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AUDIT COMMITTEE – 21 JUNE 2013

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2012/13

1. INTRODUCTION

1.1 This 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).

1.2 During 2012/13 the minimum reporting requirements were that the Council should receive the following reports:

- a forecast of the likely activity for the forthcoming year in an annual treasury strategy report (Council 27/02/2012)
- reviews of activity during the year in treasury update reports (Audit Committee - September 2012; January 2013 and March 2013)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, discussion and consultation was made on a regular basis throughout the year with meetings between the Cabinet member, who is the Portfolio Holder for Finance and Efficiency, the Audit Committee Chairman and other Audit Committee members, the Executive Director, the Accountancy Manager and the Treasury Management Accountant. This regular meeting has received regular treasury management update reports and has also reviewed the strategy to be applied, within the approved strategy, as and when changes in circumstances arise.

1.3 The regulatory environment places the onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.4 The Council's Treasury Advisors attended a meeting of this Committee in September 2012 to undertake some informal training on treasury management issues during the year in order to support Members' scrutiny role.

2. BACKGROUND

2.1 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 and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

2.2 This report sets out the information in the following appendices: -

Appendix 1

- A summary of the treasury strategy agreed for 2012/13;
- A summary of the economic factors affecting the strategy over 2012/13;
- The decisions taken and performance of the treasury service and their revenue effects;
- The Council's treasury position at 31 March 2013;

Appendix 2

- The main Prudential Indicators and compliance with limits;
- Performance indicators set for 2012/13;
- Risk and performance.

3. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

3.1 None arising directly from this report.

4. RECOMMENDATIONS

Members are recommended to consider this report.

Further Information	**Background Papers**
Please contact Jan Hawker, Treasury Management Accountant	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance
e-mail: jan.hawker@nfdc.gov.uk	Local Government Act 2003
	SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
	Cabinet 1 February 2012 -Treasury Management Strategy Report 2012/13
	Published Papers

APPENDIX 1

TREASURY MANAGEMENT PERFORMANCE - 1 APRIL 2012 TO 31 MARCH 2013

1. INTRODUCTION

This appendix sets out the performance for the Council's treasury management activities.

2. TREASURY STRATEGY SUMMARY FOR 2012/13

2.1 Borrowing Strategy

The borrowing strategy for 2012/13 indicated that: -

- Bank base rates would average 0.5% for the year;

- Long-term borrowing to meet capital expenditure would be unlikely to be undertaken as the preference expressed by Members was that the Council should not raise loans to meet the General Fund borrowing requirement in the immediate future;

- It was anticipated that loans would be raised for the HRA reform settlement with the Executive Director taking into account the most appropriate form of borrowing depending on the prevailing interest rates and Members wishes.

- The Council would borrow temporarily for cash flow purposes;

- Interest payments would be £3,972,000 for the HRA reform settlement;

2.2 Investment Strategy

The investment strategy for 2012/13 assumed that: -

- investments would be made for medium term periods with fixed rates to lock in good value and security of return if opportunities arose, subject to over riding credit counterparty security;

- total interest earnings were forecast at £421,000. Of this sum earnings from the Council's temporary cash flow investments would be £409,000, statutory interest from the Housing Revenue Account of £6,000 and £6,000 from other sources.

- A rate of investment return of 1.5% was anticipated for the year.

3. SUMMARY OF ECONOMIC FACTORS

3.1 The financial year 2012/13 continued the difficult investment environment of previous years, generally the low investment returns available and the continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 2014. 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).

3.2 The UK Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn.

3.3 The Bank Rate ended the year unchanged at 0.5% while CPI inflation fell from 3% at the start of the year to end at 2.8% in March. The estimated reduction back to below 2% is now estimated to be at quarter 1 2016.

3.4 The EU sovereign debt crisis was ongoing during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.

3.5 **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. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries. Countering that is the recent downgrading of UK by two credit rating agencies.

3.6 Weak economic figures are estimated in the immediate future and economists are now suggesting that rates will not rise until at least quarter 1 of 2015 and possibly later.

