

DERBYSHIRE COUNTY COUNCIL

CABINET

27 November 2012

Report of the Director of Finance

TREASURY MANAGEMENT
(FINANCE & MANAGEMENT)

1 Purpose of the Report

To report on Treasury Management activities for the first half of 2012-2013 and for the last financial year 2011-2012 indicating the Council's compliance with the prudential indicators set by Council in accordance with the terms of the Prudential Code for Capital Finance in Local Authorities.

2 Information and Analysis

(i) Treasury Management Activities 2011-2012

The Financial Regulations of the Council require an annual report to be presented to members. This is in accordance with the recommendations of the CIPFA Code of Practice on Treasury Management. Also under the terms of the Prudential Code the Council is required to set a series of prudential indicators each year to ensure that any capital expenditure and related borrowing undertaken is prudent, affordable and sustainable. This report compares the outcomes for the year against the prudential indicator levels approved by the Cabinet in January 2011.

(ii) Interest Rates

The Bank of England base rate was 0.5% throughout the financial year 2011-12 and still remains at 0.5% where it has been since March 2009. The Bank of England has further increased money supply through its policy of asset purchases (known as quantitative easing) by £75 billion in October 2011 and an additional £50 billion in both February and July 2012. The total of assets to be purchased under this policy now stands at £375 billion. The purchases will be spread over 4 months and the Bank of England's Monetary Policy Committee (MPC) holdings of the outstanding gilt stock will rise from approximately 27% to 30%. The purpose of the policy is to inject money into the economy in order to boost demand, and to meet the consumer price inflation (CPI) target of 2% in the medium term. Inflation has been higher than

expected driven by increases in world commodity prices and the effect of a weak pound on import costs. However, it is beginning to ease as figures for September 2012 showed the annual rate of CPI at 2.2% and retail price inflation (RPI) at 2.6%, down from 2.5% and 2.9% respectively in August.

Lending conditions facing UK households and companies tightened in 2012 Q2 and had been expected to deteriorate further in Q3 in the face of increased funding costs for banks related to the euro-area crisis. In response the Bank and the Government announced the Funding for Lending Scheme (FLS), which provides banks with a cheaper source of funding, improving the cost and availability of bank credit. The scheme provides incentives to banks and building societies to lend more to UK households and businesses. The design takes into account that, before the scheme, a number of large banks planned to reduce their lending to the real economy. The FLS is bigger and bolder than any initiative so far tried to get the banks lending again. Although its overall impact is uncertain, the early indications are positive, with some banks cutting their loan rates.

The Consensus GDP forecast (October 2012) for 2012 shows a fall of 0.2%, compared with growth of 0.9% in 2011. Consumer Price Index inflation ("CPI") for the year to September 2012 was at 2.2%, compared with 5.2% for the year to September 2011. This is the slowest rate of inflation since November 2009, when it was 1.9%. The Bank of England's Inflation Report (August 2012) forecasts inflation to fall further in the coming months, so that it is more likely than not to be around or a little below target for much of the forecast period, as the impact of external price pressures eases, and a partial recovery in productivity growth and continued unemployment levels restrain domestic cost pressures. The forecast assumes that quantitative easing would remain at £375 billion. The Consensus forecast (October 2012) for CPI in 2013 is 2.2%.

Current money-market rates (at 18 October 2012) with eligible counterparties are around 0.5% for three-month investments and 1.1% for one-year loans. The government's Debt Management Office (DMO) pays 0.25% on all deposits.

Longer-term interest rates fluctuated during the financial year. The Public Works Loans Board rate (PWLB) for 25-year new loans, which was 5.31% at the end of March 2011, stood at 4.31% at the end of March 2012 and 3.84% at 17 July 2012.

Longer-term interest rates (25 year gilt yields) have risen since 31 March 2012, having moved from around 3.28% at 31 March 2012 to 3.5% at 1 November 2012, within a range of 4.45% to 2.68%.

Long term borrowing rates from the Public Works Loan Board (PWLB), however, are currently 0.6% above gilts. Thus a 25 year fixed rate loan

from the PWLB agreed on 1 November 2012 would cost 4.08% per annum, compared with 4.31% on 30 March 2012 and 5.31% at the end of March 2011. The average PWLB 25-year rate for 2011-12 was 4.61%, in the range 3.91% to 5.44%.

From the 1 Nov 2012 the PWLB has introduced a new Certainty Rate for which the Council is eligible, this being 0.20 basis points below the Standard Loan Rate. A decision on a further, cheaper, PWLB Scrutiny Rate is under consideration by the HM Treasury, although there are no details as yet.

