Subject:	Annual Report on Treasury Management Activities for 2012/13
Committee:	Audit Committee
Date:	13th June 2013
Cabinet Member:	Councillor Lowry
CMT Member:	Adam Broome (Director for Corporate Services)
Author:	Andrew Liddicott (Senior Accountant)
Contact:	Tel: (01752) (30)7873 e-mail: andrew.liddicott@plymouth.gov.uk
Ref:	Acct/AL
Key Decision	No
Part:	I

Purpose of the report:

In order to comply with the Code of Practice for Treasury Management, the Council is required to formally report on its treasury management activities for the year, providing information on the progress and outcomes against the Treasury Management Strategy. This report covers the treasury management activities for financial year 2012/13 including the final position on the statutory Prudential Indicators.

In line with the recommendations in the Code of Practice, this report is submitted to Audit Committee as the committee responsible for scrutiny of the treasury management function.

This report is required to be submitted to Full Council.

Corporate Plan 2012-2015:

Treasury management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Into the medium and longer term the Council is facing significant pressures due to the national economic situation, which has led to a reduction in resources for local authorities over the Government's latest spending period. Effective treasury management will be essential in ensuring the Council's cash flows are used to effectively support the challenges ahead.

Other Implications: e.g. Child Poverty, Community Safety, Health and Safety, Risk Management, Equality, Diversity and Community Cohesion:

There is an inherent risk to any treasury management activity. The Council continues to manage this risk by ensuring all investments are undertaken in accordance with the approved investment strategy, and keeping the counterparty list under constant review.

Recommendations & Reasons for recommended action:

1. Audit Committee note the Treasury Management annual report for 2012/13.

2. The report be referred to Full Council as required by the CIPFA Treasury Management Code of Practice (TMP note 6).

Alternative options considered and reasons for recommended action:

None - it is requirement to report to Council on the treasury management activities for the year.

Background papers:

- Treasury Management Strategy report to Audit Committee 27 January 2012
- 2012/13 Budget Papers – presented to Full Council 27 February 2012
- Mid Year Review report to Audit Committee 13 December 2012
- Financial Outturn report for 2012/13 to Cabinet 21 May 2013

Sign off:

Fin	DJN1314.07	Leg/ Dem& Gov	LT17639310513	HR	n/a	Corp Prop	n/a	IT	n/a	Strat Proc	n/a
Originating SMT Member: Malcolm Coe											
Has the Cabinet Member(s) agreed the content of the report? Yes											

Annual Report on Treasury Management Activities for 2012/13

1. Introduction

1.1 Treasury management in Local Government is underpinned by the CIPFA Code of Practice on Treasury Management in the Public Services (The Code) and in this context is "*the management of the Council's investments and cash flows, its banking, money market and its capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks*".

1.2 The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and, as a minimum, formally report on their treasury activities and arrangements to Full Council at least twice a year-mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

1.3 This report outlines the treasury management activities in 2012/13, providing information on progress and outcomes against the approved strategy, and builds on the mid year report presented to Audit Committee on 13th December 2012 and Full Council on 28th January 2013.

1.4 The responsibility for implementing and monitoring Treasury Management Policies and Practices and for the execution and administration of treasury management decisions is delegated by the Council to its Section 151 Officer – the Director for Corporate Services, and is overseen by a Treasury Management Board consisting of senior officers within Finance, Efficiencies, Technology and Assets.

1.5 The day to day operation of the treasury management activity is carried out in accordance with detailed Treasury Management Practices (TMP's). These are required to be updated annually. The TMP's applicable to 2012/13 were approved by Audit Committee at its meeting of 21st June 2012.

1.6 The Council works closely with its treasury management advisers Arlingclose who assist the Council in formulating views on interest rates when determining the Treasury Management Strategy, providing regular updates on economic conditions and interest rate expectations and advice on specific borrowing and investment decisions.

1.7 This report:

a) is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions for the year 2012/13;
c) provides an update on the risk inherent in the portfolio and outlines actions taken by the authority during the year to minimise risk;
d) gives details of the outturn position on treasury management transactions in 2012/13;
e) confirms compliance with treasury limits and Prudential Indicators (PI's) and outlines the final position on the PI's for the year.

1.8 In accordance with TMP note 6, the report is required to be presented to Full Council.

2. The Economy and Events in 2012/13

2.1 Before reviewing the Council's performance for the year it is appropriate to outline the national and economic background within which council officers operated during 2012/13:

The global outlook stabilised mainly due to central banks maintaining low interest rates and expansionary monetary policy for an extended period. Equity market assets recovered sharply with the FTSE 100 registering a 9.1% increase over the year. This was despite economic growth in G-7 nations being either muted or disappointing.

In the UK the economy shrank in the first, second and fourth quarters of the calendar year 2012. It was the impressive 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012. The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy. Avoiding a 'triple-dip' recession became contingent on upbeat services sector surveys translating into sufficient economic activity to overhaul contractions in the struggling manufacturing and construction sectors.

Household financial conditions and purchasing power were constrained as wage growth remained subdued at 1.2% and was outstripped by inflation. Annual CPI dipped below 3%, falling to 2.4% in June before ticking up to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.

The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases (QE) in July, taking total QE to £375 billion. The possibility of a rate cut was discussed at some of the Bank's Monetary Policy Committee meetings, but was not implemented as the potential drawbacks outweighed the benefits of a reduction in the Bank Rate. In the March Budget the Bank's policy was revised to include the 2% CPI inflation remit alongside the flexibility to commit to intermediate targets.

The resilience of the labour market, with the ILO unemployment rate falling to 7.8%, was the main surprise given the challenging economic backdrop. Many of the gains in employment were through an increase in self-employment and part time working.

The Chancellor largely stuck to his fiscal plans with the austerity drive extending into 2018. In March the Office for Budgetary Responsibility (OBR) halved its forecast growth in 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The government is now expected to borrow an additional £146bn and sees gross debt rising above 100% of GDP by 2015-16. The fall in debt as a percentage of GDP, which the coalition had targeted for 2015-16, was pushed two years beyond this horizon. With the national debt metrics out of kilter with a triple-A rating, it was not surprising that the UK's sovereign rating was downgraded by Moody's to

Aa1. The AAA status was maintained by Fitch and S&P, albeit with a Rating Watch Negative and with a Negative Outlook respectively.

The government's Funding for Lending (FLS) initiative commenced in August which gave banks access to cheaper funding on the basis that it would then result in them passing this advantage to the wider economy. There was an improvement in the flow of credit to mortgagees, but was still below expectation for SMEs.

The big four banks in the UK – Barclays, RBS, Lloyds and HSBC – and several other global institutions including JP Morgan, Citibank, Rabobank, UBS, Credit Suisse and Deutsche came under investigation in the Libor rigging scandal which led to fines by and settlements with UK and US regulators. Banks' share prices recovered after the initial setback when the news first hit the headlines.

Europe: The Euro region suffered a further period of stress when Italian and Spanish government borrowing costs rose sharply and Spain was also forced to officially seek a bailout for its domestic banks. Markets were becalmed after the ECB's declaration that it would do whatever it takes to stabilise the Eurozone and the central bank's announcement in September of its Outright Monetary Transactions (OMT) facility, buying time for the necessary fiscal adjustments required. Neither the Italian elections which resulted in political gridlock nor the poorly-managed bailout of Cyprus which necessitated 'bailing-in' non-guaranteed depositors proved sufficient for a market downturn. Growth was hindered by the rebalancing processes under way in Euroland economies, most of which contracted in Q4 2012.