4. LONG-TERM BORROWING

4.1 The Council’s underlying need to borrow to finance capital expenditure is called the Capital Financing Requirement (CFR).

4.2 At 1 April 2012 the Council had General Fund CFR of £4.466m. The HRA CRF was £144.601m, but of this sum £1.897m was historic and £142.7m represented actual external debt raised for the HRA settlement.

4.3 During the year no further external long term borrowing was raised but internal borrowing was used to fund the purchase of items of Vehicle and Plant. This increased the CFR for the General Fund by £1.99m. However, the CFR is reduced each year by the amount of any provision that is made to repay loan in the future. This is known as the MRP.

4.4 The MRP for 2012/13 was £1.03m. Therefore the net movement on the GF CFR was £0.96m. These figures are shown prior to an anticipated policy change for loan financed assets that may be implemented in the final accounts.

	31 March 2012 Actual	31 March 2013 Original	31 March 2013 Actual
	£000	**£000**	**£000**
CFR General Fund	4,466	5,313	5,426
CFR HRA	1,897	1,897	1,897
CFR HRA Settlement	142,704	143,400	142,704
Total CFR	**149,067**	**150,610**	**150,027**

4.5 All external loans raised for the HRA settlement have fixed interest rates with interest payable 6 monthly and principal repayable on maturity. All loans are with the PWLB. The loans outstanding are as follows:-

Principal £	Interest Rate %	Term of loan Years	Repayment date 28 March
4,100,000	1.50%	6	2018
4,100,000	1.76%	7	2019
4,100,000	1.99%	8	2020
4,100,000	2.21%	9	2021
4,100,000	2.40%	10	2022
4,100,000	2.56%	11	2023
4,100,000	2.70%	12	2024
4,100,000	2.82%	13	2025
4,100,000	2.92%	14	2026
4,100,000	3.01%	15	2027
4,100,000	3.08%	16	2028
4,100,000	3.15%	17	2029
4,100,000	3.21%	18	2030
4,100,000	3.26%	19	2031
4,100,000	3.30%	20	2032
4,100,000	3.34%	21	2033
4,100,000	3.37%	22	2034
4,100,000	3.40%	23	2035
4,100,000	3.42%	24	2036
4,100,000	3.44%	25	2037
4,100,000	3.46%	26	2038
4,100,000	3.47%	27	2039
4,100,000	3.48%	28	2040
4,100,000	3.49%	29	2041
4,100,000	3.50%	30	2042
4,100,000	3.51%	31	2043
4,100,000	3.52%	32	2044
4,100,000	3.52%	33	2045
4,100,000	3.52%	34	2046
4,100,000	3.52%	35	2047
4,100,000	3.53%	36	2048
4,100,000	3.53%	37	2049
4,100,000	3.53%	38	2050
4,100,000	3.53%	39	2051
3,304,000	3.52%	40	2052
142,704,000			

The average interest rate for the first 6 years will be 3.1% assuming that no principal is repaid prematurely.

4.6 The estimate for interest paid during the year on long term borrowing was £3.97m. The actual interest paid was £4.46m. The reason for the variation is that when the original estimate was made neither the maturity profile of the debt raised, nor the interest rate that would be applicable, was known.

5. TEMPORARY BORROWING

5.1 There were no temporary loans outstanding on 1 April 2012.

5.2 No temporary loans were raised during the year for cash flow purposes.

5.3 The original estimate for 2012/13 for interest payable was £1,000. There were no payments for interest on temporary borrowing during the year.

5.4 There were no temporary loans outstanding at 31 March 2013.

6. INVESTMENT

6.1 The original estimate for 2012/13 for interest receivable on temporary investments was £409,000 with an anticipated rate of return of 1.2%. The actual interest receivable was £578,000 with an average interest rate of 1.53%.

