Cheltenham Borough Council

Treasury Outturn Report for 2012/13

Report of the Director, Resources

Purpose

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).

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

- an annual treasury strategy in advance of the year (Council 10/02/2012)
- a mid-year (minimum) treasury update report (Council 17/12/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Treasury Management Panel and Cabinet before they were reported to the full Council.

Executive Summary

During 2012/13, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Capital Expenditure:			
• General Fund	7,094	8,943	6,883
• HRA	4,740	5,492	4,742
• Total	**11,834**	**14,435**	**11,625**
Capital Financing Requirement:			
• General Fund	28,302	28,522	28,732
• HRA	46,142	44,750	44,750
• Total	**74,444**	**73,272**	**73,482**
Net borrowing	72,472	69,077	64,424
External debt	61,809	58,577	58,702
Investments			
• Longer than 1 year	3,927	2,655	2,985
• Under 1 year	5,810	5,570	6,184
• Total	**9,737**	**8,225**	**9,169**

Other prudential and treasury indicators are to be found in the main body of this report. The Director of Resources also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2012/13 prudential and treasury indicators in this report
2. Note the annual treasury management outturn report for 2012/13

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2012/13

The Council undertakes capital expenditure on 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.

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

£m General Fund	2011/12 Actual	2012/13 Estimate	2012/13 Actual
Capital expenditure	7,094	8,943	6,883
Financed in year	7,094	8,943	6,883
Unfinanced capital expenditure	0	0	0

£m HRA	2011/12 Actual	2012/13 Estimate	2012/13 Actual
Capital expenditure	4,740	5,492	4,742
Financed in year	4,740	5,492	4,742
Unfinanced capital expenditure	0	0	0

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2012/13 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2012/13 on 10/02/2012.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need.

Net borrowing and the Capital Financing Requirement (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. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2012/13. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator.

	31 March 2012 Actual	31 March 2013 Budget	31 March 2013 Actual
Net borrowing position	£62.735m	£60.852m	£55.267m
CFR	£74.444m	£73.272m	£73.482m

The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. 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.

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.

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

	2012/13
Authorised limit	£109m
Maximum gross borrowing position	£64,424m
Operational boundary	£96m
Average gross borrowing position	£58.283m
Financing costs as a proportion of net revenue stream	4.06%

3. Treasury Position as at 31 March 2013

The Council’s debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the beginning and the end of 2012/13 the Council‘s treasury position was as follows:

TABLE 1	31 March 2012 Principal	Rate/ Return	31 March 2013 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£40.81m	3.83%	£40.78m	3.81%
-Market	£15.90m	4.00%	£15.90m	4.00%
-Temporary	£5.10m	0.35%	£2.00m	0.30%
Total debt	£61.81m	3.59%	£58.68m	3.74%
CFR	£74.444m		£73.482	
Over / (under) borrowing	(£12.634m)		(£14.802m)	
Investments:				
- in house	£5.81m	0.51%	£3.84m	0.75%
Total investments	£5.81m	0.51%	£3.84m	0.75%

4. The Strategy for 2012/13

The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate (starting in quarter 4 of 2014), with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

The actual movement in gilt yields meant that PWLB rates fell during the first quarter of the year to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt, and from shares, as investors became concerned about the potential for a Lehman's type crisis of financial markets, if the Greek debt crisis were to develop into a precipitous default and exit from the Euro. During the second and third quarters, rates rose gradually and agreement of a second bail out for Greece in December saw the flight to quality into gilts reverse somewhat, as confidence rose that the Eurozone crisis was finally subsiding. However, gilt yields then fell back again during February and March as Eurozone concerns returned, with the focus now shifting to Cyprus, and flight to quality flows into gilts resumed. This was a volatile year for PWLB rates, driven by events in the Eurozone which oscillated between crises and remedies.

5. The Economy and Interest Rates

Sovereign debt crisis

The EU sovereign debt crisis was an ongoing saga during the year. However, the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was (at last) beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions Scheme in September. During the summer, a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in the new Five Star anti-austerity party gaining a 25% blocking vote; this has the potential to make Italy almost ungovernable if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election – but one which could yield an equally 'unsatisfactory' result! This result emphasises the dangers of a Eurozone approach heavily focused on imposing austerity, rather than promoting economic growth, reducing unemployment, and addressing the need to win voter support in democracies subject to periodic general elections. This weakness leaves continuing concerns that this approach has merely postponed the ultimate debt crisis, rather than provide a conclusive solution. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

The UK coalition 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. Moody's followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe.

UK growth
2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. In the March 2013 Budget, the Office of Budget Responsibility yet again slashed its previously over optimistic growth forecasts, for both calendar years 2013 and 2014, to 0.6% and 1.8% respectively.

UK CPI inflation
It has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

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

Bank Rate
Was unchanged at 0.5% throughout the year, while expectations of when the first increase would occur were pushed back to quarter 1 2015 at the earliest.

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. This has resulted in some return of confidence to move away from only very short term investing.