There is, therefore, currently a wide difference between short-term and long-term interest rates. Current short-term interest rates affect the level of the Council's interest receipts, and lower receipts have been budgeted for. Longer-term rates have an impact on the Council's borrowing costs.

The Office for National Statistics reported that retail sales volumes for September 2012 were up by 2.5% from a year earlier, with volumes rising by a healthy 0.6% on the previous month. The unemployment rate for June - August 2012 was 7.9% compared with 8.1% for this period last year. Average earnings growth (excluding bonuses) for the same period was 2.0% compared with 1.8% a year earlier. The ONS house price review in August 2012 showed annual house prices increased by 1.8%, down from a 2.0% increase in the 12 months to July 2012. House prices remain relatively stable across most of the UK with the average UK house price rising 0.6% during October. However Nationwide warned that the market remains volatile and that sustained growth is some way off.

Borrowing

Total borrowing remained at all times within the limits approved under the terms of the Prudential Code.

No new borrowing was taken during the year 2011-12. A loan of £10m was due to be repaid to the PWLB on 31 March 2012. Due to the weekend it was repaid on the following business day, 2 April 2012, in accordance with normal policy. Internal resources were also utilised in line with the approved strategy. At the end of the year, the total loans outstanding for capital expenditure were £389,023,050. Total debt charges were approximately £50.1m (i.e. interest payable of £27.4m and principal repayment of £22.7m). These include charges of £8.25m in respect of PFI and lease agreements. The overall average borrowing rate of 5.17% is slightly less than the previous year (5.25%).

The above figure includes debt that has been serviced on behalf of Derby City Council since Local Government Reorganisation. This accounts for approximately £35.3m of debt (at 31 March 2012) and

£3.3m of debt charges for the year, which is fully recharged to the City Council.

The Council has not undertaken any additional borrowing in the first half of 2012/13 nor have any of the existing loans matured, so no repayments have been necessary.

The projected (Jan 2012) Capital Financing Requirement (excluding PFI projects and Finance Leases) for the end of March 2013 was £490.34m and has since been revised to £454m. Current long-term borrowing stands at £389m. A further £3.4m repayment is due on loans maturing in January and March 2013, which, without further borrowing, would result in total borrowing of £385.6m at 31 March 2013. Internal resources are being used to fund capital, taking advantage of very low short term interest rates. Opportunities may be sought to switch to long term borrowing, subject to advantageous market conditions. The relative position of short term and long term interest rates is being monitored.

On 2 February 2011 Council approved the Annual Treasury Management Strategy for 2011-12, including performance indicators against which to assess the Council's cost of new borrowing. This indicator is the average interest rate for 25 years PWLB maturity loans for the latest financial year.

Performance is also to be measured against the average rate of interest for County Councils for the latest financial year, taken from the CIPFA publication "Capital Expenditure and Treasury Management Statistics". The data for 2011-12 is not expected to be available until the end of the year, and the relevant statistics will be reported in due course. Figures for 2010-11 were as follows:

2010-11	%
Derbyshire County Council	2.72
County Councils average on new borrowing in the year	3.26
Average PWLB 25 Years Rate	4.77

(iv) Debt Rescheduling and Repayment

There was no early repayment or rescheduling in 2011-12 or for the first half of 2012-13.

(v) Lending in 2011-12

Short term lending of revenue funds/capital receipts pending their use earned interest of £3.2m in 2011-12 at an average rate of 1.14%. Short-term deposits were placed with a number of financial institutions, from a list previously approved by the Cabinet.

For the purpose of monitoring performance, the interest rate actually achieved of 1.14% can be compared against a benchmark market rate of interest. The Local Authority seven-day rate (LA7D) is considered to be the most suitable for this purpose and for 2011-12 the weighted average rate was 0.5250%. The County Council's continuing lending policy is to place security of capital and liquidity ahead of investment return. The status of the Council's counterparties is constantly under review and changes to its lending list are made as and when required.

The Council's investments at 31 March 2012 can be analysed in the following ways:

The following table shows the split between the different types of counterparty.

