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OXFORD CITY COUNCIL

To: City Executive Board

Date: 11th September 2013

Report of: Head of Finance

Title of Report: TREASURY MANAGEMENT ANNUAL REPORT 2012/2013

Summary and Recommendations

Purpose of report: The report sets out the Council's treasury management activity and performance for 2012/2013

Key decision No

Executive lead member: Councillor Ed Turner

Policy Framework: Treasury Management Strategy

Recommendation: That the report is noted

Executive Summary

1. The Council held investments totalling approximately £45 million as at 31st March 2013. These investments are held in accordance with the Council's Treasury Management Strategy. Interest earned during the year was approximately £540,000 against a budget of £252,000.

2. The primary principle governing the Council's investment criteria is the **Security** of its investment, with **Liquidity** and **Yield** being secondary considerations.

3. The average rate of return on the Council's investments has decreased during the financial year 2012/2013 from 1.14% in April 2012 to 0.93% at the 31st March 2013. This is below the Council's performance target of 1.0% and due to some longer term loans taken out during 2011/12 at higher interest rates (maximum of 3%) maturing and the equivalent rate of replacements being significantly lower (1%).

4. The Council has £1.0m outstanding with the failed Icelandic Banks, a total of £0.284m was received in the year, and it is expected that the remaining funds will be received in due course. Further information can be found in paragraphs 29 to 33.

5. The Council's debt portfolio was £202 million as at 31st March 2013. Approximately £201.1 million is held with the Public Works Loan Board (PWLB) at fixed interest rates and £0.9 million is held with South Oxfordshire District Council (SODC) at a variable rate of interest. The PWLB loans include £198.5 million borrowed in March 2012 to fund the buy out of the Housing Revenue Account (HRA). The debt relates purely to Housing and the maturity profile ranges from 9 - 45 years. Interest paid on this debt during 2012/2013 was £6.470m.

6. The Council's debt strategy takes a number of factors into account including:

    - The ability and value of using the Council's cash balances to finance capital expenditure Where external borrowing is undertaken the borrowing decision will take account of:
        - prevailing interest rates
        - the debt profile of the Council's portfolio
        - the type of asset being financed

7. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2012/2013.

8. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of authorities are affordable, prudent and sustainable.

9. The prudential indicators detailed in the body of this report look back at the results for 2012/2013, and are designed to compare the Council's outturn position against the target set.

Economic Backdrop to 2012/2013

10. The Bank Base Rate was expected to remain static during 2012/13 and not rise until quarter four of 2014. This date has now been pushed back to quarter 1 of 2015. UK Economic growth (GDP) was virtually flat during 2012/13, due to subdued domestic consumer expenditure, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market – the European Union (EU). Consequently the Monetary Policy Committee increasing quantitative easing by £50bn in July 2012 to a total of £375bn. Consumer Price Index (CPI) inflation has remained above the 2% target, starting the year at 3% and still being at 2.8% in March. The EU sovereign debt crisis continued during the year, with a very protracted second bailout being agreed for Greece in December and further concerns over Cyprus, towards the end of the year.

11. Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuation in safe haven flows into/out of UK gilts (Government bonds). This, together with a further £50bn of Quantative Easing (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.

12. The funding for Lending scheme, announced in July, has resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling drastically in the second half of the year. However, perceptions of counterparty risk have improved after the European Central Bank (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. The Treasury team will consider the impact of these changes when making treasury management decisions.

13. The UK coalition Government maintained its tight fiscal policy stance which it related in part to warnings from two credit rating agencies that the UK could lose its AAA credit rating. In fact 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 in March. This has not shown any visible signs of changes on the market conditions and rates have not changed following this.

Financing of the Capital Programme 2012/13

14. Table 1 below shows actual capital expenditure and financing compared to the original plan or budget.

Table 1

Capital Expenditure	2011/12 Actual £'000	2012/13 Budget £'000	2012/13 Actual £'000	Variation £'000
Non-HRA Capital Expenditure	12,434	16,120	8,770	7,350
HRA Capital Expenditure	8,577	8,395	7,590	805
Total Capital Expenditure	**21,011**	**24,515**	**16,360**	**8,155**
Resourced by:				
Capital Receipts	6,394	3,900	1,544	2,356
Capital Grants and contributions	3,943	8,985	9,389	-404
Prudential Borrowing	650	6,281	0	6,281
Revenue	10,024	5,349	5,427	-78
Total Capital Resources	**21,011**	**24,515**	**16,360**	**8,155**

