AUDIT COMMITTEE – 26 JULY 2013

Title of paper:	**TREASURY MANAGEMENT 2012/13 ANNUAL REPORT**	
Director(s)/ Corporate Director(s):	Carole Mills Deputy Chief Executive/Corporate Director for Resources	**Wards affected:** All
Report author(s) and contact details:	Jeff Abbott, Head of Corporate and Strategic Finance Tel: 0115 8763648 E-mail: jeff.abbott@nottinghamcity.gov.uk	
Other colleagues who have provided input:	Members of Treasury Management Panel: Tony Kirkham, Director of Strategic Finance Geoff Walker, Strategic Finance Manager Barry Dryden, Senior Finance Manager Peter Guest, Treasury Management Officer	

Relevant Council Plan Strategic Priority: (you must mark ✓ in the relevant boxes below)	
World Class Nottingham	✓
Work in Nottingham	✓
Safer Nottingham	✓
Neighbourhood Nottingham	✓
Family Nottingham	✓
Healthy Nottingham	✓
Leading Nottingham	✓

Summary of issues (including benefits to citizens/service users):
This report sets out the 2012/13 performance in respect of treasury management - the management of the Council's external debt and investments.

Recommendation(s):	
1	To consider and comment on the Treasury Management 202/13 Annual report, shown at Appendix A.

1. BACKGROUND

1.1 Treasury management is the management of an organisation's borrowings and investments, the effective management of the associated risks and the pursuit of optimum performance or return consistent with those risks.

1.2 The treasury management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice. Under the latter Code, an annual report is required to be submitted to and considered by councillors.

1.3 The 2012/13 annual report is shown at Appendix A for information. This report was considered by Executive Board on 18 June 2013.

2. REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

2.1 The CIPFA Prudential Code requires local authorities to nominate a body within the organisation to be responsible for scrutiny of treasury management activity. It is considered that the City Council's Audit Committee is the most appropriate body for this function.

2.2 In undertaking this function, the Audit Committee holds the responsibility to provide effective scrutiny of treasury management policies and practices.

3. OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

3.1 Options for management of the Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

4. FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

4.1 The financial implications of Treasury Management performance in 2012/13 are detailed in Appendix A, section 5.

5. RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS AND CRIME AND DISORDER ACT IMPLICATIONS)

5.1 Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

6. EQUALITY IMPACT ASSESSMENT

Has the equality impact been assessed?

Not needed (report does not contain proposals or financial decisions)	✓
No	☐
Yes – Equality Impact Assessment attached	☐

7. LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

7.1 None.

8. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

8.1 Treasury Management in the Public Services, Code of Practice 2009 – CIPFA

EXECUTIVE BOARD – 18 June 2013

Subject:	**TREASURY MANAGEMENT 2012/13 ANNUAL REPORT**
Corporate Director(s) / Directors:	Carole Mills Deputy Chief Executive & Corporate Director for Resources
Portfolio Holder(s):	Councillor Graham Chapman, Portfolio Holder for Resources, Economic Development and Reputation
Report author and contact details:	Jeff Abbott, Head of Corporate and Strategic Finance Tel: 0115 8763648 E-mail: jeff.abbott@nottinghamcity.gov.uk

Key Decision ☐ **Yes** ε **No**	
Reasons: Expenditure ☐ **Income** ☐Savings of £1,000,000 or more taking account of the overall impact of the decision ☐	**Revenue** ☐ **Capital** ☐
Significant in terms of its effects on communities living or working in an area consisting of two or more wards in the City	☐ **Yes** **No** ε

Relevant Council Plan Strategic Priority:		
World Class Nottingham	☒	**Wards affected:** All
Work in Nottingham	☒	
Safer Nottingham	☒	
Neighbourhood Nottingham	☒	**Date of consultation with Portfolio Holder(s):** Throughout 2012/13 and specifically in May 2013
Family Nottingham	☒	
Healthy Nottingham	☒	
Leading Nottingham	☒	

Summary of issues (including benefits to customers/service users):

