CABINET – 27 JUNE 2013   EXECUTIVE SUMMARY OF AGENDA ITEM 10

Report title: Treasury management annual report 2012/13
Wards affected: Citywide
Strategic Director: Angie Ridgwell – Corporate Services
Report Author: Peter Robinson – Service Director - Finance

RECOMMENDATION for the Mayor's approval:

- That the Treasury Management annual report for 2012/13 is noted.

Key background / detail:

1. During 2012/13 the Council complied with its legislative and regulatory requirements.

2. The Service Director- Finance also confirms that borrowing was only undertaken for a capital purpose and the approved borrowing limit was not breached.

3. At 31 March 2013, the Council's external debt was £425m excluding finance leases and accrued interest (£425m at 31 March 2012) and its investments totalled £184m (£176m at 31 March 2012). The Net debt was £241m (£249m at 31 March 2012). The net debt per head of population at the 31st March 2013 was £546. This is one of the lowest values of any one of the core cities. The borrowing cover funding of the range of assets deployed by the Council which includes schools, roads, housing, leisure centres and other property and operational assets.

4. The financial year 2012/13 continued the challenging environment of the previous year 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 three 2013. However, economic growth in the UK was disappointing 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 European Union (EU). Latest forecast suggest Bank Rate will begin to rise from quarter one 2015.

5. Details of Treasury Management activity are shown in Appendix 1 with the summary of performance against the Prudential indicators given in Appendix 2.

Agenda Item 10

BRISTOL CITY COUNCIL
CABINET
27 June 2013

REPORT TITLE: Treasury Management Annual Report 2012/13

Ward(s) affected by this report: Citywide

Strategic Director: **Angie Ridgwell**

Report author: **Peter Robinson - Service Director - Finance**

Contact telephone no. & e-mail address: **Jon Clayton - 0117 9222424 jon.clayton@bristol.gov.uk**

Report signed off by Executive member: **Cllr. Geoffrey Gollop**

Purpose of the report:

1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2. This report and appendices set out the Treasury management strategy outturn position for 2012/13. The significant issues in the report are:
    - Borrowing and lending during 2012/13 was undertaken within Prudential Indicator targets set by the Council in February 2012;
    - Targets in respect of borrowing and lending rates were achieved;
    - The latest progress on Icelandic banks status;
    - The economic outlook.

RECOMMENDATION for Mayor approval:

3. That the Treasury Management annual report for 2012/13 is noted.

Overview

4. During 2012/13 the Council complied with its legislative and regulatory requirements, which included providing the specified information in this report, the annual treasury management strategy and half year performance report.

5. The Service Director- Finance also confirms that borrowing was only undertaken for a capital purpose and the Statutory-borrowing limit, the Authorised Limit, was not

breached.

6. At 31 March 2013, the Council's external debt was £425m excluding finance leases and accrued interest (£425m at 31 March 2012) and its investments totalled £184m (£176m at 31 March 2012). The Net debt was £241m (£249m at 31 March 2012). The net debt per head of population at the 31st March 2013 was £546. This is one of the lowest values of any one of the core cities. The borrowing cover funding of the range of assets deployed by the Council which includes schools, roads, housing, leisure centres and other property and operational assets.

7. The financial year 2012/13 continued the challenging environment of the previous year 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 three 2013. However, economic growth in the UK was disappointing 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 European Union (EU). Latest forecast suggest Bank Rate will begin to rise from quarter one 2015.

8. Details of Treasury Management activity are shown in Appendix 1 with the summary of performance against the Prudential indicators given in Appendix 2.

Icelandic Banks

9. Two investments were made to Icelandic banks, Glitnir (£5m) and Landsbanki (£3m) and have been subject to decisions of the Icelandic Courts. Following the successful outcome of legal test cases in the Icelandic Supreme Court in late-2011, the authority anticipate a full recovery and the administrators have commenced the process of dividend payments in respect of both of these banks;
    - Glitnir Bank – The administrator has repaid 100% of investment, with 79% being received by the Council, while the remainder (Icelandic Kroner) is being held in an escrow account currently earning interest at 4.20% until foreign exchange restrictions are resolved.
    - Landsbanki – The administrator has made distributions amounting to (50%). No timescale has been given for future repayments, though it is expected these will be fully recovered by December 2019.