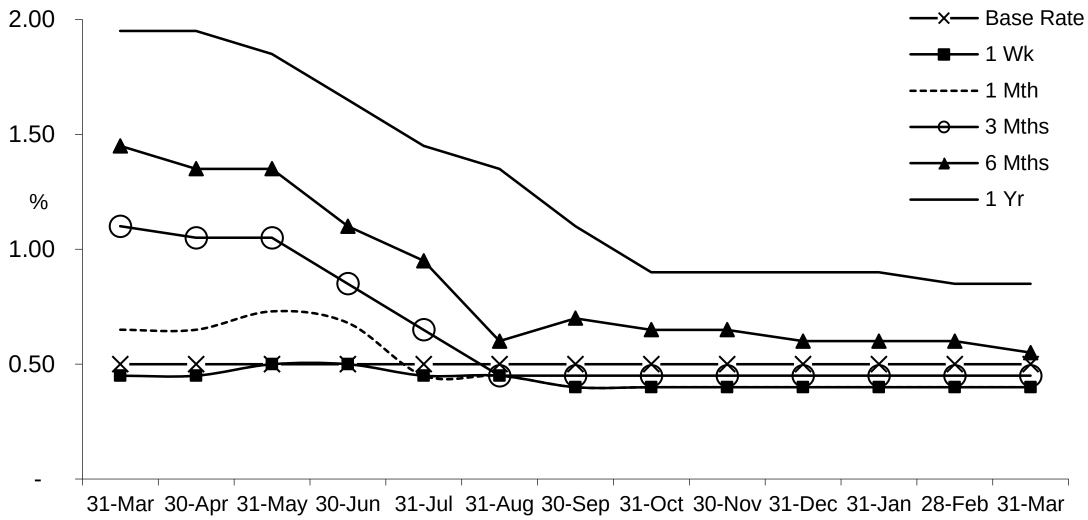
6.2 There are two factors that caused this variation:-

	£
Original 2012/13 estimate for temporary investment earnings	409,000
Higher level of average balances than originally estimated	44,000
Higher Interest rate than originally forecast	125,000
	578,000

6.3 Variations were reported to Cabinet in September 2012 as part of the variation on the overall net interest earnings.

6.4 The following chart shows how the interest rates in the money markets generally have reduced over the year. However the rates offered by those organisations with which the Council can invest can differ from these averages. Although the interest rates have reduced as shown, the higher interest earnings for 2012/13 were achieved through adopting a policy of investing funds for longer periods and therefore benefiting from a positive yield curve.

Money Market Interest Rates 1/4/12 to 31/03/13



6.5 There were no movements in the bank base rate during the year:

Date	Bank Base Rate
At 1 April 2012	0.50%
31 March 2013	0.50%

6.6 All temporary investments had been made in accordance with the parameters set within the Council's Treasury Policy Statement and with any other parameters that were imposed at regular reviews during the year.

6.7 At the end of March 2013 most of the temporary investments were, or had been, invested over a period of a year. This made the most use of the positive yield curve. The table below shows the list of temporary investments at 31 March 2013.

Borrower	Amount £	Interest Rate %	Maturity Date
National Westminster PLC	2,000,000	2.25	04.04.13
Lloyds TSB Bank PLC	7,000,000	3.15	11.04.13
National Westminster PLC	3,000,000	2.25	22.05.13
Lloyds TSB Bank PLC	3,000,000	3.00	04.07.13
National Westminster PLC	2,000,000	2.25	16.08.13
Nationwide BS	2,000,000	0.38	04.04.13
Barclays Bank PLC	2,000,000	0.65	29.11.13
Money Market Funds	4,100,000	0.83	Instant access
Total	**25,100,000**		