This report sets out the 2012/13 performance in respect of the management of the Council's external debt and investments (i.e.: treasury management). The key issues are:

- The average rate of interest payable on external debt increased from 3.740% at 1 April 2012 to 3.788% at 31 March 2013 (see section 3.3).
- The average rate of interest earned on short-term investments in 2012/13 was 0.778%. This is benchmarked against the 7 day London Inter-bank (LIBID) rate provided by the Bank of England, which averaged 0.487% for the same period (see section 3.6).
- The 2012/13 out-turn showed net General Fund expenditure of £46.790m (see section 5.1)

Recommendation(s):

1	To note the performance information in this annual treasury management report.

1 BACKGROUND

1.1 Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks. To assist in this process the Council retains external financial advisors.

2 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

2.1 The Council adopted the Chartered Institute of Public Finance and Accountancy

(CIPFA)'s revised Code of Practice on Treasury Management in Local Authorities (the Code) on 18 February 2002. Part of the Code requires a formal annual report on the performance of the Treasury Management function.

3 TREASURY MANAGEMENT ACTIVITY IN 2012/13

3.1 External advisors

External advisors (Arlingclose) are retained to provide additional input on treasury management matters. The service comprises economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters, as required.

3.2 Prudential Indicators

Following the Local Government Act 2003, the Council is required to approve a series of treasury management prudential indicators. **Appendix 1** shows actual performance against these indicators for 2011/12 and 2012/13 - enabling comparison. The final column in the table reflects actual outturn against targets. For the affordability and treasury management indicators, this indicates whether the outturn was within set limits. For the prudence indicators, the actuals reflect the management of the capital programme and associated debt, within existing resource limitations. All of the outturn indicators at 31 March 2013 are within the parameters set for the year and there were no breaches of limits during the year.

The' PFI and leasing debt' figures within the indicators reflect the notional debt element of those schemes financed through Private Finance Initiative funding or finance leases.

3.3 Loan debt portfolio

Total outstanding debt during 2012/13 increased by £21.6m to £776.6m at 31 March 2013. The average rate of interest on that debt increased slightly, from 3.740% at 1 April 2012 to 3.788% at 31 March 2013. The majority of long-term borrowing is raised from the Government's Public Works Loan Board (PWLB). **Table 1** analyses the debt portfolio:

TABLE 1: DEBT PORTFOLIO				
	1 APR 2012		**31 MAR 2013**	
DEBT	**£m**	**%**	**£m**	**%**
PWLB borrowing	628.0	4.073	684.8	3.950
Market loans	51.3	4.287	51.3	4.287
Local bonds	1.0	2.417	0.6	2.200
Temporary borrowing	74.7	0.574	39.9	0.393
TOTAL DEBT	**755.0**	**3.740**	**776.6**	**3.788**

Good treasury management practice requires a spread of maturing debt over future years, avoiding large amounts of debt falling to be repaid in any one year. Prudential indicators include a requirement for fixed debt maturity to be within set parameters. **Table 2** shows those parameters and the actual debt percentages at 31 March 2013.

TABLE 2: DEBT MATURITY ANALYSIS		
Period of loan	**Parameters** %	**31/03/13** %
Under 12 months	0 – 20	9.82
1 to 2 years	0 – 20	1.80
2 to 5 years	0 – 25	5.99

5 to 10 years	0 – 25	19.67
10 to 25 years	0 – 50	35.54
25 to 40 years	0 – 25	16.41
> 40 years	0 - 75	10.77

The debt maturity profile is reviewed as part of the overall review of treasury management strategy.

3.4 Economic background

The UK economy registered overall growth of 0.2% in Gross Domestic Product (GDP) for the calendar year 2012, largely as a result of the boost provided by the Olympic Games in the third quarter. Following a return to negative growth in quarter 4, a 'triple-dip' recession was narrowly avoided in the first quarter of 2013. Although there are some encouraging signs in terms of declining inflation and unemployment levels, a return to healthy GDP growth is not expected before 2014 at the earliest.