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Consultation and scrutiny input

10. The report does not require any internal consultation to be undertaken. The report has been discussed with the Council's external treasury management advisers.

Risk Assessment

11. Borrowing and lending activity is reported quarterly to the Cabinet Member responsible for resources.

12. The principal risks associated with treasury management are:

- The risk of loss as a result of failure of counterparties.
- This is mitigated by limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties;
- The risk of loss as a result of borrowing at high rates of interest/lending at low rates of interest.
- This is mitigated by planning and undertaking borrowing and lending in the light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Public sector equality duties:

13. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

14. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

15. **Legal-** The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

    Legal advice provided by Shahzia Daya – Senior Solicitor – Corporate Services

Financial

(a) Revenue

16. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

    Advice given by Jon Clayton (Corporate Accountant)

(b) Capital

17. There is no direct capital investment implications contained within this report.

Land

18. There are no direct implications for this report.

Personnel

19. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2012/13

Appendix 2: Prudential Indicators

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985
Background Papers:

20. None.

Appendix 1

Annual Report on the Treasury Management Service 2012/13 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

   - The capital activity during the year
   - What resources the Council applied to pay for this activity;
   - The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
   - The reporting of the required prudential indicators;
   - Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
   - A summary of interest rate movements in the year;
   - The detailed debt activity;
   - The detailed investment activity;
   - Icelandic Banks; and
   - Local Issues

The Council's Capital Expenditure and Financing 2012/13

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of long-term assets. These activities may either be:

   - Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
   - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2011/12 Actual £m	2012/13 Original Budget £m	2012/13 January forecast £m	2012/13 Actual £m
Non-HRA capital expenditure	106	123	98	69
HRA capital expenditure	26	42	32	28
Total capital expenditure	**132**	**165**	**130**	**97**
Resourced by:				
Capital receipts	6	14	9	9
Capital grants	49	70	62	42
HRA Self Financing	20	29	29	25
Prudential borrowing	12	36	15	9
Revenue	16	16	15	12
Hengrove PFI Scheme	19		-	-
Waste Service Contract – technical accounting adjustment	10		-	-
Total Resources	**132**	**165**	**130**	**97**

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2012/13 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.

7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or

- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

8. The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved on 28 February 2012.

9. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	**General Fund 31 March 2012 Actual £m**	**General Fund 31 March 2013 Actual £m**	**HRA 31 March 2012 Actual £m**	**HRA 31 March 2013 Actual £m**	**Total CFR 31 March 2013 Actual £m**
Opening balance	438	463	200	245	708
Add unfinanced capital expenditure (as above)	12	9	-	-	9
Hengrove PFI Scheme	19	-	-	-	-
Waste Service Contract	10	-	-	-	-
Add adjustment for HRA reform	-	-	45	-	-
Less MRP/VRP	(13)	(13)	-	-	(13)
Less PFI & finance lease repayments	(3)	(3)	-	-	(3)
Closing balance	463	456	245	245	701

Treasury Position at 31 March 2013

10. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:

    - Borrowing to the CFR; or
    - Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
    - Borrowing for future increases in the CFR (borrowing in advance of need).

11. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

Actual borrowing position	**31 March 2012 £m**		**31 March 2013 £m**	
	Principal £m	**Average Rate**	**Principal £m**	**Average Rate**
Fixed Interest Rate Debt	425	4.84%	425	4.76%
Variable Interest Rate Debt	-	-	-	-
PFI & embedded leases	178	-	174	-
Total Debt	603	4.84%	599	4.76%
Capital Financing Requirement (including leasing arrangements)	708		701	
Over/(Under) borrowing	(105)		(102)	
Investment position	**31 March 2012 £m**		**31 March 2013 £m**	
	Principal £m	**Average Rate**	**Principal £m**	**Average Rate**
Fixed Interest Investments	176	1.16%	184	1.43%
Variable Interest Investments	-	-	-	-
Total Investments	176	1.16%	184	1.43%
Net borrowing position (excl leasing arrangements)	249	-	241	-

12. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit	**Approved Max Limit**	**31 March 2012 Actual £m**	**%**	**31 March 2013 Actual £m**	**%**
Under 12 Months	0%	20%	1	0.14%	10	2.46%
1 to 2 years	0%	20%	10	2.35%	0	0.00%
2 to 5 years	0%	40%	-	0.00%	3	0.71%
5 to 10 years	0%	40%	13	3.06%	15	3.52%
10 years and above	25%	100%	401	94.45%	397	93.31%
Total			**425**	**100%**	**425**	**100%**

13. The authority borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk. Therefore the authority has not undertaken any new borrowing during the year.

Prudential Indicators and Compliance Issues

14. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

15. **Net Borrowing and the CFR** - 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. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2012 Actual £m	**31 March 2013 Latest Indicator £m**	**31 March 2013 Actual £m**
Net borrowing position	249	275	241
CFR (excluding PFI)	530	553	538

16. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2012/13 the Council has maintained gross borrowing within its Authorised Limit.

17. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

18. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2012/13 £m
Authorised Limit	753
Operational Boundary	588
Average gross borrowing position (excluding PFI)	425
Financing costs as a proportion of net revenue stream General Fund HRA	 4.20% 9.90%

Economic Background for 2012/13

19. The Bank of England Bank Rate continued to remain at 0.50% throughout 2012/13.

20. Gilt yields fluctuated during the year as events in the on-going Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50b of quantitative easing in July and widely expected further quantitative easing still to come combined to keep PWLB rates depressed for much of the year at historically very low levels.

21. Deposit rates - The Funding for Lending Scheme, announced in July, 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.

The Strategy Agreed for 2012/13

22. The strategy provided for 2012/13 expected:

- The suspension of long-term borrowing in order to reduce investments and thus exposure to counterparty risk.

- The continuation of the current arrangements for assessing institutions to which the council might lend with the application of the Lowest Common Denominator approach to counterparty management.