US: The US Federal Reserve extended quantitative easing through 'Operation Twist', in which it buys longer-dated bonds with the proceeds of shorter-dated US Treasuries. The Federal Reserve shifted policy to focus on the jobless rate with a pledge to keep rates low until unemployment falls below 6.5%. The country's extended fiscal and debt ceiling negotiations remained unresolved.

Gilt Yields and Money Market Rates: Gilt yields ended the year lower than the start in April. By September the 2-year gilt yield had fallen to 0.06%, raising the prospect that short-dated yields could turn negative. 10-year yields fell by nearly 0.5% ending the year at 1.72%. The reduction was less pronounced at the longer end; 30-year yields ended the year at 3.11%, around 25bp lower than in April. Despite the likelihood the DMO would revise up its gilt issuance for 2012/13, there were several gilt-supportive factors: the Bank of England's continued purchases of gilts under an extended QE programme; purchases by banks, insurance companies and pension funds driven by capital requirements and the preference for safe harbour government bonds.

One direct consequence of the Funding for Lending Scheme was the sharp drop in rates at which banks borrowed from local government. 3-month, 6-month and 12-month Libid rates which were 1%, 1.33% and 1.84% at the beginning of the financial year fell to 0.44%, 0.51% and 0.75% respectively.

Money market data and PWLB rate movements in 2012/13 are attached as Appendix 1 to this report.

3. The Council's Strategy for 2012/13

3.1 The Council's Treasury Management Strategy was approved by Full Council on 27th February 2012. As an overriding principle, the strategy proposed that the Council would continue to minimise risk contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balanced certainty and security, with liquidity and yield. The Council would continue to make use of short-term variable rate borrowing, whilst at the same time seeking to balance its investments across a range of investment instruments.

3.2 The borrowing strategy was to be based on affordability and subject to credit conditions throughout the year. In adverse credit conditions the strategy was to use internal balances to cover any borrowing requirement, enabling the Authority to minimise borrowing costs and reduce overall treasury risk by reducing the level of external investment balances. In improved credit conditions the Director for Corporate Services would consider externalising borrowing using short-term or long-term loans as part of a balanced maturity profile within the approved Prudential Indicators.

Review of the Council's Performance 2012/13

4. Treasury Portfolio

4.1 Table 1 shows the Council's overall Treasury Portfolio at the end of 2012/13 compared to 2011/12.

Table 1

31/3/2012 £m	Average Interest rate %		31/3/2013 £m	Average Interest rate %
		External Borrowing Long-term:		
61.315	5.4001	PWLB	61.315	5.4001
130.000	4.4202	Market	130.000	4.4202
0.083	1.1668	Bonds	0.087	1.0007
15.000	0.2900	Temporary Borrowing	34.800	0.2809
206.398	**4.4098**	**Total PCC Borrowing**	**226.202**	**4.0477**
		Long-term liabilities		
31.017	8.7300	PFI Schemes	30.246	8.7300
2.585	n/a	Finance leases	2.189	n/a
9.510	n/a	Tamar Bridge & Torpoint Ferry	9.156	n/a
43.110		**Total Long term Liabilities**	**41.591**	
249.510		**Total External Debt**	**267.793**	
(83.975)	1.0564	**Total Investments**	**(82.374)**	0.8889
165.535		**Net Borrowing/(Net Investment) Position**	**185.419**	

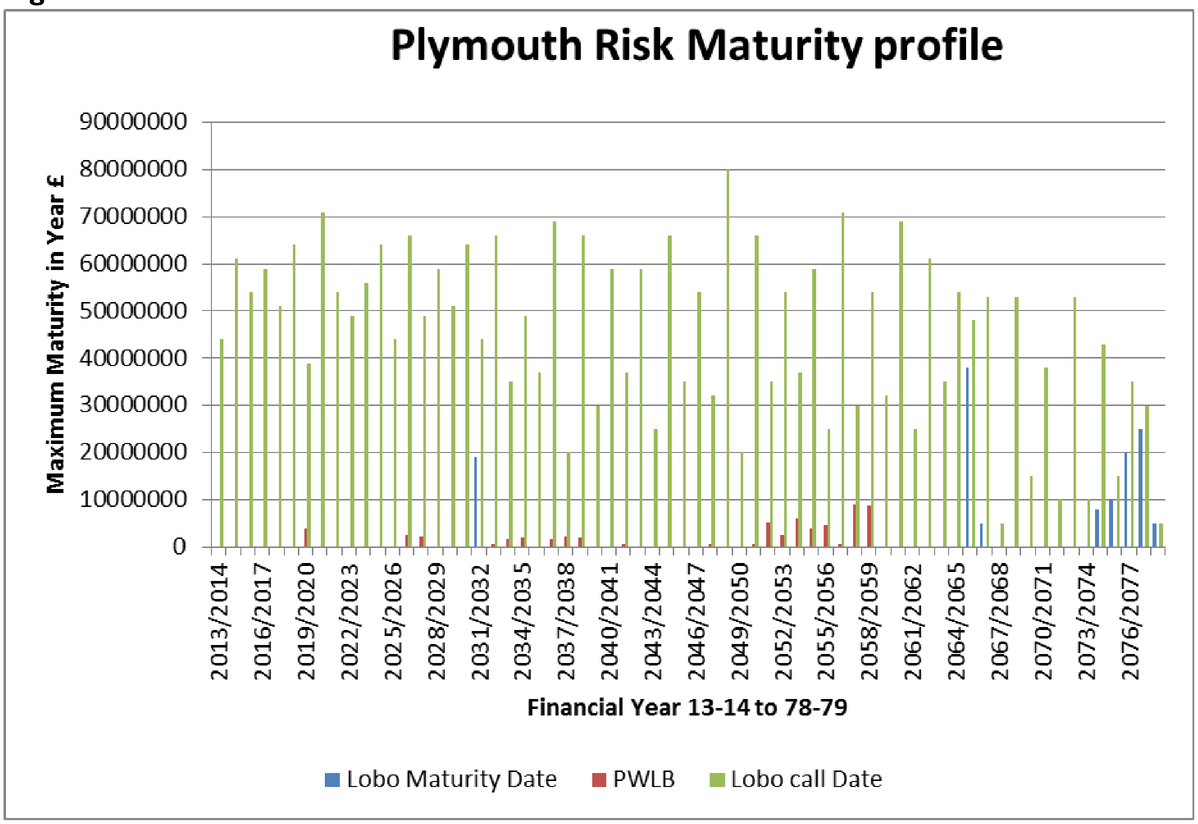
4.2 The total external debt as shown above includes long-term liabilities in respect of PFI schemes or finance leases as these liabilities are seen as a credit arrangement thus increasing the Council's total debt and must be taken into account within the statutory borrowing limits. The Tamar Bridge & Torpoint Ferry balance relates to 50% of the debt on the Joint Committee balance sheet required to be brought onto the Council's balance sheet from 2011-12.

The total investments at 31st March 2012 included £21.49m invested on behalf of the Heart of the South West Local Enterprise Partnership (LEP) in respect of the Growing Places Fund. This balance was transferred to Devon County Council who took over the administration of the Fund on 8th August 2012.

5. Borrowing

5.1 Figure 1 below shows the maturity profile of the long-term debt for the Council as at 31 March 2013.

Figure 1



5.2 The debt portfolio continues to include £130m of LOBO (market) loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed adversely. This is reflected within the maturity profile shown above (in green) to enable officers to risk manage the Council's cashflows. During the year £64m of LOBO loans entered the period where they could have been called, but options were not exercised by the relevant banks.