Type of Institution	£000s	%
Banks	96,781	33
Building Societies	20,000	7
Money Market Funds	40,005	14
Other local authorities	133,500	46

The Council's access to liquidity is shown in the following table which analyses the Council's loans by maturity date:

Duration	£000s	%
Less than 1 month	82,286	28
1 to 3 months	68,500	24
3 to 6 months	48,500	17
6 months to 1 year	91,000	31

The following table shows investments split according to the Counterparties' credit ratings. Whilst losses from the Council's counterparties are not expected, the table also shows the historic market level of defaults for each credit rating category and an estimate of the Council's maximum exposure to default based on that experience:

Credit Rating	£000s	Historic market level of default	Estimated maximum exposure to default £000s
AAA	173,505	0.00%	0
AA	0	0.03%	0
A	116,781	0.08%	93
Baa/BBB+	0	0.24%	0

(vi) Lending in 2012-13 to date

The average return on investments for the period 1/4/12 to 30/9/12 is estimated at 0.92% compared with pre-year forecasts of around 1.0%. These rates have however been affected since the introduction of the

FLS with 3 month LIBOR falling to 0.54%, combined with recommended advice from our Treasury Management Consultants, Sector, giving a duration limit of 3 months for lending money (except part nationalized banks). Consequently new loans are now achieving a return below base rate. This may change if the Council adopt a Local Authority Mortgage Scheme which could result in a longer term investment of up to five years. This would be with advice from Sector.

The average level of Council investments is around £318m (2011: £325m). The availability of temporary funds for lending arises from a combination of positive cash flow (as in general funding is received prior to spend) and available reserves.

There has been no new borrowing in 2012-13 to date.

(vii) Prudential Code for Capital Finance & Treasury Management

On 2 February 2011 the Council approved the Capital Programme, borrowing limits and other prudential indicators for 2011-12. The levels set by Council and the outturns for the year are shown in Appendix 1. All Prudential Indicators have been complied with.

For 2012-13, a summary of the Prudential Indicators set are shown in the Council report dated 2nd February 2012 as attached in Appendix 2. It compares the original limits set by the Council and the actual position at the half-year stage. Again this shows that all Prudential Indicators are currently being complied with.

(viii) Training

A series of training on financial matters has been suggested for inclusion on the Member Development Groups Training Programme. Treasury Management is included within this programme.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property and transport considerations.

4 Key Decision

No

5 Call-in

Is it required that call-in be waived in respect of the decisions proposed in the report? NO

6 Background Papers

Borrowing and Loan records 2011-12 and 2012-13
Treasury Management Strategy 2011-12
CIPFA Local Authority Debt Statistics
Consensus Economic Forecasts October 2012
ONS October 2012
Bank of England Report August 2012

7 OFFICER'S RECOMMENDATIONS

That the report on Treasury Management for the year 2011-2012 and the first half of 2013 be noted.

That compliance with prudential indicators as shown in Appendix 1 and Appendix 2 be noted.

PETER HANDFORD

Director of Finance

County Hall
Matlock

15 November 2012

Prudential Code for Capital Finance & Treasury Management

Compliance with Prudential Indicators 2011-12, as approved by Council in February 2011.

Capital Expenditure and Capital Financing Requirement

These Indicators show the total capital expenditure and the Capital Financing Requirement (CFR) for the year against the initial estimates approved in February 2011. The CFR is the Council's underlying need to borrow for capital purposes and is therefore dependent on the approved level of capital expenditure.

	2011-12 Estimate £m	2011-12 Actual £m
Capital Expenditure	148.30	104.65
Capital Financing Requirement	500.50	430.14

The Authorised Limit and the Operational Boundary

The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be revised if necessary by members, whilst the Operational Boundary is based on the probable external debt during the course of the year. It is not a limit and actual borrowing may vary around this boundary during the year.

For this purpose, temporary deposits of £15m taken from the Derbyshire Fire Authority and the Peak District National Park Authority have been included in the borrowing figure.

Authorised limit for external debt	Authorised limit for external debt 2011-12 £m	Operational boundary for external debt 2011-12 £m	Actual external debt 2011-12 £m
Borrowing	525	475	404
PFI & other long term liabilities	86	86	86
Total	611	561	490

The above table shows that at the year end actual debt was comfortably within both the Authorised Limit and the Operational Boundary. At no stage during the year did External Debt exceed the authorised limit.

Net Borrowing and Capital Financing Requirements

This indicator requires that the Council's net borrowings should not exceed its capital financing requirement. Actual figures for the year ended 31 March 2012 are compared with the initial estimates approved in February 2011.

	2011-12 Estimate (year end) £m	2011-12 Actual (year end) £m
Gross Borrowing*	415.0	368.72
Investments	200.0	290.28
Net Borrowing	215.0	78.44
CFR	500.5	430.14

* For this indicator, debt managed on behalf of others (Derby City) is required to be excluded.