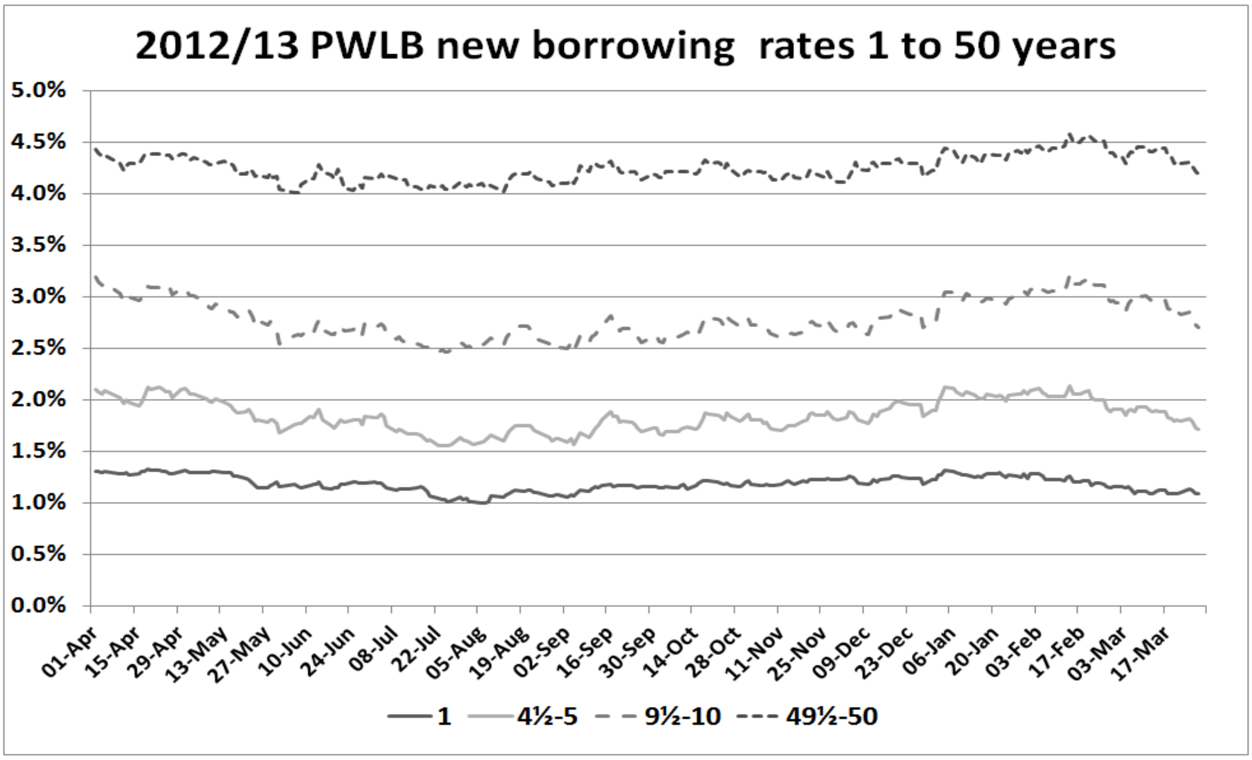
- Depositing surplus cash with UK based institutions that meet the Council's lending criteria.

Actual Debt Management Activity during 2012/13

Borrowing Rates in 2012/13

23. PWLB borrowing rates - the graph and table for PWLB maturity rates below show, for a selection of maturity periods, the range (high and low points) in rates, the average rates, and individual rates at the start and the end of the financial year.

24. PWLB Borrowing rates 2012/13. The graph below shows how PWLB rates remained close to historically very low levels during the year.



25. **Borrowing** – No loans were drawn in 2012/13 as part of the Treasury Strategy to reduce its exposure to counterparty risk (para 22).