5.3 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit – This is the statutory limit which should not be breached. This can only be amended with the approval of Full Council.
- The Operational Boundary – This is based on the same estimate as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

5.4 The borrowing limits for 2012/13, originally approved by Council in February 2012, were as follows:

- Authorised Limits £309m
- Operational Boundary £279m

The revised Prudential Indicators, as approved by Council on 25 February 2013, reduced the limits to fall in line with the Council's updated capital programme and reduction in the forecast borrowing requirement. The approved updated limits were as follows:

- Authorised Limits £301m
- Operational Boundary £279m

5.5 The Director for Corporate Services confirms that there were no breaches to the authorised limit during the year. The maximum debt outstanding during 2012/13 was £282.988m on 9th November 2012 (including £41.486m for the PFI, finance lease liabilities and the Tamar Bridge loan). This was within the authorised limit but in excess of the operational boundary due to cashflow requirements. There were other occasions throughout the year where debt was above the operational boundary however by 31st March total debt had fallen to £267.688m (including £41.486m for PFI, finance lease liabilities and the Tamar Bridge loan) well within both of the borrowing limits.

5.6 Table 2 shows the movement in the borrowing portfolio during the year.

Table 2 Movement in Borrowing Portfolio

	Balance on 01/04/12 £000s	Debt Maturing £000s	Debt Repaid £000s	New Borrowing £000s	Balance on 31/03/13 £000s	Increase/ (Decrease) in Borrowing
Short-term Borrowing	15,000	(210,390)		230,190	34,800	19,800
Long-term Borrowing	191,398			5	191,403	5
Total Borrowing	**206,398**	**(210,390)**	**0**	**230,195**	**226,203**	**19.805**

5.7 The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2013 was estimated at £276.552m (including PFI, finance leases and Tamar Bridge & Torpoint Ferry debt).

5.8 New borrowing in year

The use of short-term borrowing has been the most cost effective means of financing capital expenditure and cashflow requirements. Matching short-term borrowing with the availability of liquid deposits held in bank call accounts lowered overall treasury risk by allowing flexibility to reduce debt and investment levels at short notice when credit conditions deteriorated during the year.

At the start of the year the Council had £15m of short-term loans. These are generally taken for periods of one to three months and repaid and replenished with new loans, subject to availability and favourable rates, during the year. At the end of the year the Council had £34.8m of short-term loans.

The average period of new loans taken in the year was for 42.85 days at an average interest rate of 0.2742%. This is below the bank base rate. Short-term loans are generally taken from other local authorities.

5.9 Debt Repayment

There were no loan repayments made in 2012/13. The increase in overall debt is a result of externalising some borrowing to move closer to the Council's overall borrowing requirement as credit conditions improved in the second half of the year.

5.10 Debt Rescheduling

There has been no debt rescheduling in the period due to falling interest rates making the repayment of any PWLB loans more expensive. Officers, along with the Council's advisers Arlingclose will continue to monitor PWLB interest rates looking for opportunities to repay any debt, maximising the savings achieved whilst maintaining a balanced maturity profile.

5.11 Overall Debt Performance for the year

The average interest rate on the Council's borrowing has decreased over the course of the year from 4.4098% to 4.04778%. This rate reflects the position at the end of each financial year (i.e. 31st March 2012 and 2013). The reduction in rates is due to the increase in low rate short-term loans taken in periods maturing beyond the year end. Loan transactions were taken at various times throughout the year at various rates and, taking all transactions in the year, the overall average borrowing rate for 2012/13 was 4.2079% compared with a rate of 3.9652% for 2011/12. This increase is a result of a much lower average of short-term borrowing taken in 2012/13 compared to 2011-12. The reduced borrowing was due to deteriorating credit conditions during 2012/13 resulting from concerns over Eurozone sovereign debt. During these periods short-term loans were not replaced on maturity and investment balances were reduced.

6. Investments

6.1 Figure 2 below shows the actual split of deposits by country/sector as 31st March 2013. Table 4 provides more detail on the actual deposits by counterparty group.

Figure 2

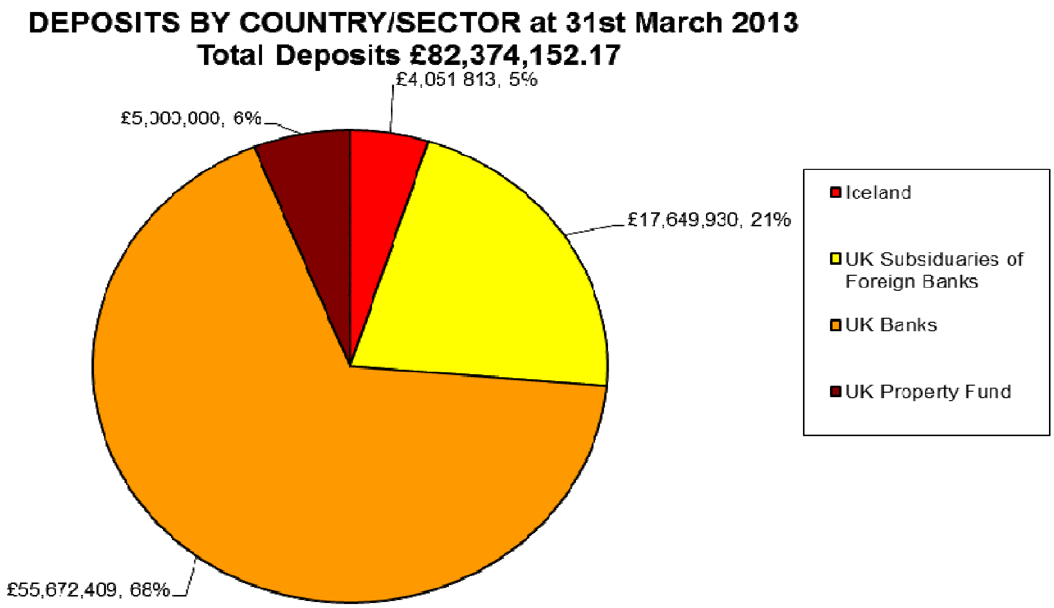


Table 4

Group	Bank/Institution	Total deposits £m
RBS Group	Royal Bank of Scotland	19.022
Lloyds Banking Group	Bank of Scotland	12.650
	Lloyds TSB	5.000
Barclays Banking Group	Barclays	19.000
Banco Santander Group	Santander UK	17.650
Iceland deposits	Landsbanki Island	2.112
	Heritable Bank	0.682
	Glitnir	1.258
Total Deposits @ 31st March 2013		**77.374**
Pooled Investment	CCLA Lamit Property Fund	5.000
Total Investments @ 31st March 2013		**82.374**

6.2 The movement in the investment portfolio during the year was as follows:

Table 5 **Movement in Investment Portfolio**

Investments	Balance on 31/3/12 £000	Investments Made £000	Maturities/ £000	Balance on 31/03/13 £000	Avg Rate % / Avg Life to maturity (days)
Short-term Investments (less than 1 year)	78,975	1,493,270	(1,494,871)	77,374	1.28%/ 11 days
Long-term Investments (over 1 year)	5,000	0	(5,000)	0	
Pooled Funds	0	5,000		5,000	Variable
Total Investments	**83,975**	**1,498,270**	**(1,499,871)**	**82,374**	

6.3 The majority of the short-term deposits were held in call or short-term notice accounts. In line with the Council's approved investment strategy for 2012/13 the following longer term deposits were taken in the year:

Amount	Start Date	End Date	Term (days)	Rate %
£5.0m	24/04/12	24/07/12	91	1.40
£5.0m	20/08/12	20/11/12	92	1.35
£5.0m	17/09/12	17/12/12	91	1.35
£5.0m	15/10/12	07/01/13	84	1.35
£5.0m	06/11/12	07/05/13	182	1.60

6.4 The above deposits have been taken above target rates and increased the return on investments in 2012/13. The maximum approved term for new deposits in 2012/13 was 1 year.