7. BENCHMARKING

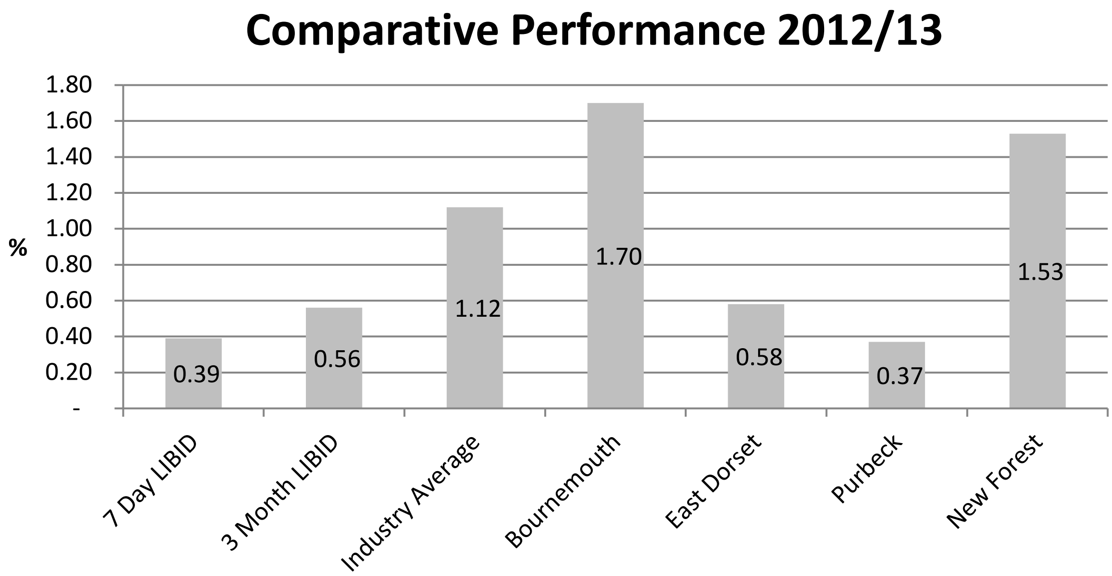
7.1 In order to measure the performance of the Council's investments it is necessary to compare the earnings to a benchmark. The benchmark is established by taking a daily figure published by the money markets and averaging this over the period being measured. In this case the interest rate paid for 7 day money at the London Interbank Bid (LIBID) rate is averaged over one year. The LIBID rate is the rate that major UK banks will pay for money deposits on the London Interbank market.

7.2 The average rate of 7 day LIBID, the interest rate used for benchmarking the Council's interest earnings for 2012/13, was 0.39%. Therefore, the interest earned on temporary investments exceeded the benchmark.

7.3 In addition to benchmarking to the London Money Market interest rates Members have requested a comparison of interest earnings to be made with other councils. All councils develop their own investment criteria and each differs either in the permitted period of investment, the institutions that deposits can be placed with or the limit to which funds can be invested with each organisation. These criteria are also often based on the overall value of funds available for investment within each council. It should be noted that the other councils used in this example have different investment parameters to NFDC and therefore direct comparison is difficult. For example Purbeck District Council relies heavily on investments with the Debt Management Office which pays very low rates of interest but is backed by central government and so deemed a very "safe" investment. East Dorset District Council's investments are generally for a few months while Bournemouth Borough Council can invest for longer periods.

7.4 It is interesting to note the widely differing rates of return given the variation in investment parameters.

7.5 The following table shows the average earnings for this council's temporary investments against those of 7 day LIBID, 3 month LIBID, external fund managers' industry average and other councils.



7.6 The performance of this Council's treasury function was better than the benchmarks and the external fund managers' industry average.

7.7 Results to 31 March 2013 are summarised as follows: -

	NFDC Temporary interest earnings %	7-day Bench-mark earnings %	Fund Manager industry average %
Actual Return	1.53	0.39	1.12
Benchmark Return	0.39	0.39	0.39
	£000	**£000**	**£000**
Actual Return	578	147	423
Benchmark Return	147	147	147
Return above/(-)below benchmark	431	0	276

7.8 The value of the interest earned by NFDC on temporary investments as at 31 March 2013 was £431,000 above the benchmark figure as shown at paragraph 7.7. These earnings were £155,000 more than the external fund manager industry average.

8. INVESTMENT PORTFOLIO STRATEGY

8.1 Funds are invested in cash deposits.

8.2 At the start of the year the portfolio was invested in instruments with interest rates averaging 1.0%. This was a strategic move to keep investments short and flexible prior to the final decisions on the profile of loans that were to be raised for the HRA settlement in March 2012. On finalisation of the HRA borrowing, investments were lengthened to benefit from the higher interest rates available.