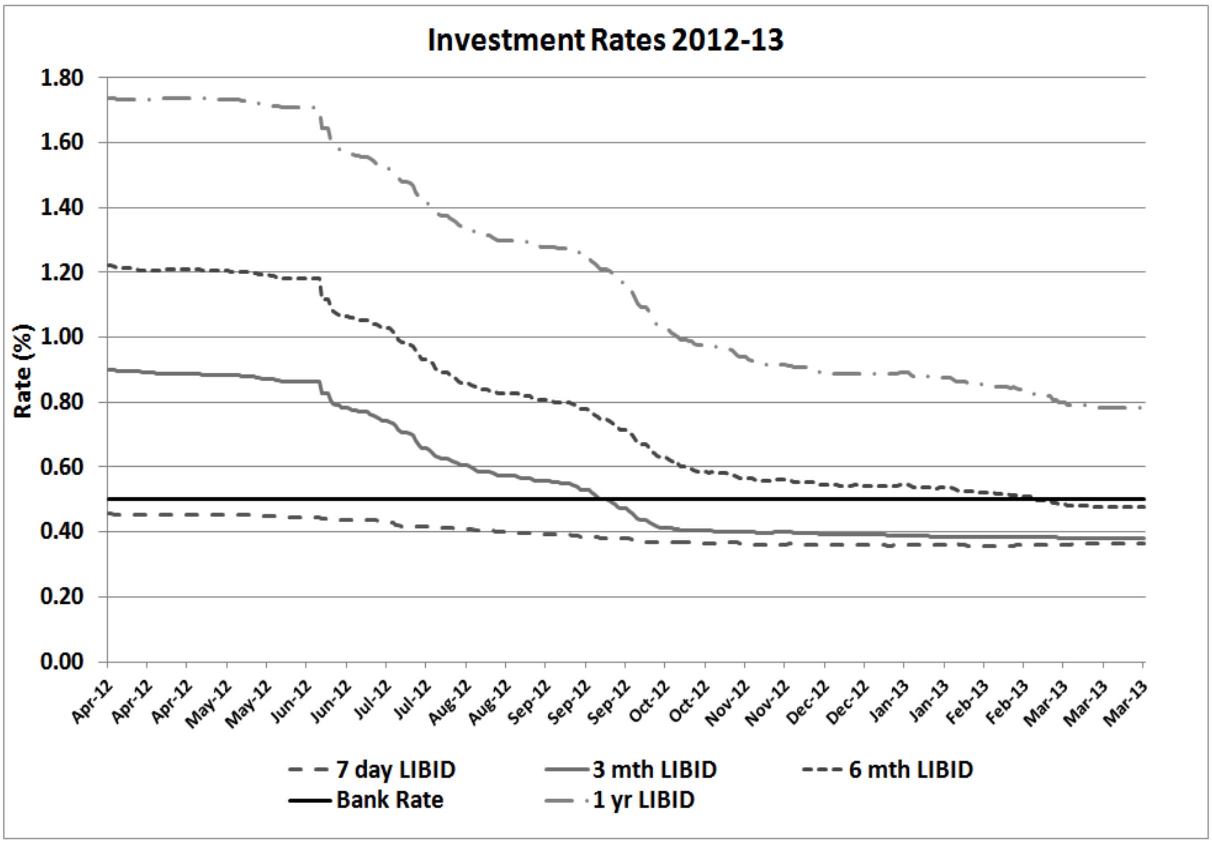
26. **Rescheduling –** No debt rescheduling activity was undertaken in 2012/13.

27. **Repayment –** During 2012/13 the Council repaid £52k of PWLB loans.

28. **Summary of Debt Transactions –** The overall position of the debt activity resulted in a decrease in the average interest rate from 4.84% (31/03/2012) to 4.76%, due to £45m of additional debt undertaken at 3.48% for Housing finance reform. Housing finance reform abolished the subsidy system financed by central government and consequently, all housing debt has been reallocated nationally between housing authorities. The result of this reallocation is that the Council has made a capital payment to the Department of Communities and Local Government of £45m funded by borrowing.

Investment Rates in 2012/13

29. Bank Rate remained at its historic low of 0.5% throughout the year; 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.



30. The Council's investment policy is governed by CLG Guidance, which has been implemented in the annual investment strategy approved by Council on 28 February 2012. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

31. **Investments held by The Council -** The Council maintained an average balance of £245m (£168m 2011/12) of internally managed funds. The internally managed funds received an average return of 1.43% (1.16% 2011/12). The comparable performance indicator is the average 7-day LIBID rate, which was 0.40%. This compares with a budget assumption of an average of £100m investment balances at 0.50% interest rate.

Performance Indicators set for 2012/13

32. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

33. This service has set the following performance indicators:

- *Debt – Borrowing - Average rate of borrowing for the year compared to average available*
    - *No short-term borrowing was undertaken in 2012/13. The target rate is 7 day LIBID, the annual average for the year was 0.40%*
    - *No long-term borrowing was undertaken in 2012/13. The target rate for the year is 25 year PWLB, the annual average for the year was 4.08%*
- *Debt – Average rate movement year on year*
    - *Pool rate in 2012/13: 4.76 %*
    - *Pool rate in 2011/12: 4.84%*
- *Investments – Internal returns above the 7 day LIBID rate*
    - *Average rate for the year 1.43% vs. annual average 7 day LIBID of 0.40%*

Icelandic Banks

34. Investments held in Icelandic Banks - The Council have two outstanding investments with Landsbanki (£3m principal) and Glitnir (£5m principal) banks, which are subject to a recovery process.