6.5 In line with the Council's approved strategy, to diversify investment away from purely cash deposits, a £5m investment was made in the CCLA Lamit Property Fund on 31st March 2013. This is a pooled investment fund meeting the criteria in SI 2004 No 534 and subsequent amendments. This is an available for sale investment that can be cashed in after 6 months or at any time thereafter. However this is seen as a long-term investment to generate additional income and realise a capital gain for the Council. The performance of this fund will be monitored throughout the year and included in the treasury management mid-year and out-turn reports for 2013/14.

6.6 Managing Investment Risk

6.6.1 The Guidance on Local Government Investments in England gives priority to security and liquidity of investments and the Council's aim is to achieve a yield commensurate with these principles.

6.6.2 Security

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. Investments made during the year were restricted to:

- Deposits with the Debt Management Office.
- Call Accounts and deposits with UK Banks and Building Societies systemically important to the UK banking system.
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.

6.7 Credit Risk

6.7.1 Counterparty credit quality was assessed and monitored with reference to credit ratings; credit default swaps; GDP of the country in which the institutions operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. The minimum long-term counterparty rating determined for the 2012/13 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

6.7.2 In June Moody's downgraded a swathe of banks with global capital market operations, including the UK banks on the Council's lending list. This included Barclays, HSBC, Royal Bank of Scotland/Natwest, Lloyds TSB/Bank of Scotland and Santander UK Plc as well as several non UK banks. However none of the ratings fell below the Council's minimum credit rating threshold.

6.7.3 The Council reacted to changes in credit conditions during the year by changing the maximum maturity limits for deposits with banks and building societies. Between 18th May 2012 and 20th August 2012 £15m was kept on overnight deposit with the Debt Management Office (DMO) and deposits suspended with Santander UK Plc in this period as a reaction to concerns over the Eurozone and global credit conditions.

6.8 Credit Score Analysis

6.8.1 The Council's treasury advisers, Arlingclose, have developed a matrix to score the credit risk of an authority's investment portfolio. The matrix allocates a numerical score based on the credit rating of an institution, with a AAA rated institution scoring 1 and a D rated institution scoring 15. This is then weighted to reflect both the size of the deposit and the maturity term of the deposit. The aim is to achieve an overall score of 7 or lower on both weighted averages to reflect an investment approach based on security. The lower the score the better the security of the deposit.

6.8.2 Table 6 shows the rating currently attached to the Council's portfolio and its movement during the year using this matrix.

Table 6 **Credit Risk Matrix**

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2012	5.48	A+	5.42	A+
30/06/2012	5.10	A+	5.65	A
30/09/2012	5.99	A	6.06	A
31/12/2012	6.01	A	6.01	A
31/03/2013	6.00	A	6.25	A

Note : These scores exclude any deposits with Icelandic banks.

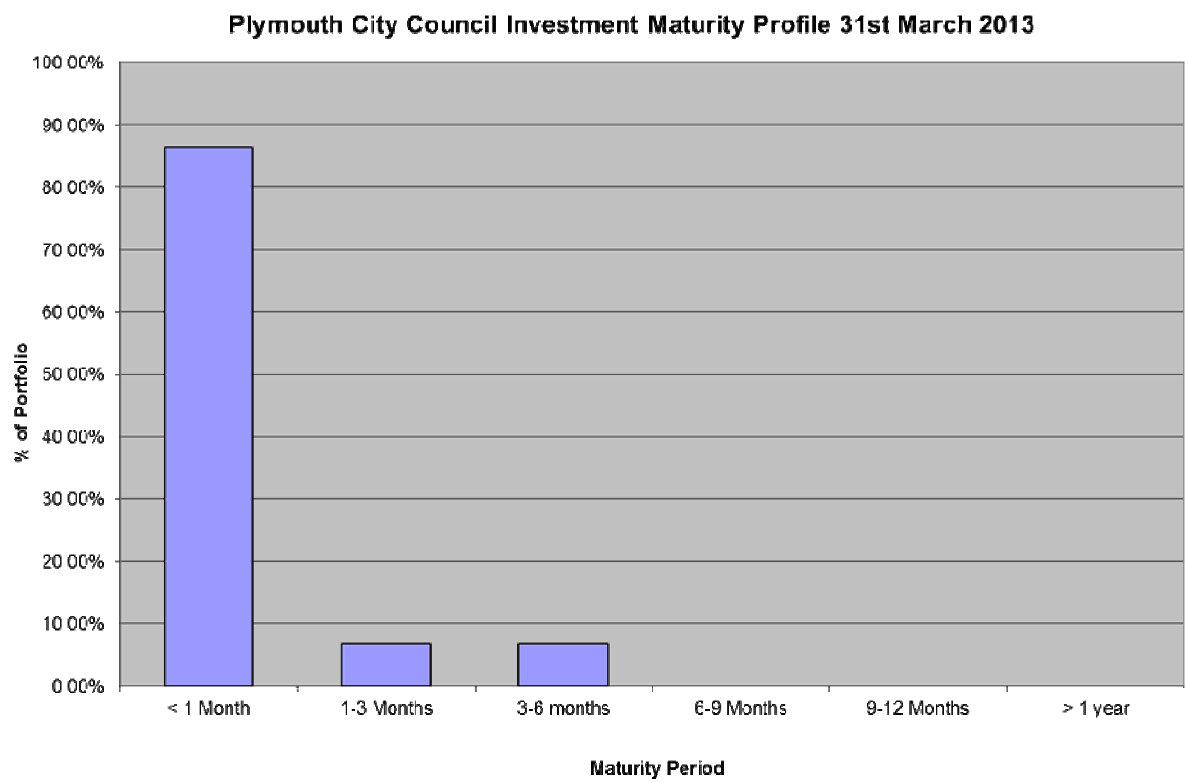
Based on the scoring methodology, the Council's counterparty credit quality has reduced over the course of the year. This is due to the credit rating downgrade of the counterparties used by the Council. All Council deposits in 12-13 have been made with UK banks considered to be systemically important to the UK financial system. Despite the downgrades the credit score has still been maintained below the 7 score set in the Council's Treasury Management Strategy for 2012/13. Council officers are currently in the process of taking alternative investments to reduce the credit score of the Council's investment portfolio.

6.9 Liquidity

6.9.1 In keeping with the CLG's guidance on investments, the Council maintained a sufficient level of liquidity through the use of overnight deposits and the use of call accounts.

6.9.2 The maturity profile of the Councils deposits is represented in figure 3. This shows a large proportion of deposits maturing in less than one month, reflecting the deposits in call accounts giving the liquidity requirement to cover any adverse changes in market conditions. The Treasury Management Board has set a requirement that at least £15m should remain within callable deposits at all times.

Figure 3



6.10 Yield- Investment performance for the year

6.10.1 The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year.

6.10.2 Investments are made short-term to cover cashflow and liquidity requirements and longer-term to maximise and guarantee future income. During 2012/13 the Council invested for a range of periods from overnight to 6 months, dependent on the Council's cash flows, officers' interest rate view, the interest rates on offer and the economic climate/credit risk. The Council's treasury management officers work to a benchmark rate of return, the 7 day London Interbank Bid (LIBID) rate – which is the rate which can be achieved on the London interbank market for cash deposits of 7 days and is regarded as the standard benchmark.