8.3 At the beginning of the year the anticipation was that interest rates would remain fairly stable. Although base rates have stayed at 0.50% for the period, longer term rates have reduced significantly as the UK Government has made cheap funding available to banks so that they no longer are competing for councils' funds.

8.4 As the investments were lengthened at the start of the year this has made possible to increase in earnings. However as these investments mature the longer term rates are not now available and the earnings are likely to reduce for 2013/14.

8.5 The Money Market Funds (MMFs) were used extensively during the year. The funds are AAA rated and the council has instant access to all deposits. The interest rate was not as good as period deposits for 3 months or more at the start of the year. However, with falling rates generally, they were on a par with 3 month deposits for the second part on the year. The MMFs interest rates were also much better than both the Government's Debt Management Account Deposit Facility and other local authorities. This fund was used for short term deposits or where other allowable investment limits had been reached.

9. TREASURY POSITION AT 31 MARCH 2013

The following table shows the treasury position at the 31 March 2013 compared with the previous year.

	31 March 2012		31 March 2013	
	Principal	Average Rate	Principal	Average Rate
	£m	%	£m	%
Total Long-Term Debt	£142.70m	3.1%	£142.70m	3.1%
Total Debt	**£142.70m**	**3.1%**	**£142.70m**	**3.1%**
Variable Interest Rate				
- Money Market Funds	£15.40m	0.8%	£4.10m	0.4%
- Call Account	£0.00m	0.2%	£0.00m	0.0%
	£15.40m	0.8%	£4.10m	0.4%
Fixed Interest Rate				
- Temporary Investments	£10.50m	1.3%	£21.00m	2.3%
- Long Term Investments	£0.00m	0.0%	£0.00m	0.0%
	£10.50m	1.3%	£21.00m	2.3%
Total Investments	**£25.90m**	**1.0%**	**£25.10m**	**2.0%**
Net Debt	**£116.80m**	**3.6%**	**£117.60m**	**3.3%**

APPENDIX 2

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES TO 31 MARCH 2013

1. INTRODUCTION

1.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year-end.

1.2 The following table, at Paragraph 2, provides a schedule of all the mandatory prudential indicators.

1.3 Certain of these indicators must be compared to others and are detailed later in this appendix.

2. ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

2.1 The following table compares the actual figure for 2012/13 with the original indicator for 2012/13 and the actual figure for 2011/12.

2.2 The original indicator for 2012/13 is the same as was included in the Treasury Strategy Report 2012/13.

		2011/12 Actual £000	**2012/13 Original Indicator £000**	**2012/13 Actual £000**
1	**Capital Expenditure**	17,023	14,357	17,900
2	**Capital Financing Requirement (CFR) at 31 March**			
	Housing	144,601	145,297	144,601
	Non Housing	4,466	5,313	5,427
	Total	**149,067**	**150,610**	**150,028**
3	**Treasury Position at 31 March**			
	Borrowing	142,704	143,400	142,704
	Other long term liabilities	0	0	0
	Total Debt	**142,704**	**143,400**	**142,704**
	Investments	-25,900	-18,500	-25,100
	Net Borrowing/Investments (-)	**116,804**	**124,900**	**117,600**
4	**Authorised Limit** (against maximum position)	**Maximum** 143,193	**Authorised** 173,400	**Maximum** 150,126
5	**Operational Boundary** (against average position)	**Average** 142,715	**Average** 143,400	**Average** 142,793
6	**Ratio of financing costs to net revenue stream** (non Housing)	0.1%	2.1%	-3.5%

