Epping Forest District Council Treasury Outturn Report 2012/13

1. Background

The Council's treasury management activity for 2012/13 was underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity for the forthcoming financial year.

The Code also recommends that Members are informed of Treasury Management activities at least twice a year. The Council reports twice a year to the Finance and Performance Management Cabinet Committee and scrutiny of treasury policy, strategy and activity is delegated to the Audit and Governance Committee.

Treasury management is defined as: "The management of the local authority'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."

Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

2. Economic Background and Update

Growth: The UK economy showed some improvement, although growth was subdued. GDP for the first quarter of 2013 was +0.3%, but the underlying numbers were disappointing as inventory growth contributed largely to the output figures. Revisions by the Office of National Statistics to GDP back-data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008-09 was deeper than previously estimated. Growth is now nearly 4% below its peak back in 2007.

Some positive signs for household spending emerged, mainly from a slower deterioration in real earnings growth (i.e. earnings less inflation) which implied a slower erosion of purchasing power. Household savings rates remained high, which is unsurprising given the uncertain economic outlook.

Inflation: Annual CPI was 2.7% in May. Inflation was expected to pick up again temporarily in the near term, peaking around 3% in June and remaining close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures. The oil price (Brent Crude) climbed above $100/barrel on the back of political unrest in Egypt and the unresolved crisis in Syria.

Monetary Policy: There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. Minutes of the Bank of England's Monetary Policy Committee meetings showed that whilst the MPC voted unanimously for no change in official interest rates, it remained split (6-3 in favour of no change) on whether further QE was required to stimulate the economy.

In his testimony to Congress on 22nd May the US Federal Reserve (the Fed), Chairman Ben Bernanke stated that, if the nascent recovery in the US economy became established, the Fed would reduce its $85bn monthly asset purchase programme (QE). The apparent movement by the Fed towards tapering its open-ended QE programme prompted extreme asset price volatility in bonds and equities, as investors sought to crystallise gains driven by excessive liquidity. As a consequence, government bond yields spiked. UK gilt yields jumped up 0.50% over the six weeks to the end of June.

The market negativity appeared to be overdone. Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remained, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the European Central Bank (ECB) to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region remains in recession and up-coming political events, such as the German general election (22nd September 2013), could derail any progress towards a more balanced and stable regional economy. The US recovery appears to be in train, but political risks remain regarding the debt ceiling and the federal budget.

3. Debt Management

Borrowing Activity in 2012/13

	Balance on 01/04/2012 £m	Debt Maturing £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 31/03/2013 £m	Avg Rate % and Avg Life (yrs)
CFR	184.672				184.672	
Short Term Borrowing[1]	0	0	0	0	0	
Long Term Borrowing	185.456	0	0	0	185.456	3% - 25yrs
TOTAL BORROWING	185.456	0	0	0	185.456	
Other Long Term Liabilities	0	0	0	0	0	
TOTAL EXTERNAL DEBT	185.456	0	0	0	185.456	
Increase/ (Decrease) in Borrowing £m					0	

PWLB Borrowing

The PWLB remained an attractive source of borrowing for the Council as it offers flexibility and control. As concerns mounted over the timing of the removal or 'tapering' of QE by the US Federal Reserve, gilts sold off and yields rose in May and June. The sharp rise in gilt yields led to a corresponding rise in PWLB rates (see Appendix A), with the most pronounced increase for 5-20 year loans with increases around 0.6% - 0.8%. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

For the Council the use of internal resources in lieu of borrowing has, therefore, continued to be the most cost effective means of funding £12.177m of capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, the Council acknowledges that this position will not be sustainable over the medium term. Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor.

The Authority funded none of its capital expenditure from borrowing in 2012/13. The PWLB remains the Authority's preferred source of borrowing given the transparency and control that its facilities continue to provide.

1 Loans with maturities less than 1 year.

This strategic exposure to variable interest rates will be regularly reviewed and, if appropriate, reduced by switching into fixed rate loans.

Debt Rescheduling:
The increase in PWLB repayment rates during this year lowered the premium that would apply on premature redemption of loans, but the premia were still relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

A year after their commencement, the £185.456m of loans borrowed on 28th March 2012 for the HRA self-financing settlement became eligible for rescheduling. These loans were borrowed at one-off preferential rates made available specifically for the settlement. If the increases in gilt yields and PWLB redemption rates seen at the end of this quarter prevail in subsequent months, they may present early loan repayment opportunities at close to par. Early repayment or rescheduling will first be assessed against the requirements of the HRA business plan and any future borrowing requirements. Where rescheduling is appropriate, the Authority will consider alternative refinancing to achieve cost savings and a reduction in risk.