The 7 day rate is calculated on a daily basis and averaged for the year. Table 7 below compares the average return achieved by the in-house team with the benchmark. An average rate of 0.8917% was achieved for new investments in the year against a budget of 0.8%.

Table 7

	Weighted Average Investment	Benchmark Rate %	Actual Return %
Internally Managed:	£99.035m	0.47	0.9456

The table shows that the internal performance exceeded the benchmark for the year, despite the restricted investment counterparty list and the tighter limitations placed on deposits in periods throughout the year.

6.11 Breach of Counterpart Limit with Santander UK Plc

6.11.1 Council officers work within approved counterpart limits. This is set at a maximum of £30m for approved UK banks and building societies, included on the council's lending list, meeting the credit criteria set out in 6.7.1. An error occurred on 14th November when a £0.6m recorded on the Council's cashflow and dealing reconciliations worksheets as being paid to our Barclays call account was paid to Santander. This led to a balance in our Santander call account of £0.6m more than recorded on the cashflow, dealing record and reconciliation sheets. Due to this error, when funds were paid into the Santander call account on certain dates in December and January, the total investment with Santander exceeded £30m. On 20th December the balance reached £30.6m and on 3rd January £30.1m. When discovered following the reconciliation of the Council's Santander account statement on 8th January, the Director of Corporate Services was informed and an immediate withdrawal made to bring the account balance back below £30m.

6.11.2 The Devon Audit Partnership were immediately informed of the breach. The Senior Accountant reviewed working practices and introduced additional controls, improving the check and authorisation process, to ensure all future payments are made to the correct call account and deposits were maintained within approved limits. Audit was requested to review these controls in its annual audit of Treasury Management. They viewed the controls in place to be of a high standard.

6.12 Benchmarking

6.12.1 As outlined above, Arlingclose have developed a set of benchmarking criteria to enable comparisons on investment performance to be made on data provided by all their clients. To compare like with like, the graphs compare our investment performance with other unitary authorities. This is based on data provided to 31st March 2013. The results of the benchmarking are discussed at regular strategy meetings with our advisers. The benchmarking has to be taken in the context of risk appetite and the legacy investments that the Council has in its portfolio.

The graphs used for comparison attached as appendix 2 to this report are:

1. Average rate of investments against average maturity period
2. Average rate of investments against value weighted average credit risk score
3. Average rate of investments against time weighted average credit risk score

7. Icelandic Banks Update

7.1 The latest position on the recoveries of monies invested in the Icelandic banks is as follows:

7.2 <u>Heritable Bank £3m</u>
The Council received further dividends totaling 9.36p in the £ in 2012/13, made up of principal of £0.281m and interest of £0.014m, bringing total dividends paid to 31st March 2013 to 77.28%. This left a balance left to recover of £0.716m.

7.3 <u>Glitnir £6m</u>
No further payments were received in 2012/13. With 79.03% recovered to date this leaves £1.335m left to recover.

7.4 <u>Landsbanki £4m</u>
The Council received further dividends totaling 18.06p in the £ in 2012/13, made up of principal of £0.722m and interest of £0.04m, bringing total dividends paid to 31st March 2013 to 47.19%.

7.5 <u>Impairment of Icelandic bank deposits</u>
In the 2009-10 accounts impairment was calculated based on an estimate of future collections. At this point the impairment of the deposits was calculated as £5,903,956.28. To cover this impairment a capital direction was applied for and agreed to the value of £5.7m. This allowed the Council to capitalise this expenditure and spread the charge to revenue over 20 years. The remaining balance of £203,956.28 was met by a transfer from the internal Icelandic Bank reserve. This reserve had been created to cover Icelandic legal costs and losses on recovery of the Icelandic deposits. Following the receipt of dividends in 2011-12 and the early part of 2012/13 the impairment had been recalculated and reduced by £1,284,162.58 in the 2011/12 accounts to bring the impairment in line with the unrecovered deposits. Additional receipts of £297,985.83 were received in 2012/13 and the impairment reduced accordingly. Any additional receipts prior to the publication of the 2012/13 Statement of Accounts will result in an amendment to these accounts and a further reduction in the impairment.

7.6 <u>Further recoveries</u>
The Council continues to pursue recovery of the outstanding monies through the Icelandic courts in partnership with the LGA. The cost of the continuing external legal advice has been met from the Council's internal reserve set up

for Icelandic bank issues. No costs were incurred in 2012/13 but a fee of £9,845.37 was paid in April 2013.

8. Revenue Implications of Treasury Management

8.1 The expenditure arising from the Council's borrowing and lending accrues to the revenue accounts. This includes interest payable and receivable, the minimum revenue provision (for debt repayment) and premiums and discounts written out to revenue from previous debt rescheduling. Some of the interest receivable is passed onto specific accounts where this interest has accrued from the investment of surplus balances for these services. The balance (net cost) is met by the General Fund. Table 8 below shows the income and expenditure arising from these transactions in 2012/13.

8.2 The net cost of capital financing to the General Fund in 2012/13 reduced by £0.526m from the 2012/13 budget due to a reduction in MRP of £0.09m, reduced treasury management costs of £1.128m and other cost increases of £0.692m. The MRP is a statutory charge to revenue based on the Council's capital expenditure financed from borrowing. The reduction in treasury management costs is due to the use of low rate short-term borrowing, as an alternative to the use of long-term borrowing or internal balances, to fund capital expenditure and a reduction in debt management costs.

Summary of Capital Financing Costs 2012/13

Table 8

	2012/13 Budget £000	2012/13 Outturn £000	Variance £000
External interest payments	9,660	9,198	(462)
External interest received	(503)	(1,074)	(571)
Interest transferred to other accounts	115	52	(63)
Premiums / Discounts written out to Revenue	(189)	(189)	0
Debt Management Expenses	143	111	(32)
Treasury Management Cost	**9,226**	**8,098**	**(1,128)**
Minimum Revenue Provision	7,897	7,807	(90)
Recharges for unsupported borrowing	(4,295)	(3,886)	409
Recovered from trading Accounts	(3,142)	(2,859)	283
Net Cost to General Fund	**9,686**	**9,160**	**(526)**

9. Compliance with Prudential Indicators

Under the arrangements set out in the Prudential Code for Capital Finance in Local Authorities, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the Code, and for establishing a range of Prudential Indicators covering borrowing limits and other treasury management measures. The compliance of borrowing within the Authorised

Limit and Operational Boundary is confirmed in section 5.5 of this report. The Prudential Indicators for 2012/13 were approved by Council on 27th February 2012 and updated on 25th February 2013 as part of the approved Treasury Management strategy for 2013/14. The latest position on the indicators is set out in Appendix 3.

10. External Service Providers

10.1 Arlingclose is appointed as the Council's treasury management adviser. The Council is clear as to the services it expects and is provided under the contract. The service provision is comprehensively documented. The Council paid a sum of £23,000 in 2012/13 for this service.

10.2 The Council is also clear that overall responsibility for treasury management remains with the Council.

11. Training

11.1 CIPFA's revised Code requires the Director for Corporate Services to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

11.2 The CLG's revised investment guidance also recommends that a process is adopted for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

11.3 The Council commissioned a treasury management awareness and training session from external consultants Griffiths Morley and this was delivered on 22nd January 2010. The Council subsequently provided an updated session for Members on 10th January 2011. Additional training was provided to Council Members by Arlingclose in October 2012. The provision of 1 days training is included in the contract with Arlingclose running to 31st December 2014. Member training will be provided on an annual basis.

