Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 14TH JUNE 2013

ANNUAL TREASURY MANAGEMENT REPORT 2012/2013

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

Purpose of Report

1. To report on the action taken and the performance achieved in respect of the treasury management activities of the Council in 2012/13.

Policy Framework and Previous Decisions

2. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2012/2013 by the end of September 2013. This report will be considered by Cabinet on 9th July 2013.

Background

3. The term treasury management is defined as:-

   "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

4. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Treasury Management 2012/2013

5. There were no departures from the Treasury Management Policy Statement which was agreed by the full Council on 22nd February 2012 in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

6. The list of available counterparties to whom surplus funds can be lent is based on credit ratings assigned to each institution by independent agencies. The ratings required to become an acceptable counterparty for the Authority are very high, and as a result there are very few acceptable counterparties. During the year the only change that impacted onto the list was the downgrading of Royal Bank of Canada, which removed them from the list. As this counterparty was not active in the market at acceptable interest rates, the downgrade had no actual impact onto treasury management activities.

7. The action taken in respect of lending during 2012/13 was relatively subdued, mainly as a result of the low number of acceptable counterparties. Market rates

reduced quite substantially over the course of the year as a result of the extra cheap liquidity injected into the financial system by the Government's Funding for Lending Scheme, and also because continued sluggish economic activity made it apparent that base rate increases in the foreseeable future were unlikely.

8. On the debt portfolio, no new loans were taken and one loan of £12m matured in June 2012. It continues to be considerably more advantageous to finance some of the historic capital expenditure by using internal cash resources – at a cost of the loss of interest that would be earned (c. 0.4%) – than it is to 'externalise' this debt by taking further borrowing.

<u>Position at 31st March 2013</u>

9. The Council's external debt position at the beginning and end of the year was as follows:-

	31st March 2013			31st March 2012		
	Principal	Average Rate	Average Life	Principal	Average Rate	Average Life
Fixed Rate Funding						
- PWLB	£191.8m	6.03%	31 yrs	£203.8m	5.81%	28 yrs
-Market	£ 2.0m	8.12%	4 yrs	£ 2.0m	8.12%	5 yrs
Variable Rate Funding:						
- Market (1)	£103.5 m	4.37%	1 yr	£103.5 m	4.37%	1 yr
Total Debt	£297.3m	5.47%	20 yrs	£309.3m	5.35%	18 yrs

(1) The lenders all have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option we can either repay or accept the higher rate. The average life is based on the next option date.

10. The position in respect of investments varies throughout the year as it depends on large inflows and outflows of cash. Over the course of the year the loan portfolio (which includes cash managed on behalf of a large number of schools with devolved banking arrangements) varied between £127m and £205m and averaged £159m.

<u>Debt transactions in 2012/2013</u>

11. The Council began the year with approximately £62m of internal debt – in other words, money that would otherwise have been available to lend on the money markets was being used to fund the historic capital programme. During the year a loan of £12m matured and was not replaced. Minimum Revenue Provision (MRP) - a charge that is intended to ensure that loans raised to finance capital expenditure are paid off over the longer term - of £41m was charged to the revenue account (£15m being the statutory charge and £26m being a voluntary payment from revenue account underspends). The net of these figures means that £29m of internal debt was 'repaid' during the year and that internal debt at the end of the year was approximately £33m.

12. Internal debt remained a very attractive option, as it is funded at the loss of interest that would otherwise be earned on lending the extra cash if it had been available – this 'cost' averaged around 0.40% in 2012/13. Most of the internal debt comes as a result of previous premature repayments of loans, where the average rate of debt being paid was 4.44%.

13. Holding internal debt will become less attractive as the interest rates available for lending cash in the money markets rise. The current medium-term outlook for the

bank base rates, in comparison to the interest rates payable on raising new loans, does not make external borrowing an attractive option at present, although a pro-active stance in managing this position will continue. If it is considered attractive to borrow externally – either from a cost or a risk management perspective – then the internal debt position will be reduced.

14. The savings made by the proactive management of the debt portfolio in recent years have been substantial but will only be able to be fully quantified when the internal debt position has been fully closed out. It is entirely possible that this will not happen for a number of years, as opportunities will be taken to raise external debt only if it is felt to be appropriate. Bank base rates (and hence the interest lost by not having the cash available to lend) will not remain at ultra-low levels for ever, although it currently looks as if they will be low for a further extended period, and the debt portfolio will be managed on a medium/long term view and not with the aim of maximising short-term savings.

Investment Undertaken in 2012/13

15. Bank base rates reached 0.50% in March 2009 and have stayed at this level since. The global economic outlook is such that it appears highly unlikely that there will be an increase in UK base rates for at least another 12 -18 months and possibly longer than this.

16. The future outlook for base rates, combined with the extra cash injected into the financial system by the Funding for Lending Scheme, has impacted negatively onto the rates available when lending. By the end of the financial year there was only one acceptable counterparty (Bank of Scotland – part of the Lloyds Banking Group) to whom it was possible to lend at rates that were higher than the historically low base rate.

17. The loan portfolio produced an average return of 1.36% in 2012/13, compared to an average base rate of 0.50% and the average local authority 7 day deposit index (representative of what could be achieved if only short-term loans within the money market were made) of 0.39%. This level of out performance is mainly the result of longer term loans that were placed at attractive interest rates in the previous financial year, and as these matured during the year the margin of out performance of the comparators reduced (and will reduce further in 2013/14).

Longer Term Performance of Portfolios

18. The loan portfolio has achieved out performance of both the average base rate and the local authority 7 day deposit rate in every one of the last 18 years, which is when the figures started to be produced. The level of the out performance is flattered somewhat by the significant out performance achieved both during and in the immediate aftermath of the credit crunch but even without this, the record is impressive. The average rate of interest earned in the last 18 years is 4.91%, which compares to an average base rate of 4.15% and an average local authority 7 day deposit index return of 4.11%.

19. The last five financial years (2008/09 to 2012/13) has seen the performance of the loan portfolio generate an extra £13.7m in interest than would have been generated if the average local authority 7 day deposit rate had been achieved. The variability of balances makes it more difficult to calculate the excess interest that the out

performance has achieved over the whole 18 year period, but it is estimated to be at least £23.5m.

20. The action taken on the debt portfolio, or rather the lack of action, increased the average rate of external debt over the course of the year as the maturing loan was at a lower rate (2.36%) than the portfolio average. In reality, the maturity of this loan was actually positive to the Authority as, instead of paying 2.36% in external debt, it was effectively refinanced at 0.40% (the cost of not having the cash available for lending).

Summary

21. Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium/long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings but there are risks associated with having internal debt and these need to be rigorously assessed and action taken if deemed appropriate. Short term gains might, on occasion, be sacrificed for longer term certainty and stability.

22. The loan portfolio has produced an exceptional level of out performance in the period since performance figures were calculated. At present it is difficult to 'add value' to any great extent as a result of the combination of the lack of acceptable counterparties, a financial system that has lots of cheap liquidity and the fact that there is a very broad consensus about what the immediate outlook for base rates is.

Recommendation

23. The Committee is asked to note this report.

Resource Implications

24. Treasury management is an integral part of the County Council's finances. Interest on revenue balances generated over £2.3m in 2012/13 and the interest paid on external debt was about £16.7m.

Equal Opportunities Implications

25. None.

Background Papers

Report to County Council on 22nd February 2012 – 'Medium Term Financial Plan': Appendix L 'Treasury Management Strategy Statement and Annual Investment Strategy 2012/13'.

Circulation under local issues alert procedure

None.

Officers to Contact

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