15. The key variations relate to the following:

- slippage on the construction of the Competition Swimming Pool at Blackbird Leys of £7 million due to a Judicial Review of the Council's decision to progress the project, reducing the need to prudentially borrow
- £0.8 million slippage on housing related capital projects including tower block refurbishment

The Council's Overall Borrowing Need

16. The Council's underlying need to borrow or Capital Financing Requirement (CFR) is a gauge of the Council's level of indebtedness. It represents all prior years' net capital expenditure which has not been financed by other means (revenue, capital receipts, grants etc).

17. The CFR can be reduced by:
    I. The application of additional capital resources, such as unapplied capital receipts; or
    II. By holding a voluntary revenue provision (VRP) or depreciation against it.

18. Table 2 below shows the Council's CFR position as at the 31st March 2013, this is a key prudential indicator, and shows that our actual borrowing is below our CFR:

CFR	31st March 2012 Actual £'000	31st March 2013 Estimate £'000	31st March 2013 Actual £'000	Variation £'000
Opening Balance	**26,044**	**218,943**	**218,943**	**0**
Plus repayment of Prudential Borrowing	-1,399	0	-500	**-500**
HRA reform borrowing	198,528	0	0	**0**
Minimum Revenue Provision	-4,137	-268	-268	**0**
Finance Lease	-93	-53	-53	**0**
CFR Closing Balance	**218,943**	**218,622**	**218,122**	**-500**

19. The CFR position above has decreased due to no new prudential borrowing being undertaken in 2012/13 and repayment of previous years' prudential borrowing of £500k.

Treasury Position at 31st March 2013

20. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual borrowing position by either:
    I. Borrowing to the CFR;
    II. Choosing to utilise some temporary cash flow funds, which will reduce our investment balance, instead of borrowing (this is known as "under borrowing");
    III. Borrowing for future increases in the CFR (borrowing in advance of need*)*

21. It should be noted that accounting practice requires financial instruments (debt, investments etc.) to be measured in a method compliant with International Financial Reporting Standards. The figures in this report are based on the actual amounts borrowed and invested and therefore may differ slightly to those in the Statement of Accounts for 2012/13.

22. No new debt was taken out during 2012/13 and as at 31st March 2013 the Council's total debt was £202 million. This is below the CFR shown in table 2 and indicates that the Council continues to 'internally borrow' in the order of £16 million.

23. The Council's treasury position as at the 31st March 2013 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3

Treasury Position	31st March 2012 Principal £'000	31st March 2012 Average Rate %	31st March 2013 Principal £'000	31st March 2013 Average Rate %
Borrowing				
Fixed Interest Rate Debt	202,166	11.33	201,177	3.39
Other Long-term Liabilities	1,158	0.82	889	0.56
Variable Interest Rate Debt	0	0	0	0
Total Debt	**203,324**	**8.79**	**202,066**	**3.38**
Investments				
Fixed Interest Investments	30,315	1.09	31,900	1.13
Variable Interest Investments	1,685	0.69	12,205	0.42
Total Investments	**32,000**	**1.03**	**44,105**	**0.93**
Net Position	**171,324**		**157,961**	

Prudential Indicators and Compliance Issues

24. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:

25. **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. Net borrowing should not therefore, except in the short-term exceed the CFR. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, and implies that a significant amount of internal borrowing has been undertaken.

Table 4

Net Borrowing & CFR	31st March 2012 Actual £'000	31st March 2013 Actual £'000
Total Debt	203,324	202,066
Total Investment	32,000	44,105
Net Borrowing Position	**171,324**	**157,961**
CFR	**218,943**	**218,122**
Under Borrowing	**47,619**	**60,161**

26. **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 unless it explicitly agrees to do so. Table 5 below demonstrates that during 2012/13 the Council has maintained gross borrowing within its authorised limit. The authorised limit

allows the Council to borrow to the future CFR if required, and this has been reflected in the limit itself, with a little headroom built in.