11.4 The Council continues to keep its training requirement under review.

The average, low and high rates correspond to the rates during the financial year and rather than those in the tables below

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2012		0.50		0.55	0.55	0.61	1.00	1.33	1.84	1.24	1.30	1.59
30/04/2012		0.50		0.50	0.65	0.60	0.99	1.32	1.84	1.35	1.43	1.68
31/05/2012		0.50		0.48	0.65	0.57	0.97	1.30	1.82	1.20	1.20	1.34
30/06/2012		0.50		0.50	0.50	0.55	0.83	1.13	1.65	0.96	0.99	1.25
31/07/2012		0.50		0.50	0.65	0.45	0.63	0.92	1.43	0.76	0.77	1.02
31/08/2012		0.50		0.50	0.52	0.40	0.57	0.81	1.23	0.75	0.78	1.01
30/09/2012		0.50		0.25	0.52	0.40	0.47	0.66	0.95	0.70	0.76	1.00
31/10/2012		0.50		0.25	0.44	0.40	0.44	0.55	0.82	0.69	0.77	1.05
30/11/2012		0.50		0.25	0.30	0.40	0.44	0.54	0.80	0.73	0.80	1.05
31/12/2012		0.50		0.25	0.43	0.40	0.44	0.54	0.80	0.69	0.76	1.00
31/01/2013		0.50		0.42	0.43	0.40	0.44	0.54	0.80	0.73	0.86	1.17
29/02/2013		0.50		0.41	0.42	0.40	0.44	0.54	0.80	0.59	0.69	1.05
31/03/2013		0.50		0.40	0.40	0.40	0.44	0.51	0.75	0.59	0.68	0.97
Minimum		0.50		0.25	0.30	0.40	0.44	0.51	0.75	0.55	0.65	0.90
Average		**0.50**		0.39	0.49	0.45	0.62	0.82	1.19	0.84	0.90	1.17
Maximum		0.50		0.55	0.65	0.61	1.00	1.33	1.84	1.38	1.45	1.72
Spread		--										

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2012	130/12	1.29	2.07	3.25	4.22	4.43	4.46	4.41
30/04/2012	166/12	1.31	2.09	3.15	4.13	4.38	4.42	4.39
31/05/2012	210/12	1.19	1.76	2.74	3.79	4.13	4.19	4.16
29/06/2012	248/12	1.2	1.84	2.83	3.79	4.11	4.19	4.16
31/07/2012	292/12	1.01	1.57	2.58	3.6	3.97	4.07	4.05
31/08/2012	336/12	1.07	1.62	2.61	3.62	4.05	4.14	4.11
28/09/2012	376/12	1.15	1.67	2.64	3.71	4.12	4.2	4.14
28/10/2012	422/12	1.19	1.82	2.82	3.81	4.17	4.25	4.19
30/11/2012	466/12	1.22	1.81	2.74	3.74	4.1	4.16	4.11
31/12/2012	504/12	1.22	1.89	2.83	3.82	4.18	4.25	4.21
31/01/2013	044/13	1.26	2.06	3.1	4.06	4.37	4.43	4.4
28/02/2013	084/13	1.16	1.91	3.04	4.04	4.36	4.43	4.4
28/03/2013	124/13	1.13	1.75	2.84	3.87	4.18	4.25	4.22
	Low	1.01	1.57	2.58	3.60	3.97	4.07	4.05
	Average	1.18	1.84	2.86	3.86	4.20	4.26	4.23
	High	1.31	2.09	3.25	4.22	4.43	4.46	4.41

Table 3: PWLB Repayment Rates - Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2012	130/12	0.18	0.84	2.04	3.08	3.32	3.31	3.24
30/04/2012	166/12	0.20	0.87	1.95	3.00	3.27	3.27	3.22
31/05/2012	210/12	0.07	0.54	1.53	2.64	3.01	3.07	3.04
29/06/2012	248/12	0.07	0.62	1.63	2.64	2.99	3.07	3.04
31/07/2012	292/12	0.02	0.35	1.37	2.44	2.84	2.94	2.92
31/08/2012	336/12	0.02	0.40	1.41	2.47	2.92	3.02	2.99
28/09/2012	376/12	0.03	0.46	1.44	2.55	2.99	3.08	3.02
28/10/2012	422/12	0.07	0.59	1.62	2.66	3.05	3.13	3.07
30/11/2012	466/12	0.10	0.60	1.54	2.59	2.97	3.04	2.98
31/12/2012	504/12	0.10	0.66	1.63	2.67	3.05	3.13	3.09
31/01/2013	044/13	0.14	0.81	1.90	2.91	3.24	3.31	3.27
28/02/2013	084/13	0.04	0.66	1.83	2.89	3.23	3.31	3.27
28/03/2013	124/13	0.02	0.52	1.62	2.72	3.05	3.13	3.10
	Low	0.02	0.30	1.31	2.41	2.81	2.88	2.84
	Average	0.08	0.62	1.67	2.72	3.09	3.16	3.12
	High	0.22	0.92	2.10	3.11	3.42	3.50	3.47

Table 4: PWLB Borrowing Rates – Fixed Rate, EIP Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2012	130/12	-	1.56	1.77	2.14	2.77	3.91	4.38
30/04/2012	166/12	-	1.60	1.81	2.15	2.72	3.81	4.31
31/05/2012	210/12	-	1.37	1.52	1.81	2.33	3.41	4.03
29/06/2012	248/12	-	1.41	1.59	1.89	2.42	3.45	4.01
31/07/2012	292/12	-	1.17	1.33	1.63	2.16	3.23	3.85
31/08/2012	336/12	-	1.22	1.38	1.67	2.20	3.25	3.90
28/09/2012	376/12	-	1.29	1.44	1.72	2.23	3.31	3.99
28/10/2012	422/12	-	1.39	1.56	1.88	2.42	3.46	4.05
30/11/2012	466/12	-	1.41	1.58	1.86	2.36	3.37	3.98
31/12/2012	504/12	-	1.45	1.64	1.94	2.45	3.46	4.06
31/01/2013	044/13	-	1.54	1.76	2.12	2.69	3.73	4.27
28/02/2013	084/13	-	1.39	1.60	1.97	2.59	3.70	4.25
28/03/2013	124/13	-	1.31	1.49	1.81	2.38	3.53	4.08
	Low	-	1.14	1.28	1.57	2.10	3.18	3.81
	Average	**-**	**1.40**	**1.58**	**1.90**	**2.45**	**3.52**	**4.10**
	High	-	1.64	1.85	2.21	2.85	3.94	4.45