As a consequence of these growth figures, Government borrowing increased in 2012/13, leading to the loss of the UK's AAA credit rating status (Moodys rating agency). Any potential increase in Government borrowing costs as a result of this downgrade was offset by continuing problems in the Eurozone, with the UK remaining an attractive safe haven for funds.

The introduction of the Government's Funding for Lending scheme in 2012, providing cheap funding for banks in return for passing this credit flow into the wider economy, led to a sharp fall in short-term interest rates (the 6 month gilt rate reduced from 1.33% to 0.51% during the course of the financial year).

The continuation of the Government's re-purchase of longer-term gilts (Quantitative Easing) also served to depress long-term interest rates, with the 40-year gilt yield falling by around 0.25% in the year.

3.5 Strategy during year

The overall Treasury Management strategy for 2012/13 was approved at a meeting of the Council on 5 March 2012 and included:

- *new borrowing*

A borrowing requirement of £53.8m was estimated for 2012/13, to replace maturing debt and finance capital expenditure. The type, period, and timing of new borrowing would be dependant on the expected movement in interest rates and the existing debt maturity profile, as well as approved prudential indicators and limits. The continued use of existing surplus cash to fund the borrowing requirement ('internal borrowing') would remain an option, given projected interest rates.

- *rescheduling*

Rescheduling of debt (the early repayment of existing loans and the replacement of that debt with new borrowing for different periods) is undertaken to improve the maturity profile of outstanding debt and reduce the interest charge on the revenue account. It was intended to take advantage of such opportunities if and when they arose during the year.

- *investments*

Cash surpluses during the year would be invested with security and liquidity being the primary driver. Within those stated guidelines, the interest earned would be maximised. Investment activity would follow the specific approach included within the Treasury Management strategy report. The use of such surpluses to fund the borrowing requirement, on a temporary basis, would continue where appropriate.

3.6 Performance

Performance on the various elements within the adopted treasury management strategy during 2012/13 (see 3.5) is set out below:

- *Overall borrowing strategy*
  In 2012/13, surplus cash continued to be used to suppress the need for new borrowing, because of the margins between long-term borrowing costs and short-term investment returns. This strategy, which commenced in 2010/11, continues to generate significant revenue savings.

- *New borrowing*
  There was no new long-term borrowing raised in 2012/13, other than the specific PWLB loan to finance the development of the Nottingham Express Tram (NET) scheme network, detailed below.

- *NET loan*
  The NET Phase 2 scheme includes a large capital payment by the Council to the developer on construction completion, to be funded from prudential borrowing. (Future interest and principal costs from that borrowing will be met from Private Finance Initiative (PFI) grant and Workplace Parking Levy income streams). With long-term interest rates at a very low level during 2012/13, the opportunity to raise this borrowing in advance of need was taken, with £100m being raised from the PWLB in November and December 2012, at an average rate of 2.702%.

- *Other repayments / rescheduling*
  Opportunities to reschedule existing debt remained very limited during the year, as a result of continuing low rates of interest across all periods.

- *Investments*
  Investments of surplus cash, generated from a combination of core cash, short-term surpluses and various reserves and provisions, were made with approved counterparties throughout the year, in line with the strategy approved by Council in March 2013.

  The counterparty list is based on the approved financial institution achieving a minimum specified credit rating, with the lowest rating from the three rating agencies being applied. Other factors, such as share prices, Credit Default Swap rates, sovereign credit ratings and support mechanisms and market sentiment are also considered. Monitoring of all these elements is carried out by the Council and by its advisors each day.

- *overall investment performance*
  The average sum formally invested during the year was £174m, earning total interest of £1.345m at an average rate of 0.778%. The investment portfolio was inflated by the £100m advance borrowing raised for NET Phase 2 during the year (see *NET loan* above). The effect of this additional investment sum, and the sharp fall in short-term interest rates following the Government's Funding for Lending scheme, meant that the average return for 2012/13 fell below the original estimate of 1.10%.

  The Council benchmarks its average return against the 7-day London Inter-bank (LIBID) rate provided by the Bank of England. For 2012/13, the average LIBID rate was 0.487%.