7	**Incremental impact of capital investment decisions on the Band D council tax**	£ 0.31	£ 6.38	£ -9.29
8	**Incremental impact of capital investment decisions on the housing rent levels**	£ 4.29	£ 7.61	£ 9.51
9	**Upper limits on fixed interest rate investments** (against maximum position)	**Maximum** 100%	**Maximum** 100%	**Upper Limit** 89%
10	**Upper limits on variable interest rate investments** (against maximum position)	**Maximum** 60%	**Maximum** 50%	**Upper Limit** 66%
11	**Upper limit on fixed interest rate borrowing** (against maximum position)	**Maximum** 100%	**Maximum** 100%	**Upper Limit** 100%
12	**Upper limit on variable interest rate borrowing** (against maximum position)	**Maximum** 0%	**Maximum** 50%	**Upper Limit** 0%
13	**Maturity structure of fixed rate borrowing** (against maximum position)			
	Under 12 months (temporary borrowing only)	1%	**Upper Limit** 100%	0%
	12 months to 2 years	0%	100%	0%
	2 years to 5 years	0%	100%	0%
	5 years to 10 years	14%	100%	14%
	10 years and above	85%	100%	85%
14	**Maturity structure of variable rate investments** (against maximum position)		**Upper Limit**	
	Under 12 months	100%	100%	100%
	12 months to 2 years	0%	75%	0%
	2 years to 5 years	0%	75%	0%
15	**Maximum principal funds invested** (against maximum position)	**Maximum** 52,365	**Maximum** 62,400	**Maximum** 53,000

2.3 Any indicators that were exceeded were guideline limits only. There were no breaches of statutory limits during the year.

2.4 At note 6 the financing cost has reduced dramatically this is because the policy for the financing of equipment has been amended. In previous years the equipment was financed by loan and there was a charge, the MRP, which was set aside to repay the loan in the future. In 2012/13 it was decided that no MRP would be applicable to small items of equipment as they would be purchased from revenue expenditure in the future.

2.5 The amended policy, at 2.4 note 6, has also affected note 7. Because the equipment has been purchased from revenue the capital element of the Council Tax charge has been reduced.

2.6 At note 8 the rise in the rent levels reflects the financing of the purchase of former council dwellings to provide new accommodation. However, as the Council has adopted the Governments rent restructuring policy this has no effect of housing rents charged to tenants.

2.7 At note 10 the upper limit on variable interest rate investments was exceeded on 26 days only. As more funds are now invested with the MMFs, which pay a variable rate of interest, it is likely that the proportion of funds invested in these instruments will be higher and that the limit will be revised for the future. The average of the variable investments, compared to maximum investments during the year, was 37%

2.6 In addition to the above the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice. The compliance for this indicator is shown at paragraph 2.1 in the body of the report.

- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR). The compliance for this indicator is shown at paragraph 3.1 below.

3. LIMITS TO BORROWING ACTIVITY

3.1 Net external borrowing

	31 March 2012 Actual	31 March 2013 Original Indicator	31 March 2013 Actual
Net borrowing position	**£116.8m**	**£124.9m**	**£117.6m**
Capital Financing Requirement	**£149.1m**	**£150.6m**	**£150.0m**

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is an indication of the Council's debt position. In order to ensure that borrowing net of investments will only be for a capital purpose, net borrowing should not exceed the CFR for 2012/13.

The table above shows that the Council has complied with this requirement.

3.2 Borrowing Limits

	2012/13
Authorised Limit	**£173.4m**
Operational Boundary	**£143.4m**
Maximum gross borrowing position during the year	**£142.7m**
Average gross borrowing position during the year	**£142.7m**
Minimum gross borrowing position during the year	**£142.7m**

The Authorised Limit must not be breached. The table demonstrates that during 2012/13 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary is the expected average borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

4. TREASURY SERVICE PERFORMANCE INDICATORS FOR 2012/13

The treasury service has set the following performance indicators:

- The return on interest earnings should be higher than a benchmark of the 7-day LIBID rate averaged over the year.

5. RISK AND PERFORMANCE

5.1 The Council has complied with all of the relevant statutory and regulatory requirements that limit 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 that its capital expenditure is prudent, affordable and sustainable, and that 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 proactively managed the investments over the year within the constraints of the investment guidelines.

5.3 The investment of surplus funds with highly credited rated organisations is the main consideration in the treasury strategy to minimise counterparty risk.

5.4 Shorter-term market rates and likely future movements of interest 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.

5.5 Section 6 and 7 of appendix 1 shows the investment returns for 2012/13.