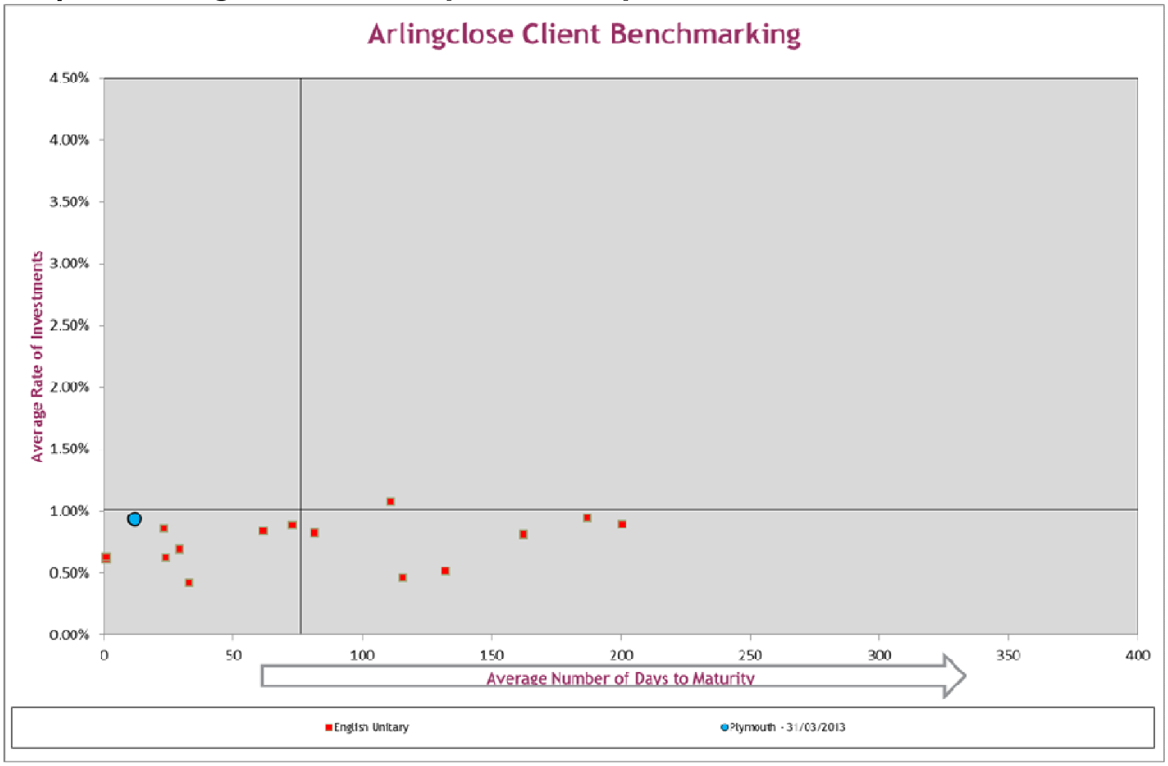
Table 5: PWLB Repayment Rates - Fixed Rate, EIP Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2012	130/12	-	0.40	0.60	0.96	1.60	2.78	3.26
30/04/2012	166/12	-	0.44	0.64	0.98	1.56	2.67	3.20
31/05/2012	210/12	-	0.21	0.36	0.64	1.16	2.27	2.90
29/06/2012	248/12	-	0.25	0.42	0.72	1.25	2.31	2.88
31/07/2012	292/12	-	0.02	0.17	0.45	0.99	2.09	2.72
31/08/2012	336/12	-	0.07	0.21	0.50	1.03	2.10	2.77
28/09/2012	376/12	-	0.14	0.28	0.55	1.06	2.16	2.86
28/10/2012	422/12	-	0.23	0.39	0.70	1.24	2.32	2.93
30/11/2012	466/12	-	0.26	0.41	0.69	1.19	2.23	2.86
31/12/2012	504/12	-	0.29	0.47	0.77	1.28	2.32	2.93
31/01/2013	044/13	-	0.37	0.58	0.94	1.52	2.59	3.14
28/02/2013	084/13	-	0.22	0.42	0.79	1.41	2.56	3.12
28/03/2013	124/13	-	0.16	0.32	0.63	1.21	2.39	2.95
	Low		0.02	0.12	0.40	0.93	2.04	2.69
	Average		0.24	0.41	0.73	1.28	2.37	2.98
	High		0.48	0.69	1.04	1.68	2.81	3.32

Table 6: PWLB Variable Rates

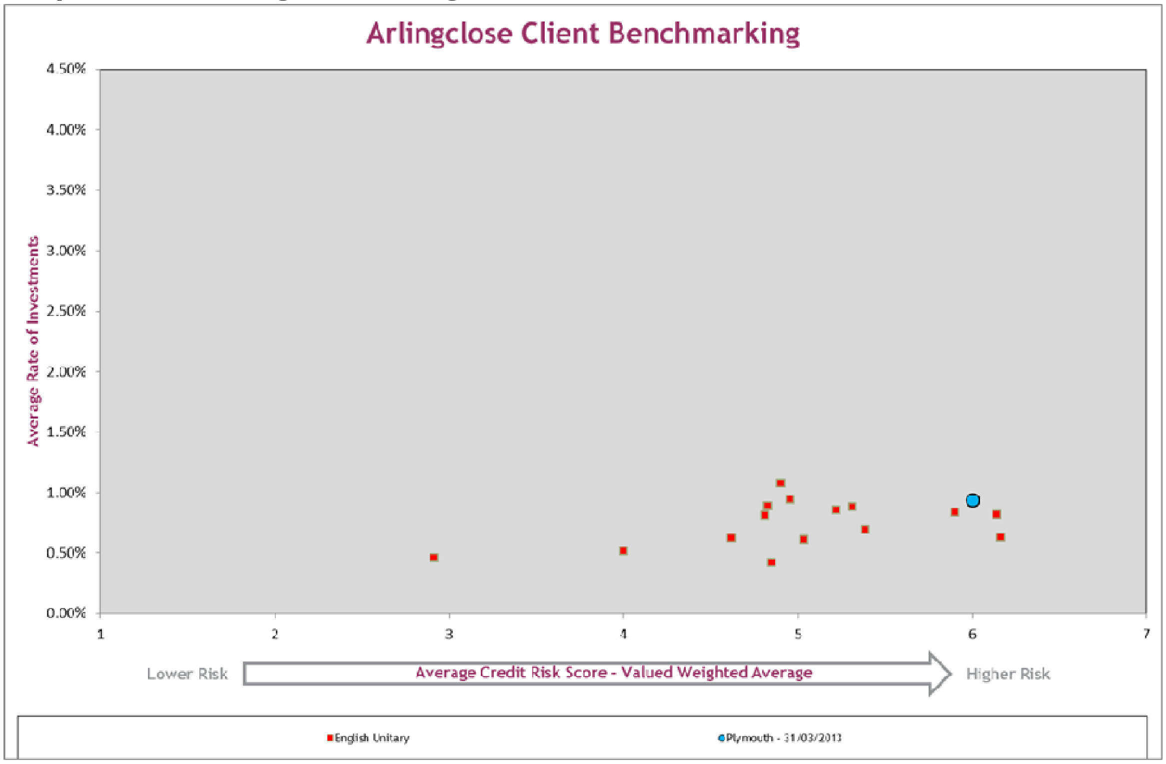
	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR			Post-CSR		
02/04/2012	0.5900	0.6000	0.6200	1.4900	1.5000	1.5200
29/06/2012	0.5800	0.5700	0.5600	1.4800	1.4700	1.4600
28/09/2012	0.5700	0.5600	0.5400	1.4700	1.4600	1.4400
31/12/2012	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
28/03/2013	0.5700	0.5600	0.5500	1.4700	1.4600	1.4500
Low	0.5400	0.5300	0.4800	1.4400	1.4300	1.3800
Average	0.5700	0.5600	0.5500	1.4700	1.4600	1.4500
High	0.6000	0.6000	0.6200	1.5000	1.5000	1.5200