4. Investment Activity

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

Investment Activity in 2012/13

Investments	Balance on 01/04/2012 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2013 £m	Avg Rate % and Avg Life (yrs)
Short Term Investments	32.500	115.004	117.245	30.259	0.97% 114 days
Long Term Investments	0.140	9.934	0	10.074	1.15% 1278 days
Investments in Pooled Funds (MMF)	10.000	0	5.000	5.000	
TOTAL INVESTMENTS	42.64	124.938	122.245	45.333	

Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. Investments during the year included :

- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with Banks and Building Societies systemically important to the UK Banking system
- UK Local Authorities

Counterparty credit quality is assessed and monitored with reference to: Credit Ratings (the Authority's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms /potential support from a well-resourced parent institution; share price. The minimum long-term counterparty credit rating determined for the 2012/13 treasury strategy was A- across rating agencies Fitch, S&P, and Moody's.

Credit Risk
Counterparty credit quality has been maintained as demonstrated by the Credit Score Analysis summarised below where it can be seen that the target of remaining below an average credit risk score of 6 was achieved throughout the year. Table 3 in the Appendix explains the credit score.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating	Average Life (days)
31/03/2012	AA-	4.35	A+	5.36	42
30/06/2012	AA-	4.12	A	5.56	19
30/09/2012	A+	4.56	AA+	2.42	118
31/12/2012	A+	5.02	AA	2.68	277
31/03/2013	A+	5.27	AA	2.71	233

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 6 or lower, to reflect current investment approach with main focus on security

Counterparty Update
In April Fitch downgraded the UK's long-term sovereign rating by one notch from AAA to AA+, the second of the rating agencies to do so (Moody's had downgraded the UK's ratings in February to Aa1). Where assigned, local authorities' ratings, which benefit from an uplift due to their close and direct links to central government, were also downgraded.

The proposed sale of 632 Lloyds' branches to the Co-op Bank – referred to as Project Verde – fell through in April. Lloyds now instead plans to sell the branches in an Initial Public Offering (IPO) later this year.

In May Moody's downgraded the long-term rating of Co-op Bank by six notches from A3 to Ba3 which is sub-investment grade. The downgrade reflected the agency's opinion that the bank faced the risk of further substantial losses in its non-core portfolio. In June the Co-op announced it had a £1.5bn regulatory capital shortfall requiring a recapitalisation via burden-sharing with junior creditors and asset disposals of its parent's insurance businesses. Moody's downgraded the bank's long-term rating a further four notches to Caa1 whilst Fitch downgraded the long-term from BBB- to BB-.

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In the Chancellor's Mansion House speech on 19th June he signalled his intention to sell the government's stake in the Lloyds Banking Group reasonably soon, whilst the situation was more complicated with RBS since its problems were greater and reflected in its share price. It appeared that a 'good bank' and 'bad bank' split for RBS was being favoured by the Chancellor and sat behind the announcement concerning the departure of RBS Chief Executive, Stephen Hester, who disagreed with that route.

Update on Investments with Icelandic Banks

Following the lastest guidance from CIPFA, issued 28th May 2013, it is expected that the latest position on the Heritable dividend/impairment will be a recovery overall for the Heritable investment of approximately 94p in the pound, this may rise depending on the September 2013 report from the Administrators. Repayments in 12/13 were 3.79% on 24.4.12, 2.85% on 23.7.12, 2.72% on 18.1.13. In total 77.28% has been repaid to 31st March 2013. The Council has since received 16.73% on August 2013.

Budgeted Income and Outturn

The Authority's budgeted investment income for the year had been estimated at £0.561_m. The average cash balances representing the Council's reserves, were £53.9m during the period and interest earned was £0.517m.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2012/13, which were approved on 14th February 2012 as part of the Council's Treasury Management Strategy Statement.

6. Outlook for Q1

At the time of writing this activity report in July 2013, the UK economic outlook appears to have improved, but the projected path for growth remains subdued. Recent data has been mixed and what previously looked likely to be a strong start to the year is now more doubtful. Looking forward the only likely positive contributor to overall growth is household consumption, which itself remains under pressure given the deterioration in real earnings growth, high unemployment and general low confidence. A variety of other factors will continue to weigh on a domestic recovery, including on-going fiscal consolidation, muted business confidence and subdued foreign demand.

7. Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during the year 2012/13. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

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Appendix 1

Capital Financing Requirement
Estimates of the Authority's cumulative maximum external borrowing requirement for 2012/13 to 2014/15 are shown in the table below:

	31/03/2013 Estimate £m	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
Gross CFR	184.672	184.672	184.672	184.672
Less: Other Long Term Liabilities	0	0	0	0
Borrowing CFR	**184.672**	**184.672**	**184.672**	**184.672**
Less: Existing Profile of Borrowing	185.456	185.456	185.456	185.456
Gross Borrowing Requirement/Internal Borrowing	**(0.784)**	**(0.784)**	**(0.784)**	**(0.784)**
Usable Reserves	**47**	**49.1**	**43.8**	**43.8**
Net Borrowing Requirement/Investment Capacity	**(47.784)**	**(49.884)**	**(44.584)**	**(44.584)**

In the Prudential Code Amendment (November 2012), it states that the chief finance officer should make arrangements for monitoring with respect to gross debt and the capital financing requirement such that any deviation is reported to him/her, since any such deviation may be significant and should lead to further investigation and action as appropriate.

	31/03/2013 Estimate £m	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
CFR	184.672	184.672	184.672	184.672
Gross Debt	185.456	185.456	185.456	185.456
Difference	**(0.784)**	**(0.784)**	**(0.784)**	**(0.784)**
Borrowed in excess of CFR? (Yes/No)	**Yes**	**Yes**	**Yes**	**Yes**

Usable Reserves
Estimates of the Authority's level of Usable Reserves for 2013/14 to 2015/16 are as follows:

	31/03/2013 Estimate £m	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
Usable Reserves	47	49.1	43.8	43.8

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Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Authority to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

The Director of Finance and ICT confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; borrowing at its peak was £185.5m.

	Authorised Limit (Approved) as at 31/03/2013 £m	Operational Boundary (Approved) as at 31/03/2013 £m	**Actual External Debt** as at 31/03/2013 £m
Borrowing	200	188	185.456
Other Long-term Liabilities	0	0	0
Total	**200**	**188**	**185.456**

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

- These indicators allow the Authority 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.

	Approved Limits for 2012/13 £/%	Maximum during 2012/13 £/%
Upper Limit for Fixed Rate Exposure on Debt Investment	 100 (100)	 81 (66)
Compliance with Limits:		Yes
Upper Limit for Variable Rate Exposure on Debt Investment	 25 (75)	 19 (34)
Compliance with Limits:		Yes

(c) 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 as at 31/3/2013 £m	% Fixed Rate Borrowing as at 31/3/2013	Compliance with Set Limits?
under 12 months	100	0	0	0	Yes
12 months and within 24 months	100	0	0	0	Yes
24 months and within 5 years	100	0	0	0	Yes
5 years and within 10 years	100	0	31.8	0	Yes
10 years and within 20 years	100	0	0	0	Yes
20 years and within 30 years	100	0	153.656	100	Yes
30 years and above	100	0	0	0	Yes

(d) **Total principal sums invested for periods longer than 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 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
	30	12	30	30	30

(e) **HRA Limit on Indebtedness**

This indicator reports on the level of the limit imposed by the CLG at the time of the self-financing settlement (or subsequently amended) to which the HRA Capital Financing Requirement is compared.

	2012/13 Approved £m	2012/13 Revised £m	2013/2014 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
HRA Debt Cap (as prescribed by CLG)	**185.457**	**185.457**	**185.457**	**185.457**	**185.457**
HRA CFR	**153.575**	**154.391**	**154.391**	**154.391**	**154.391**
Difference	**31.882**	**31.066**	**31.066**	**31.066**	**31.066**
HRA Debt (Actual)	**185.456**	**185.456**	**185.456**	**185.456**	**185.456**

(f) **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 and in the case of the HRA, housing rent levels. This includes Revenue Expenditure funded from Capital under Statute (REFCuS) REFCuS relates to expenditure of a capital nature that does not result in the creation of a fixed asset either tangible or intangible. Previously known as Deferred Charges.

Capital Expenditure Including REFCuS	2012/13 Estimate £m	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m
Non-HRA	2.700	2.529	3.457	1.361
REFCuS	0.869	0.906	0.869	0.869
HRA	9.518	9.654	13.918	16.223
Total	13.087	13.089	18.244	18.453

Capital expenditure has been and will be financed as follows:

Capital Financing	2012/13 Estimate £m	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m
Capital Receipts	2.763	2.734	4.398	2.224
Government Grants & Other Contributions	0.758	0.783	0.937	0.569
Major Repairs Allowance	5.218	5.418	8.709	9.960
Revenue Contributions	4.230	4.228	4.200	5.700
Total Financing	12.969	13.163	18.244	18.453

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Appendix 2

Money Market Data and PWLB Rates

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

Please note that the PWLB rates quoted below relate to the standard rates.