- *Icelandic bank deposits*

  In October 2008, the Icelandic banking system failed, resulting in the collapse of its four major banks. At that time, the Council had a total of £41.6m deposited with three of those banks - Glitnir, Landsbanki and Heritable. The administration process to enable repayments to be made to the banks' various creditors has continued throughout 2012/13, with further instalments being received at regular intervals.

  The repayment position at 31 March 2013, and the final expected recovery levels, based on the latest reports from the various bank administrators, are shown in **Table 3**:

TABLE 3: ICELANDIC BANK DEPOSITS			
Bank	**Deposit**	**Recovery To 31/3/13**	**Final Est. Recovery**
	£m	**%**	**%**
Glitnir	11.0	77	100
Landsbanki	15.0	47	100
Heritable	15.6	79	88
TOTAL	**41.6**		

  In cash terms, the Council had recovered a total of £27.8m of its original deposits, plus a further £1.1m in interest at 31 March 2013. Based on the final estimated percentage returns in **Table 3** above, the total final principal sum recovered will be £39.7m plus £1.6m interest, although the final repayment is not currently scheduled to be received until 2018. Full provision for the financial loss (impairment) associated with these deposits was made in 2010/11, from the Treasury Management Reserve.

  Accounting regulations require notional accrued interest in respect of the outstanding principal sums to be credited to the revenue account each year, together with any changes in the impairment calculation, until the recovery process is complete. These sums are then transferred to the Treasury Management Reserve to offset the original gross impairment provision (see **Table 4** below).

- *daily cash management*

To avoid bank overdraft charges and maximise interest earned, the Council seeks to maintain an overnight cash balance between - £300k and + £150k. The target for 2011/12 was 99%, with an actual rate of 98.83% being achieved.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

Options for management of the Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

5 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

5.1 General Fund Revenue Implications

Revenue costs associated with borrowing and lending can be volatile, being affected by a number of factors including movements in interest rates, the timing of capital spending, the extent of reserves held and actual cash flows during the year.

Total treasury management-related costs in 2012/13, comprising interest charges less receipts, plus provisions for repayment of debt, were £57.449m. A proportion of the Council's debt relates to capital expenditure on council housing and £12.385m of these costs was charged to the Housing Revenue Account (HRA). The remaining costs, £45.064m ware included within the treasury management section of the General Fund corporate budget.

Accrued notional interest and changes in the impairment charge in respect of Icelandic deposits produced a credit to the revenue account of £0.617m in 2012/13. The transfer of this sum to the Treasury Management Reserve (see **3.6** above), along with a further transfer of £1.726m in respect of revenue savings in the year leaves a net General Fund charge in 2012/13 of £46.790m, equal to the revised estimate for the year.

The final General Fund position for 2012/13 is summarised in **Table 4:**

TABLE 4: GENERAL FUND TREASURY MANAGEMENT COSTS 2012/13			
DESCRIPTION	**ORIGINAL BUDGET 2012/13 £m**	**REVISED BUDGET 2012/13 £m**	**OUTTURN 2012/13 £m**
External interest	30.277	30.755	29.079
Debt repayment provision	31.426	30.511	30.157
Prudential borrowing recharge	(0.562)	(0.504)	(0.565)
Investment interest	(1.350)	(1.040)	(1.060)
Other interest	(0.151)	(0.151)	(0.162)
Gross Treasury Management costs	**59.640**	**59.571**	**57.449**
Less: HRA interest element	(12.781)	(12.781)	(12.385)
Net Treasury Management costs	**46.859**	**46.790**	**45.064**
Icelandic bank impairment – change in year	-	-	(0.617)
General Fund expenditure	**46.859**	**46.790**	**44.447**
Treasury Management Reserve transfer – Icelandic banks impairment change in year	-	-	0.617
Treasury Management Reserve transfer – revenue savings	-	-	1.726
NET GENERAL FUND POSITION	**46.859**	**46.790**	**46.790**

5.2 Treasury Management Reserve

The Treasury Management Reserve is maintained to smooth the impact of any volatility in treasury management revenue charges in any one year. The balance on the Reserve at 31 March 2013 is £6.002m.