As outlined earlier, the use of internal resources as part of the borrowing strategy reduced both external borrowing and investments.

The above total shows that the Council's net borrowings at £78.44m are significantly less than its capital financing requirement.

Ratio of Financing Costs to Net Revenue Stream

This shows capital financing costs as a proportion of the total revenue stream and as expected was 5.1% of total revenue, including DSG, and 9.4% excluding DSG.

Incremental Impact on Council Tax

The impact in the year of new financing costs was within the estimate.

Fixed and Variable Rate Exposures

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	2011-12 Upper	2011-12 Actual (year end)
Borrowing		
Limits on fixed interest rates	100%	89%
Limits on variable interest rates	40%	11%
Investments		
Limits on fixed interest rates	25%	0%
Limits on variable interest rates	100%	100%

The Council remained within the approved limits.

Maturity Structures

The maturity profile is the rate at which long-term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments in any one year, thus a spread of redemptions is desirable.

The maturity structure is a prudential indicator under the Code, with lower and upper limits recommended as shown in the table below. These are set quite widely to ensure that full advantage can be taken of interest rate movements and debt rescheduling opportunities, within an acceptable degree of risk.

Maturity Structure limits for borrowing		2011-12	2011-12 Actual (year end)
Under 12 months	Lower - Upper	0% - 15%	0.87%
12 months - 2 years	Lower - Upper	0% - 15%	3.92%
2 years - 5 years	Lower - Upper	0% - 45%	8.36%
5 years - 10 years	Lower - Upper	0% - 40%	7.20%
10 years - 20 years	Lower - Upper	10% - 40%	19.02%
20 years - 30 years	Lower - Upper	10% - 40%	30.46%
30 years and above	Lower - Upper	10% - 40%	30.17%

The above analysis does not include PFI debt or temporary deposits from the Derbyshire Fire Authority and the Peak District National Park Authority.

The Council's debt maturity structure as at 31 March 2012 complied with the limits set by Council.

Longer Term Investments

The prudential code requires councils to set limits for any investments made for more than 364 days. Whilst most of the Council's surpluses are of a temporary nature, others, for example the insurance fund reserve, could reasonably be invested for periods in excess of one year.

A limit for lending for more than one year is set out below and compared with the total amount on deposit at 31 March 2012. The total includes all loans outstanding at 31 March 2012 which, at inception, had over 1 year to maturity.

	2011-12 Limit	2011-12 Actual
Maximum principal sums invested for more than 364 days	£75m	£10m

Longer term investments were therefore within the limit set by Council.

DERBYSHIRE COUNTY COUNCIL
Prudential Indicators Monitoring 2012-13

	2012/13 Estimate or Limit	At 30/9/12
Ratio of financing costs to net revenue - estimate	5.40%	no change
Ratio of financing costs to net revenue - actual		no change
Incremental Impact on Council Tax of capital programme	£10.10	no change
Capital Expenditure - estimate	£144.7m	£144.7m
Capital Expenditure - actual to 30/9/12		£34m
Net Borrowing/Capital Financing Requirement		
Net Borrowing (Borrowing less investments)	£165m (est)	£173.07m
Capital Financing Requirement - est. excl PFI & Finance Leases	£490.34m	£454m
Net Borrowing < Capital Financing Requirement		yes
External debt		
Authorised limit	£605m	no change
Operational boundary	£555m	no change
External debt - actual (includes temporary loans & est PFI debt)		£497.57m
Treasury management		
Adoption of CIPFA code of practice	Confirmed	Confirmed
Interest rate exposures		
Borrowing		
Fixed - upper limit	100%	73%
Variable - upper limit	40%	27%
Investment		
Fixed - upper limit	25%	0%
Variable - upper limit	100%	100%
Maturity Structure - Borrowing		
Under 12m (incl DFA & PDNPA)	0 - 15%	6.37%
12m - 2 yrs	0 - 15%	3.71%
>2 - 5 yrs	0 - 45%	9.11%
>5 - 10yrs	0 - 40%	5.58%
>10 - 20yrs	10 - 40%	17.97%
>20 - 30yrs	10 - 40%	28.77%
Over 30 yrs	10 - 40%	28.49%
Average maturity of external borrowing	10 - 35yrs	21.76yrs
Investment		
Specified investments - minimum limit	£150m	£281.75m
Non-specified investments - maximum limit		
a) short-term P2/A2/F2 credit rating	£70m	£37.75m
b) 364 days at inception (max - 2 years)	£75m	£5m