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| **CLACKMANNANSHIRE COUNCIL** | **THIS PAPER RELATES TO ITEM 13**<br>**ON THE AGENDA** |

**Report to** **Council**

**Date:** **27th June 2013**

**Subject:** **Annual Treasury Report 2012/13**

**Report by:** **Accountancy Manager**

## 1.0 Purpose

1.1. The purpose of this report is to detail the Treasury Management activities for the Council for 2012/13.

## 2.0 Recommendations

2.1. It is recommended that the Council note and consider the Annual Report 2012/13 of the Council's Treasury Management activities.

## 3.0 Considerations

### 3.1. Background

3.2. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Council be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This annual report therefore ensures the Council is implementing best practice in accordance with the Code.

3.3 The report covers the following:

- Economic background
- Interest rate forecast
- Annual Investment Strategy
- New borrowing
- Debt Rescheduling
- Compliance with Treasury and Prudential Limits

**3.4 Brief Economic Update**

3.5 The Bank of England February Inflation Report downgraded its forecasts for growth and pushed back the timing of economic recovery. In addition, it also raised its forecasts for inflation (peaking at 3.2% in Q3 this year) and pushed back the timing of when inflation would fall back to the 2% target rate by eighteen months, to Q1 2016. The Bank has, therefore, continued its trend of correcting it's repeated over optimism on the speed and strength of recovery and it is now forecasting growth reaching about 1.9% in two years time.

3.6 In both the Chancellor's Autumn Statement, and then his March budget, he again extended the timetable for reducing the annual budget deficit and total outstanding debt due to weak growth depressing tax revenues and increasing benefit payments. The one slightly more optimistic area has been the housing market, as the Funding for Lending Scheme looks to be having a positive effect in improving the supply of credit via mortgages.

3.7 Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during 2013/14 as investor fears and confidence, ebb and flow, between favouring more risky assets i.e., equities, and safer bonds. Equity prices have staged an ongoing rise since mid 2012. Correspondingly, there had been a trend of a fall in bond prices and a rise in bond yields, until the Cyprus crisis reversed this trend in late February. Key areas of uncertainty include:

- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- Failure of Italian political parties to form a viable coalition after the general election due to the blocking vote of the Five Star anti-austerity party, which has refused co-operation with any major party.
- The impact of the Eurozone crisis on financial markets and the banking sector.
- Monetary policy action failing to stimulate growth in western economies.
- The impact of the UK Government's austerity plan on confidence and growth.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and recovery of economic growth.
- the potential for weak growth or recession in the UK's main trading partners - the EU and US

3.8 The overall balance of risks to economic recovery in the UK remains weighted to the downside. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. However, near-term, the prospect of further QE is likely to keep gilt yields lower than they would otherwise be. However, any concerns that central banks are getting to the point where they are likely to view the beneficial effects of further QE as being exhausted, could lead to the reversal of this effect.

3.9 Given the weak outlook for economic growth, Sector sees the prospects for any increase in Bank Rate before 2015 as very limited indeed, and the first increase could be even further delayed if growth disappoints.

**3.10 Interest Rate Forecast**

3.11 The Council's treasury advisor, Sector, provides the following forecast:

| | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 |
|---|---|---|---|---|---|---|---|---|
| **Bank rate** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.75% |
| **5yr PWLB rate** | 1.80% | 1.80% | 1.80% | 1.90% | 2.00% | 2.10% | 2.20% | 2.40% |
| **10yr PWLB rate** | 2.90% | 2.90% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.50% |
| **25yr PWLB rate** | 4.10% | 4.10% | 4.10% | 4.20% | 4.20% | 4.30% | 4.40% | 4.60% |
| **50yr PWLB rate** | 4.20% | 4.20% | 4.20% | 4.40% | 4.40% | 4.50% | 4.60% | 4.70% |

3.12 Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in February 2013. Sector has left unchanged its forecast for the first increase in Bank Rate to be in March 2015. However, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. The rise in equity prices has, conversely, resulted in a selloff in bonds and some diminution of the UK as a safe haven from more risky assets. However, towards the end of March, the Cyprus crisis has partially reversed these general trends.

**3.13 Annual Investment Strategy**

3.14 The Treasury Management Strategy Statement (TMSS) for 2012/13, which includes the Annual Investment Strategy, was approved by the Council on 28th June 2012. It can be confirmed that the approved limits within the Annual Investment Strategy were not breached during the year ended 31st March 2013.

3.15 Investment rates available in the market have continued at historically low levels and have fallen further during the quarter as a result of the Funding for Lending Scheme. However, the existing preferential rate secured with its current bankers has protected the Council from these low rates. The average level of funds available for investment purposes during the year was £28m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of payments, receipt of grants and progress on the Capital Programme. The Council holds £16m core cash balances for investment purposes (i.e. funds available for more than one year). **Appendix 2** provides details of our investments as at 31 March 2013.