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
01/04/2013		0.50		0.40	0.50	0.40	0.44	0.51	0.75	0.59	0.68	0.97
30/04/2013		0.50		0.50	0.47	0.40	0.44	0.51	0.75	0.57	0.64	0.91
31/05/2013		0.50		0.38	0.42	0.40	0.44	0.51	0.75	0.68	0.82	1.15
30/06/2013		0.50		0.43	0.38	0.42	0.51	0.51	0.86	0.79	0.98	1.55
Average		**0.50**		**0.43**	**0.45**	**0.40**	**0.44**	**0.51**	**0.75**	**0.65**	**0.76**	**1.10**
Maximum		**0.50**		**0.50**	**0.50**	**0.42**	**0.51**	**0.51**	**0.86**	**0.95**	**1.12**	**1.79**
Minimum		**0.50**		**0.35**	**0.38**	**0.40**	**0.44**	**0.51**	**0.75**	**0.55**	**0.62**	**0.87**
Spread		**--**		**0.15**	**0.12**	**0.02**	**0.07**	**0.00**	**0.11**	**0.40**	**0.60**	**0.92**

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
01/04/2013	125/13	1.11	1.74	2.83	3.87	4.18	4.25	4.22
30/04/2013	166/13	1.16	1.72	2.72	3.74	4.06	4.13	4.08
31/05/2013	208/13	1.26	1.97	3.03	3.99	4.29	4.36	4.33
28/06/2013	248/13	1.22	2.34	3.49	4.30	4.52	4.56	4.54
	Low	1.11	1.70	2.71	3.71	4.02	4.08	4.04
	Average	1.22	1.95	3.01	3.96	4.26	4.32	4.29
	High	1.40	2.51	3.59	4.36	4.58	4.62	4.61

Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2013	125/13	1.30	1.80	2.87	3.39	3.89	4.08
30/04/2013	166/13	1.31	1.77	2.76	3.39	3.75	3.96
31/05/2013	208/13	1.49	2.02	3.07	3.67	4.00	4.19
28/06/2013	248/13	1.66	2.41	3.53	4.05	4.30	4.45
	Low	1.29	1.76	2.75	3.37	3.72	3.91
	Average	1.46	2.01	3.05	3.64	3.97	4.16
	High	1.85	2.58	3.63	4.13	4.37	4.51

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2013	0.5700	0.5600	0.5500	1.4700	1.4600	1.4500
30/04/2013	0.5700	0.5500	0.5400	1.4700	1.4500	1.4400
31/05/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
28/06/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
Low	0.5500	0.5500	0.5400	1.4500	1.4500	1.4400
Average	0.5664	0.5597	0.5539	1.4664	1.4597	1.4539
High	0.5800	0.5700	0.5600	1.4800	1.4700	1.4600

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Appendix 3

Maturity limits for new investments as at 30/6/2013 as recommended by Arlingclose.

UK Institutions

- Royal Bank of Scotland and National Westminster Bank for a maximum period of overnight;
- Santander UK and Close Brothers for a maximum period of 100 days;
- Lloyds TSB and Bank of Scotland for a maximum period of 6 months;
- **Royal Bank of Scotland and National Westminster Bank for a maximum period of 6 months;
- HSBC Bank, Standard Chartered, Nationwide BS and Barclays for a maximum period of 12 months.

Non-UK Institutions

- ING Bank NV, Credit Suisse, BNP Paribas, Credit Agricole CIB, Credit Agricole SA, Societe Generale, Pohjola Bank, DBS Bank, Oversea-Chinese Banking Corp and United Overseas Bank for a maximum period of 100 days;
- Bank Nederlandse Gemeenten N.V., Deutsche Bank AG, Nordea Bank, Rabobank and Svenska Handelsbanken for a maximum period of 12 months;
- National Australia Bank, Westpac, ANZ, Commonwealth Bank of Australia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Toronto-Dominion Bank, Bank of Montreal, Bank of Nova Scotia and JP Morgan for a maximum period of 12 months.

** Note : RBS and Natwest were placed on review for possible downgrade by Moody's on 5th July 2013. The current long-term rating assigned by Moody's to the institutions is A3, which is the lowest threshold of the Authority's minimum credit criteria. The maturity limits for new investments with both institutions have been restricted to overnight investments until such time as the rating review has been resolved.