Graph 1 Average Number of days to Maturity V Return



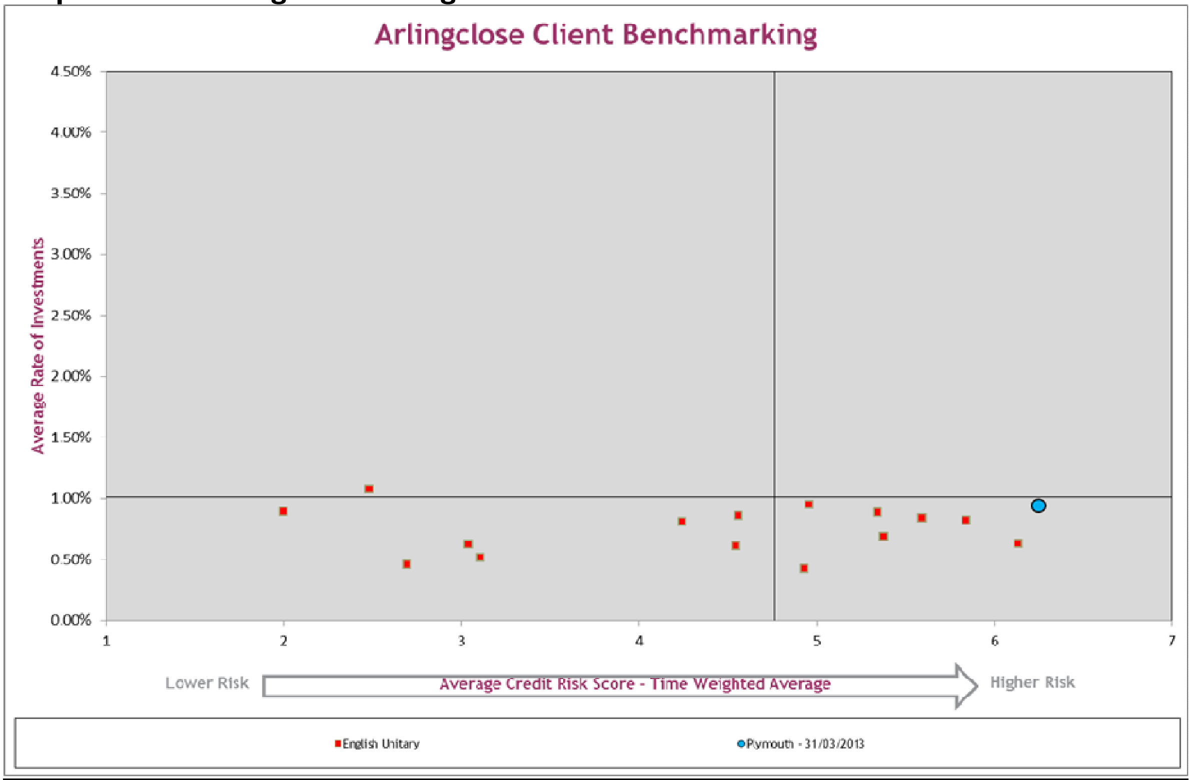
This graph shows the duration of investments against return. It shows the Council's investments have performed well against other unitary authorities. Despite reducing maturity periods of deposits the Council's return on investments as held up as a result higher rates negotiated by the treasury management officer on the Council's call accounts.

Graph 2 Value Weighted Average V Return



As a general rule the aim should be to convert a greater average length of portfolio duration into a greater than average return. There should be a positive correlation between duration and return. However, this chart should not be viewed in isolation from other measured parameters and it should be noted that a high average number of days to maturity does not necessarily mean a higher risk, in fact the reverse may be considered to be true in some cases. As can be seen from this graph, Plymouth City Council is converting duration into a higher return than many of their peer group. However with the maturity of some of the higher rate deposit previously held in the Council's portfolio and the credit rating downgrades for the banks currently used for the Council's deposits the Council's score has increased over time. Council officers will look at alternative investment to reduce the credit risk of the Council's investments.

Graph 3 Time Weighted Average V Return



Longer term investments are inherently more risky. Ideally authorities should move towards the top left hand corner of the graph. Therefore it is preferable to see risk taken converted into return at a greater than average rate. This should be seen as a longer term goal within the Council's investment portfolio which has been affected by a number of rating downgrades on banks currently used increasing the credit risk score. As previously stated Council officers are investigating alternative investments that will reduce the credit risks.

Prudential Indicator Compliance

(a) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2012/13 %	Maximum during 2012/13 %
Upper Limit for Fixed Rate Exposure	200	122.35
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	50	27.92
Compliance with Limits:	Yes	Yes

(b) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing in 2012/13		Compliance with Set Limits?
			High %	Low %	
Under 12 months	50	0	49.68	23.03	Yes
12 months and within 24 months	60	0	31.87	7.84	Yes
24 months and within 5 years	40	0	23.51	7.84	Yes
5 years and within 10 years	25	0	1.94	1.94	Yes
10 years and within 20 years	30	0	2.86	2.50	Yes
20 years and within 30 years	30	0	5.73	5.37	Yes
30 years and within 40 years	25	0	4.67	2.33	Yes
40 years and within 50 years	30	0	19.52	17.18	Yes
50 years and above	25	0	0	0	Yes

(The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date)

(c) Actual External Debt

- This indicator is obtained directly from the Authority's balance sheet. It is the closing balance for actual gross borrowing (short and long-term) plus other deferred liabilities.
- The indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2013	**£m**
Borrowing	226.202
Other Long-term Liabilities	41.591
Total	**267.793**

(d) Capital Expenditure

- This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax.

Capital Expenditure	**2012/13 Approved £m**	**2012/13 Revised £m**	**2012/13 Actual £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Total	52.121	53.691	**46.504**	71.096	34.886

Capital expenditure has been and will be financed or funded as follows:

Capital Financing	**2012/13 Approved £m**	**2012/13 Revised Estimate £m**	**2012/13 Actual £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Capital receipts	9.955	6.775	**3.977**	4.514	7.279
Government Grants/Contributions	33.578	36.655	**33.145**	50.046	14.599
Section 106/Tariff/RIF	0.956	0.801	**0.706**	0.886	0.750
Revenue Contribution/Funds	1.390	3.188	**0.973**	3.903	1.049
Total Financing	**45.879**	**47.419**	**38.801**	**59.349**	**23.677**
Supported borrowing	0.047	0.107	**0.107**	0	0
Unsupported borrowing	6.195	6.165	**7.596**	11.747	11.209
Total Funding	**6.242**	**6.272**	**7.703**	**11.747**	**11.209**
Total Financing and Funding	**52.121**	**53.691**	**46.504**	**71.096**	**34.886**

The table shows that the capital expenditure plans of the Authority could not be funded entirely from sources other than external borrowing.

(e) Ratio of Financing Costs to Net Revenue Stream

- This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.
- The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2012/13 Estimate %	2012/13 Revised %	2012/13 Actual %	2013/14 Estimate %	2014/15 Estimate %
Total	8.56	7.91	**7.64**	8.22	9.15

(f) Incremental Impact of Capital Investment Decisions

- This is an indicator of affordability that shows the impact of capital investment decisions on Council levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2012/13 Estimate £	2012/13 Revised £	2012/13 Actual £	2013/14 Estimate £	2014/15 Estimate £
Increase in Band D Council Tax	0.92	0.71	**0.55**	1.17	10.22

(g) Upper Limit for Total Principal Sums Invested Over 364 Days

- The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2012/13 Approved £m	2012/13 Revised £m	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m
	20	20	**5**	30	30

The Council's investment policy for 2012/13 was to keep deposit maturities to a maximum of 12 months. No deposits were made beyond 364 days. As stated in 6.5 of this a £5m has been invested in a Property Fund, seen as a long-term investment, in order to diversify the investment portfolio and achieve additional returns.