5.3 Value for Money

Management of borrowing and investments is undertaken in conjunction with our appointed advisors, with the aim of minimising net revenue costs, maintaining an even debt maturity profile and ensuring the security and liquidity of investments.

6 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS AND CRIME AND DISORDER ACT IMPLICATIONS)

Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

The key Strategic Risk relating to treasury management is SR17 ‘Failure to protect the Council’s investments’. The rating for this risk at 31 March 2013 was 4.57 (Likelihood = unlikely, Impact = moderate) which represents a reduction from a rating of 5.30 at 1 April 2012.

7 EQUALITY IMPACT ASSESSMENT (HAS AN EQUALITY IMPACT ASSESSMENT BEEN CARRIED OUT?)

Has the equality impact been assessed?

(a)	not needed (report does not contain proposals for new or changing policies, services or functions, financial decisions or decisions about implementation of policies development outside the Council)	ε
(b)	No	☐
(c)	Yes – Equality Impact Assessment attached	☐

8 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

Final ledgers, working papers 2012/13.

9 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

CIPFA statistics, LIBID rates 2012/13

PRUDENTIAL INDICATORS

Appendix 1

INDICATORS	2011/12 Actual	2012/13 Estimate	2012/13 Actual	Within Limits?
1) Prudence indicators **i) Capital Expenditure**				
General Fund	£ 347.5m	£ 92.3m	£ 78.9m	YES
HRA	£ 58.0m	£ 50.7m	£ 44.2m	YES
	£ 405.5m	**£ 143.0m**	**£123.1m**	
ii) CFR at 31 March General Fund	£ 552.4m	£ 605.7m	£ 553.0m	YES
HRA	£ 284.3m	£ 283.3m	£ 283.3m	YES
PFI notional 'debt'	£ 59.1m	£ 248.4m	£ 65.8m	N/A
	£ 895.8m	**£ 1,137.4m**	**£ 902.1m**	
iii) External Debt at 31 March Borrowing	£ 755.0m	£ 794.9m	£ 776.7m	YES
PFI & leasing notional 'debt'	£ 59.1m	£ 248.4m	£ 65.8m	N/A
Gross debt	**£ 814.1m**	**£ 1,043.3m**	**£ 842.5m**	
Less investments	£ (166.3)m	£ (166.0)m	£ (217.0)m	N/A
Net Debt	**£ 645.4m**	**£ 877.3m**	**£ 625.5m**	
2) Affordability indicators **i) Financing costs ratio**				
General Fund	9.81%	13.68%	14.61%	YES
HRA	12.77%	14.63%	13.35%	YES
Council Tax Band D (per annum)	-	+ £3.67	+ £1.10	YES
HRA rent (per week)	-	+ £0.55	+ £0.56	YES
	Max in year		**Max in year**	
iii) Authorised limit for external debt	£823.4m	£1,198.3m	£882.0m	YES
iv) Operational limit for ext. debt	£823.4m	£1,158.3m	£882.0m	YES
3) Treasury Management indicators	**@ 31/3/12**	%	**@ 31/3/13**	
ii) Limit on variable interest rates	9.99%	0-50%	6.99%	YES
iii) Limit on fixed interest rates	90.01%	50-100%	93.01%	YES
iv) Fixed Debt maturity structure				
- Under 12 months	15.65%	0-25%	9.82%	YES
- 12 months to 2 years	4.30%	0-25%	1.80%	YES
- 2 to 5 years	4.30%	0-25%	5.99%	YES
- 5 to 10 years	16.17%	0-25%	19.67%	YES
- 10 to 25 years	30.40%	0-50%	35.54%	YES
- 25 to 40 years	11.10%	0-25%	16.41%	YES
- 40 years and above	18.08%	0-75%	10.77%	YES
	Max in year		**Max in year**	
v) Max sum invested for >364 days	£28.2m	£60m	£17.0m	YES