6. Borrowing Outturn for 2012/13

For 2012/13 the Council's actual debt management costs (borrowing) were £2,131,018 compared to a revised budget of £2,130,300, a deficit of £718. The weighted average rate on all loans for 2012/13 was 3.77% (2011/12 3.25%) against a revised estimated rate of 3.33%.

The HRA repaid the General Fund £1.737m interest for the use of debt balances it holds since the HRA reforms at the start of this financial year began.

Loans were drawn down in 2012/13 from the PWLB for £2m to fund capital expenditure for Cheltenham Borough Homes. This loan was taken on an annuity basis in which CBH are repaying back in full to the Council based on the loan term taken with the PWLB, ensuring the GF is cost neutral.

The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£2m	Fixed interest rate	3.91%	40 years

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
On 13/02/2013 the Council repaid a PWLB £2m loan at an average rate of 4.35%. This was funded by using internal resources.

7. Investment Rates in 2012/13

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.

8. Investment Outturn for 2012/13

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 10/02/2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc)

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

The Council maintained an average balance of £6.98m of internally managed funds. The internally managed funds earned an average rate of return of 1.05%.The comparable performance indicator is the average 7-day LIBID rate, which was 0.39%. This compares with a budget assumption of £3.2m of investment balances at an average rate of 1.13%.

The Council budgeted for £58,400 investment interest for 2012/13 but made an actual return of £74,128 a surplus of £15,728.

9. Icelandic Bank Deposits

The Council had £11m deposited with three Icelandic Banks when the banking system in Iceland collapsed in October 2008.

The Icelandic Government has stated its intention to honour all of its commitments as a result of their banks being placed into receivership. The U.K. Government, Administrators and other agencies continue to work with the Icelandic Government to help bring this about. The Local Government Association is co-ordinating the efforts of all UK councils with Icelandic investments.

At the current time, the process of recovering assets is still ongoing with the administrators. In the case of Kaupthing, Singer and Friedlander Ltd, the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2013/14. To date 76p in the pound has been recovered. It is estimated that total dividends will be between 84p to 86.5p in the pound.

Investments outstanding with the two Iceland – domiciled banks (Glitnir Bank hf and Landsbanki Islands hf) 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 Administrators have now commenced the process of dividend payments in respect of both of these banks. Members will be periodically updated on the latest developments on these efforts. It is expected that 100% will be recovered from these two banks over the coming years.

The table below shows the detailed repayments in respect of the specific Icelandic investments held in administration:

Icelandic Deposits Held	Original Deposits	Amount Received to date	Amount Outstanding
	£	£	£
Kaupthing Singer & Friedlander	2,000,000	1,520,000	480,000
Kaupthing Singer & Friedlander	1,000,000	760,000	240,000
Glitnir	3,000,000	2,427,600	572,400
Landsbanki	2,000,000	973,684	1,026,316
Landsbanki	2,000,000	973,826	1,026,174
Landsbanki	1,000,000	502,468	497,532
TOTAL	**11,000,000**	**7,157,578**	**3,842,422**

10. Treasury Management Advisors

At the start of 2012/13 financial year the Council were advised by Arlinglose Ltd which had the contract until 30th November 2012. The Council tendered in October 2012 with the GO Shared Service Councils and Gloucestershire County Council to try to drive out savings. The contract was awarded to Sector for three years saving Cheltenham Borough Council £13,500 over the next three years.

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2011/12	2012/13	2012/13
Extract from budget and rent setting report	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	£7,094	£8,943	£6,883
HRA	£4,740	£5,492	£4,742
TOTAL	£11,834	£14,435	£11,625
Ratio of financing costs to net revenue stream			
Non - HRA	%	%	%
HRA	%	%	%
Net borrowing requirement			
brought forward 1 April	£	£62,735	£62,735
carried forward 31 March	£62,735	£60,852	£55,267
in year borrowing requirement	(£	(£1,883)	(£7,468)
Net debt	£	£	£
CFR			
Non – HRA	£28,302	£28,522	£28,732
HRA	£46,142	£44,750	£44,750
TOTAL	£74,444	£73,272	£73,482
Incremental impact of capital investment decisions	£	£	£
Increase in council tax (band D) per annum *	£nil	£nil	£nil
Increase in average housing rent per week **	£nil	£nil	£nil
* Council Tax Freeze for 2012/13			
** Decisions on annual rent increases are subject to rent restructuring guidelines set by Central Government. As a consequence rent levels will only rise by RPI Index plus 0.5% and this should cover all additional capital expenditure.			

2. TREASURY MANAGEMENT INDICATORS	2011/12	2012/13	2012/13
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£109,000	£109,000	£109,000
other long term liabilities	£0	£0	£0
TOTAL	£109,000	£109,000	£109,000
Operational Boundary for external debt -			
borrowing	£99,000	£96,000	£96,000
other long term liabilities	£0	£0	£0
TOTAL	£99,000	£96,000	£96,000
Actual external debt	£61,809	£58,577	£58,702
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments :-	0-100 %	0-100 %	0-100 %
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments :-	0-100 %	0-100 %	0-100 %

Maturity structure of fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%