35. The Council, through the Local Government Association, lodged its claims in the insolvency (the equivalent of a proof of debt in the UK) claiming depositor priority for the outstanding deposit. The claim was administered through the Icelandic District and Supreme Courts, both reaffirming the “Priority creditor” status.

36. Landsbanki - Distribution payments have been received amounting to 50% of the outstanding investment. No timescale has been given for the remainder payments, though it is expected that these will remain staggered until 2018.

37. With respect to the distribution from Glitnir Bank, the administrator paid out 100% of the outstanding monies with 79% being received by the Council, whilst the remainder (in Icelandic Kroner-ISK) is being held in an escrow account with a high credit quality Scandinavian bank and is accruing interest at a market rate. At present the Council is unable to repatriate these funds due to the foreign exchange restrictions being imposed by the Icelandic authorities under Icelandic law. A further update will be provided in the Treasury Management Mid-Year Report in autumn 2013.

Local Issues

38. **Ethical Investment Policy-** The Ethical Investment Policy was approved by Cabinet on 15th December 2011. There are no breaches to report.

Regulatory Framework, Risk and Performance

39. The Council’s treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2011/12);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

40. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

41. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council's highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.

Appendix 2

Prudential Indicators	2012/13 Council Approved	2012/13 Latest Estimate	2012/13 Outturn	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Planned capital expenditure (£m)						
General	£123m	£98m	£69m	£182m	£140m	£47m
HRA	£42m	£32m	£28m	£39m	£37m	£41m
	£165m	£130m	£97m	£221m	£177m	£88m
Capital financing requirement (£m)(taking account of new capital expenditure and repayment of debt)						
General	£306m	£309m	£293m	£363m	£415m	£407m
PFI	£146m	£163m	£163m	£158m	£152m	£145m
HRA	£247m	£245m	£245m	£245m	£245m	£245m
	£699m	£717m	£701m	£766m	£812m	£797m
Note that the general fund figure includes ex-Avon debt managed on behalf of other authorities (£54m as at 31/3/13)						
Confirmation that total borrowing net of investments, does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current year and next two financial years.	Confirmed	Confirmed	Confirmed	Confirmed	Confirmed	Confirmed
Authorised limit for external debt (£m) (the macimum that the authority will borrow)						
Borrowing	£733m	£753m	£753m	£804m	£853m	£837m
Operational boundary for external debt (£m) (the anticipated level of borrowing)						
Borrowing	£574m	£588m	£588m	£593m	£627m	£640m
Financing costs as a percentage of net revenue stream %)						
General	5.40%	4.21%	4.20%	4.65%	5.27%	5.80%
HRA	7.51%	9.98%	9.90%	9.47%	8.89%	8.48%
Incremental Impact of Capital Investment Decisions						
Impact on the council tax	Nil	Nil	Nil	Nil	Nil	Nil
Impact on HRA rent	Nil	Nil	Nil	Nil	Nil	Nil
Exposure to changes in interest rates (%)						
Upper limit on (net) variable rate debt	30%	30%	30%	30%	30%	30%
Lower limit on (net) variable rate debt	0%	0%	0%	0%	0%	0%
Upper limit on (net) fixed rate debt	100%	100%	100%	100%	100%	100%
Lower limit on (net) fixed rate debt	70%	70%	70%	70%	70%	70%
Maturity structure of borrowing (% Range)						
Less than 12 months	0-20%	0-20%	0-20%	0-20%	0-20%	0-20%
1-2 years	0-20%	0-20%	0-20%	0-20%	0-20%	0-20%
2-5 years	0-40%	0-40%	0-40%	0-40%	0-40%	0-40%
5-10 years	0-40%	0-40%	0-40%	0-40%	0-40%	0-40%
Over 10 years	25-100%	25-100%	25-100%	25-100%	25-100%	25-100%
Maximum principal sums invested > 364 days	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m
The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services	YES	YES	YES	YES	YES	YES