3.16 The benchmark investment returns over the last quarter of the 2012/13 financial year are illustrated in the undernoted table:

| Benchmark | Benchmark Return |
|---|---|
| 7 day | 0.36% |
| 1 month | 0.37% |
| 3 month | 0.38% |
| 6 month | 0.51% |
| 12 month | 0.83% |

The Council achieved an actual investment return of 1.84% in the year, outperforming the benchmark by between 1.00% and 1.47%. The Council's budgeted investment return for 2012/13 was £195k, and performance for the year outturned £209k above budget.

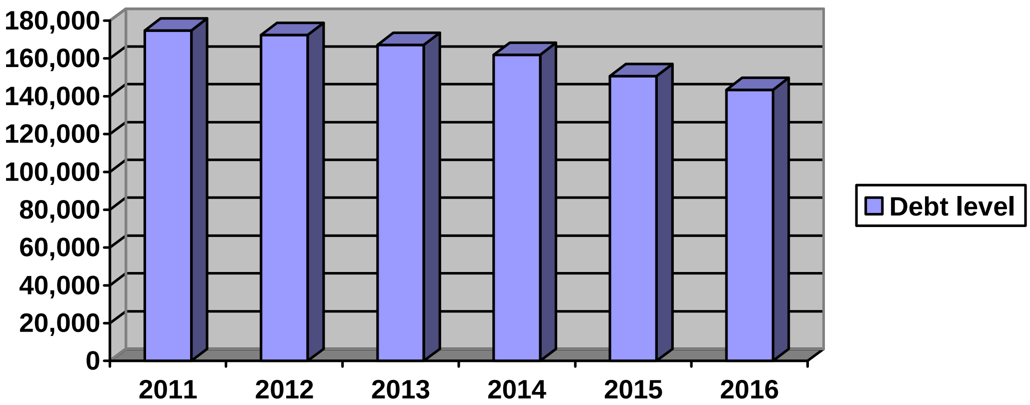
### 3.17 New Borrowing

3.18 No new borrowing was undertaken during the year, and in line with our borrowing strategy the Council had reduced its overall debt liability by repaying £4m of external debt and £1.2m toward finance lease repayment.

3.19 The Council's external borrowing position as at 31 March 2013 is illustrated in the undernoted table:

| | March 2012 £000 | March 2013 £000 |
|---|---|---|
| Public Works Loan Board | 99,703 | 95,702 |
| Market Loans | 24,029 | 24,024 |
| Other long term liabilities | 48,706 | 47,476 |
| **Total** | **172,438** | **167,202** |

3.20 This continues a trend in reducing the Council's overall level of borrowing in line with our Treasury strategy. This is illustrated in the following chart, demonstrating actual and forecast level of debt up to 2015/16. This assumes that there is no replacement borrowing in the current and next two years due to the capacity to repay these sums from cash investment balances. This strategy would be reviewed if there were significant changes in interest rates over this period.




*Borrowing in advance of need*

3.21 The Council has not borrowed in advance of need during 2012/13 and has no intention to borrow in advance in 2013/14.

**3.22 Debt Rescheduling**

3.23 Debt rescheduling opportunities have been limited in the current economic climate and structure of interest rates following increases in PWLB new borrowing rates in October 2010. Consequently no debt rescheduling was undertaken during the year.

**3.24 Compliance with Treasury and Prudential Limits**

3.25 It is a statutory duty for the Council to determine and keep under review the affordable capital expenditure limits. The Council's Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement.

3.26 During the financial year the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in **appendix 1.**

**4.0 Conclusions**

4.1 No additional borrowing has been undertaken in 2012/13

4.2 The Council's strategy to reduce external debt has delivered a reduction of £5.2 over the last 12 months.

4.3 The Council continues to outperform the benchmark return in interest on investments and cash balances remain strong at a level of c£30m which contributes to supporting the Council's capital financing requirement internally.

**5.0 Sustainability Implications**

5.1 None

## 6.0 Resource Implications

*6.1 Financial Details*

6.2 The full financial implications of the recommendations are set out in the report. This includes a reference to full life cycle costs where appropriate.

Yes ☑

6.3 Finance have been consulted and have agreed the financial implications as set out in the report.

Yes ☐

*6.4 Staffing*

6.5 None

## 7.0 Exempt Reports

**7.1 Is this report exempt? Yes ☐ (please detail the reasons for exemption below)**
**No ☑**

## 8.0 Declarations

The recommendations contained within this report support or implement our Corporate Priorities and Council Policies.

