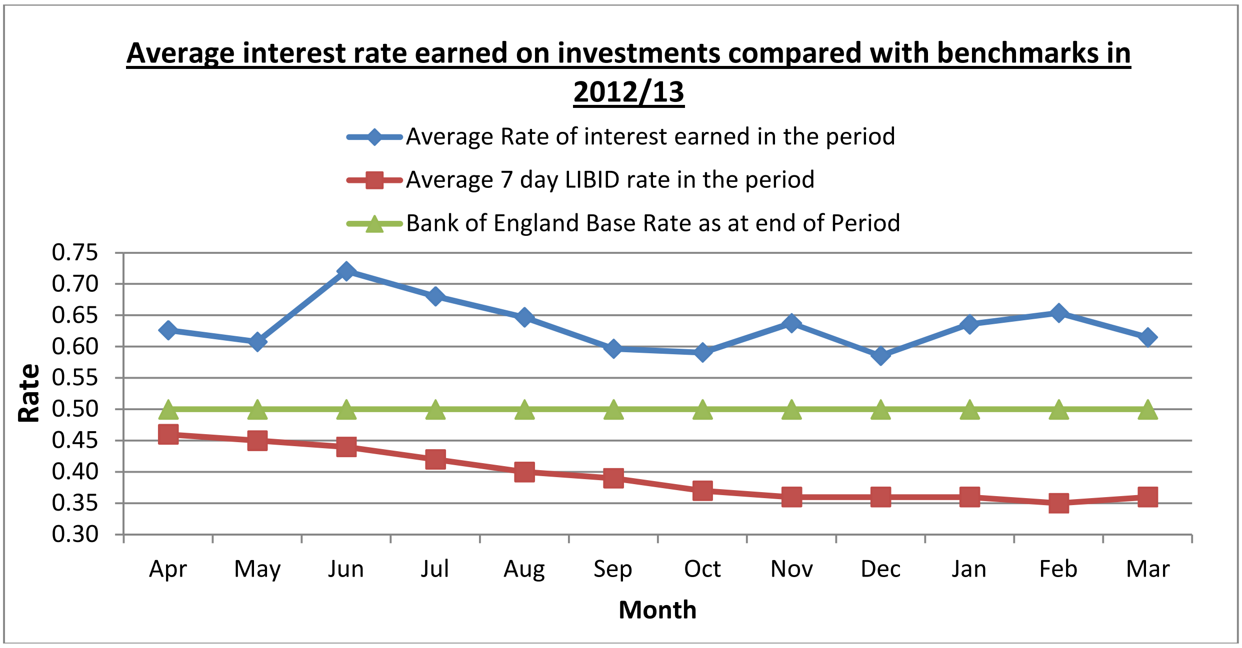
Table 11: Counterparties used

Counterparty	Country	No. of Deals	Value of Deals (£m)
Blackrock	Money Market Fund (Various Counterparties)	15	142
Goldman Sachs	Money Market Fund (Various Counterparties)	16	87
Barclays Bank	UK	1	10

7.6 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds while paying base rate or better. This meant that funds were available for unexpected cash flow events to avoid having to pay higher rates to borrow from the market. During 2012/13 an average of £17.7m was held in such accounts.

7.7 The performance during the year is compared to the average 7 day LIBID rate. The graph on the next page shows the Council's performance month by month compared to this benchmark and the bank base rate.

Graph1: Investment performance compared to benchmarks



7.8 Overall, performance on in-house managed funds was 0.25% over the average 7 day LIBID rate for the year and 0.13% over the average base rate for the year.

7.9 An average of £24.3m of investments were managed by fund managers. These earned £0.34m of interest during the year at an average rate of 1.39%. This is 1.01% over the average 7 day LIBID and 0.89% over bank base rate.

8. Corporate Implications

8.1 Contribution to Council's Vision & Critical Priorities

Treasury Management practices in accordance with statutory requirements, together with compliance with the prudential indicators acknowledge how effective treasury management provides support towards the achievement of the Council's Vision and Critical Priorities.

8.2 Financial Implications

The financial implications of Treasury Management are dealt with throughout this report.

8.3 Legal Implications

Compliance with the CIPFA Prudential Code is a statutory requirement.

8.4 People Implications

None.

8.5 Property Implications

None.

8.6 Consultation

The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

8.7 Equalities Impact Assessment

None.

8.8 Risk Assessment

The Treasury Management Policy acknowledges that the successful identification, monitoring and management of risk are fundamental to the effectiveness of its activities.

8.9 Value for Money

Treasury Management activities include the pursuit of optimum performance consistent with effective control of the risks associated with those activities.

8.10 Community Safety Implications

None.

8.11 Environmental Impact

None.

9. Background Papers

None.

10. Appendices

Appendix A - Prudential Indicators 2012/13

Prudential Indicators 2012/13

	Figures are for the financial year unless otherwise titled in italics	2012/13 Actual	2012/13 Revised Indicator
1	Capital Expenditure	£60.972m	£62.258m
2	Capital Financing Requirement (CFR)	£273.408m	£276.632m
3	Treasury Position at 31 March Borrowing Investments Net Borrowing	 £256.886m £68.570m £188.316m	 £291.914m £63.889m £228.025m
4	Authorised Limit *(against maximum position)*	£330.000m	£330.000m
5	Operational Boundary	£320.000m	£320.000m
6	Ratio of financing costs to net revenue stream	9.35%	9.72%
7	Incremental impact of capital investment decisions on the Band D council tax	+£0.62	+£0.72
8	Maturity structure of fixed rate borrowing *(against maximum position)*		
	Under 12 months	4%	20%
	12 months to 2 years	5%	40%
	2 years to 5 years	4%	60%
	5 years to 10 years	4%	80%
	10 years to 20 years	40%	100%
	20 years to 30 years	26%	100%
	30 years and above	17%	100%
	Total	100%	N/A