Table 5

Authorised Borrowing	**31st March 2012**		**31st March 2013**	
	Estimate £'000	**Actual £'000**	**Estimate £'000**	**Actual £'000**
Borrowing	245,000	202,166	251,000	201,177
Other Long Term Liabilities	1,500	1,158	1,500	889
Total Borrowed	**246,500**	**203,324**	**252,500**	**202,066**
Amount under Limit	**43,176**		**50,434**	

27. **The Operational Boundary** – the operational boundary limit is the expected borrowing position of the Council during the year. It is possible to exceed the operational boundary limit, for a short period of time, providing that the authorised borrowing limit is not breached. Table 6 below shows the operational boundary limits for the last two financial year, and these were not breached during either period.

Table 6

Operational Boundaries	**31st March 2012 Estimate £'000**	**31st March 2013 Estimate £'000**
Borrowing	236,000	242,000
Other Long Term Liabilities	1,500	1,500
Totals	**237,500**	**243,500**

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 costs net of investment income) against the net revenue stream. This table is another key indicator of affordability. The financing costs as a proportion of net revenue stream shows the general fund changing to a negative figure as investment income starts to exceed interest paid following the repayment of fixed term PWLB loans and the HRA ratio staying relatively constant. The HRA financing costs as a proportion of Net Revenue stream ratio has increased considerable due to the large increase in interest payable. This increase relates to the £198.5million borrowed under self financing. This is shown in table 7 below.

Table 7

Actual Finance Costs	**2011/12 £'000**	**2012/13 £'000**
Indicators		
Original Indicator - Authorised Limit	246,500	252,500
Original Indicator - Operational Boundary	237,500	243,500
Financing Costs as a proportion of Net Revenue Stream - General Fund	-1.3%	2.1%
Financing Costs as a proportion of Net Revenue Stream - HRA	1.9%	19.3%

Icelandic Banks

28. During 2008/09 the Council invested £4.5 million with two of the now failed Icelandic banks: £3.0 million was deposited with Heritable Bank and £1.5 million with Glitnir Bank. These investments, together with accrued interest, are overdue their initial repayment.

29. As at 31st March 2013, the Council had received approximately £2.3 million of its original Heritable Bank investment (77%) plus interest. Current guidance indicates that the repayment of the Heritable deposits will continue with an eventual total repayment of approx 90%.

30. During 2011/12 the Council received four of the five foreign currency repayments due from Glitnir bank, totalling £1.2 million. The repayment date of the fifth currency (Icelandic Krona (ISK)) is still to be confirmed and requires the resolution of changes to Icelandic law to allow ISK to be transferred out of Iceland. Once this has been resolved, it is expected that the Council will receive close to 100% of its initial deposit.

31. The Icelandic Government has stated its intention to honour all of its commitments as a result of their banks being placed in receivership. The UK 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 to all UK Councils with Icelandic investments.

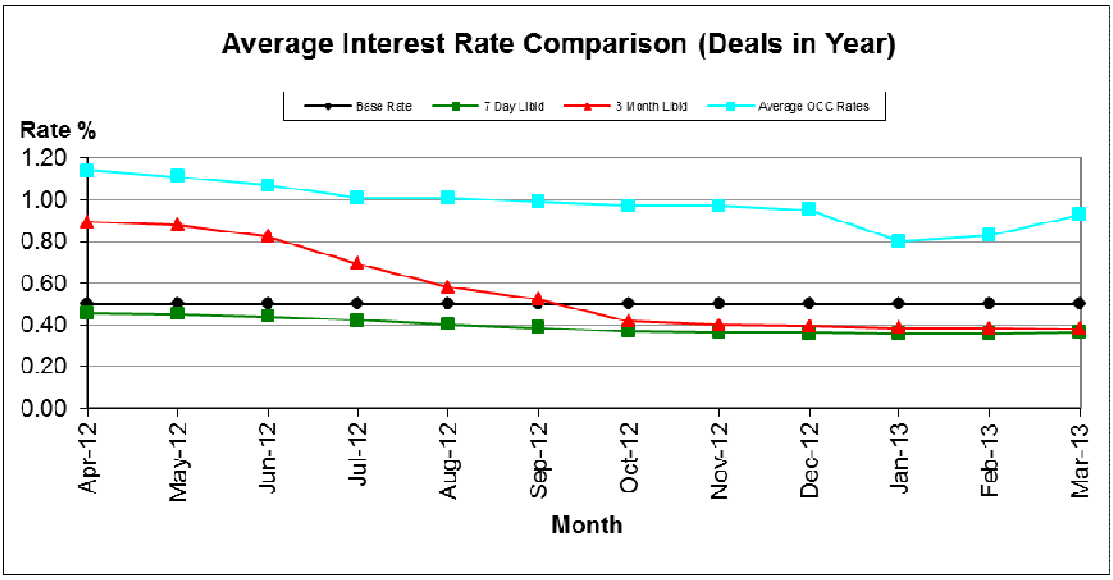
32. Table 8 below shows the original loan terms and the repayments received and outstanding as at 31st March 2013:

Table 8

Counterparty	**Original Principal**	**Interest Rate**	**Maturity Date**	**Interest Received**	**Principal Repaid**	**Exchange Rate Loss**	**Total Repaid**	**Total Outstanding as at 31.03.13**
Glitnir	£1.5m	5.51%	28/01 2009	£81,172.63	£1,213,800	(£45,238.57)	£1,249,734.06	£305,339.56
Heritable	£1.0m	6.04%	05/01 2009	£14,714.79	£772,803		£776,753.42	£228,357.81
Heritable	£1.0m	6.18%	30/04 2009	£8,984.95	£772,803		£788,660.94	£231,858.51
Heritable	£1.0m	5.83%	09/12 2008	£3,665.34	£772,803		£782,486.14	£230,043.18
Total				**£108,537.71**	**£3,532,209**	**(£45,238.57)**	**£3,597,634.56**	**£995,599.06**

Investment Income

33. The following graph shows the Council's monthly average interest rate in comparison to the base rate and also in comparison to its benchmarks: 3-months Libid and 7-day Libid.



34. As can be seen the Council's average monthly rate of return was above benchmark.

35. The Council manages its investments in-house and invests with the institutions listed in the Council's approved counterparty list. The Council invests for a range of periods from overnight to 364 days, dependant on cash flow needs, its interest rate view, the interest rates on offer and durational limits set out in the approved investment strategy.

36. During 2012/13 the Council maintained an average investment balance of £48.6 million and received an average return of 0.93%. This is slightly below the target of 1% and is mainly due to market rates dropping over the last 12 months, and a number of longer term deposits taken out in 2011/12 that were at high rates (up to 3%), maturing and being replaced with fixed rates of around 1%.

37. Actual investment income received for 2012/3 was approximately £540,000. This was significantly higher than the original budget of £230.000. This is due to higher investment balances than forecast, and deposits with highly rated and Government backed institutions being placed for up to 364days.

38. Fluctuations in the Council's balances have been managed through the use of a mix of instant access and notice accounts, money market funds and short term deposits (up to 3 months). This strategy is in line with the investment strategy approved by Council for 2012/13.

Counterparty Changes

39. In April the Co-operative Bank – the Council's Bank – was downgraded to BBB-/F3 by the Fitch Rating Agency. The Co-operative has not met the Council's investment counterparty criteria for some time, however it continues to be used for transactional purposes and up until April were used for overnight balances up to £500,000. They are currently used for transactional purposes only.

40. The Co-Operative bank does continue to provide a good service to the Council for its day to day business transactions. We carried out local benchmarking to assess the cost of the contract and following negotiations and an agreed 10% reduction of the contract value, in March 2013, it was awarded a contract for a further 3 years.

Strategy Update

41. The Treasury Management Strategy for 2013/14 was approved at Council on 18th February 2013. Within the report and subsequent approved changes to the strategy, reference was made to the use of Property Funds as a type of alternative investment type. The report advised that such funds would be classed as 'non- specified' investments since they would carry an additional risk to normal fixed investments. The strategy also stated that 'non-specified' investments would be restricted to 25% of the overall investment portfolio

42. Since the 1st April 2013 the Council have placed £1,000,000 with the CCLA property fund. In its first two months we received interest of £6,903.96 equating to a 4.064% return. It is likely that in the coming months Council officers will seek to invest more in Property Funds, within the limit for non-specified investments as laid out in the strategy.

43. The Council's Treasury Management Advisors contract has recently been retendered and Sector successfully retained this contract for a further three years.

Financial Implications

39 These are set out within the body of the report

Legal Implications

40 We are required to report on the Treasury Management Function to full Council on an annual basis, and this reports meets this requirement.

Risk Implications

41 There are no risks in connection with the report's recommendations . Risk assessment and management is a key part of Treasury Management activity especially in the selection of counterparties when investing is being considered. The Council uses external advisors and counterparty credit ratings issued by the rating agencies to assist in this process.

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Background papers: None

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