(1) **Our Priorities** (Please tick ☑)

| | |
|---|---|
| The area has a positive image and attracts people and businesses | ☐ |
| Our communities are more cohesive and inclusive | ☐ |
| People are better skilled, trained and ready for learning and employment | ☐ |
| Our communities are safer | ☐ |
| Vulnerable people and families are supported | ☐ |
| Substance misuse and its effects are reduced | ☐ |
| Health is improving and health inequalities are reducing | ☐ |
| The environment is protected and enhanced for all | ☐ |
| The Council is effective, efficient and recognised for excellence | ☑ |

**(2) Council Policies** (Please detail)

Treasury Management Policy Statement and Practices

## 9.0 Equalities Impact

9.1 Have you undertaken the required equalities impact assessment to ensure that no groups are adversely affected by the recommendations?

Yes ☐ No ☐

## 10.0 Legality

10.1 In adopting the recommendations contained in this report, the Council is acting within its legal powers. Yes ☑

## 11.0 Appendices

11.1 Please list any appendices attached to this report. If there are no appendices, please state "none".

Appendix 1 - Prudential and Treasury Indicators as at 31st March 2013

Appendix 2 - Investment portfolio as at 31st March 2013

## 12.0 Background Papers

12.1 Have you used other documents to compile your report? (All documents must be kept available by the author for public inspection for four years from the date of meeting at which the report is considered)

Yes ☑ (please list the documents below) No ☐

**Treasury Management Strategy 2012/13 - report to Council June 2012**

**Author(s)**

| NAME | DESIGNATION | TEL NO / EXTENSION |
|---|---|---|
| Martin Dunsmore | Accountancy Manager | 2041 |

**Approved by**

| NAME | DESIGNATION | SIGNATURE |
|---|---|---|
| Nikki Bridle | Director of Finance and Corporate Services | Signed: E Bridle |
| Elaine McPherson | Chief Executive | Signed: E McPherson |

# APPENDIX 1: Prudential and Treasury Indicators as at 31st March 2013

| Treasury Indicators | 2012/13 Budget £'000 | 2012/13 Actual £'000 |
|---|---|---|
| Authorised limit for external debt | 193,000 | 193,000 |
| Operational boundary for external debt | 172,000 | 172,000 |
| Gross external debt | 172,000 | 167,202 |
| Investments | 26,000 | 30,653 |
| Net borrowing | 146,000 | 136,549 |

| | | |
|---|---|---|
| Maturity structure of fixed rate borrowing - upper and lower limits | | |
| Under 12 months | 5,200 | 5,228 |
| 12 months to 2 years | 11,200 | 11,229 |
| 2 years to 5 years | 15,800 | 15,887 |
| 5 years to 10 years | 11,400 | 11,559 |
| 10 years and above | 128,400 | 123,299 |

| Prudential Indicators | 2012/13 Budget £'000 | 2012/13 Actual £'000 |
|---|---|---|
| Capital expenditure - General Fund Services | 8,556 | 6,637 |
| Capital expenditure - Housing Revenue Account | 8,661 | 9,749 |
| Capital Financing Requirement (CFR) - General Fund | 89,551 | 82,631 |
| Capital Financing Requirement (CFR) - HRA | 33,771 | 32,681 |
| Annual change in CFR - General Fund | (361) | (5,523) |
| Annual change in CFR - HRA | 2,977 | 1,817 |
| In year borrowing requirement | 2,616 | (3,706) |
| Ratio of financing costs to net revenue stream - General Fund | 7.94% | 7.75% |
| Ratio of financing costs to net revenue stream - HRA | 18.50% | 18.01% |

# APPENDIX 2: Investment portfolio as at 31st March 2013

Current Investment List

| Borrower | Principal (£) | Interest Rate | Start date | Maturity date | Lowest long term rating | Historic Risk of Default |
|---|---|---|---|---|---|---|
| Clydesdale Bank | 4,190 | 0.75% | | Call | BBB+ | 0.000% |
| Santander UK Plc | 7,416 | 0.80% | | Call | A | 0.000% |
| Bank of Scotland Plc | 19,556,072 | 1.50% | | Call | A | 0.000% |
| Bank of Scotland Plc | 47,439 | 0.51% | | Call07 | A | 0.002% |
| The Royal Bank of Scotland Plc | 5,000,000 | 2.25% | 22/05/12 | 22/05/13 | A- | 0.013% |
| Bank of Scotland Plc | 5,000,000 | 2.80% | 03/10/12 | 04/10/13 | A | 0.048% |
| **Total Investments** | **29,615,117** | **1.84%** | | | | 0.010% |