30 June 2015

Policy, Finance and Resources Committee

Annual Treasury Management Report 2014/15

Report of: *Chris Leslie, Finance Director*

Wards Affected: All

This report is: Public

1. Executive Summary

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 On 5th March 2014 Council approved the annual treasury strategy for 2014/15. This report compares the treasury activity for 2014/15 against the annual strategy.

2. Recommendation(s)

2.1 That the treasury management activity and information for 2014/15 be noted.

3. Introduction and Background

3.1 The regulatory environment places responsibility to Members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.2 The Council confirms that it has applied with the requirement under the Code to give prior scrutiny to the treasury management reports by the Finance and Resources Committee before they are reported to Full Council.

The Economy and interest rates

3.3 The Bank of England base rate remained at the historic low of 0.5% throughout 2014/15 – and has now been at that level for six years. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.

3.4 At the start of 2014/15, falling unemployment rates fuelled market expectations that the first increase in the base rates would occur in the first quarter of 2015. However, economic growth continued to be dependent on consumer demand and a combination of weak pay rises, and inflation above the level of pay rises, meant that these expectations started to recede.

3.5 During the second half of 2014 financial markets were caught out by a steep fall in the price of oil and concerns of possible deflation and recession in the Eurozone. By the end of 2014 it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. The Bank of England Monetary Policy Committee would have great difficulty in starting to raise the Bank Rate while inflation was around zero and as a result market expectations for an interest rate increase moved back to around quarter three of 2016.

3.6 Gilt yields were on a falling trend for much of the last eight months of 2014/15, but were then pulled in different directions because of continued instability in Greece and the possibility of a Greek exit from the Euro. Whilst the direct effects of this would be manageable by the European Union and the European Central Bank (ECB), it is hard to quantify the potential knock on effects on other Eurozone countries once the so-called impossibility of a country leaving the Eurozone had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitive easing – purchasing Eurozone Government and other debt in March.

3.7 Strong growth in the US economy created market sentiment that it would be the first country to start increasing its central bank rate, by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in market concerns around political risk from the May general election.

3.8 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Detailed debt activity; and
- Detailed investment activity.

4. Context

The Council's Capital Expenditure and Financing 2014/15

4.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc), which has no resultant impact on the Council's borrowing need;
  Or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

4.2 The actual capital expenditure for the year forms one of the required prudential indicators. Table 1 below shows the actual capital expenditure and how this was financed.

Table 1: Actual Capital Expenditure and Financing

	2013/14 Actual £000	2014/15 Revised Budget £000	2014/15 Actual £000
Expenditure:			
- General Fund	1,493	3,047	1,276
- HRA	2,951	3,702	2,069
Total Expenditure	**4,444**	**6,749**	**3,345**
Financed by:			
- Capital receipts, grants and contributions	1,875	3,996	1,268
- HRA Business Plan	2,569	2,753	2,077
Borrowing Needs	**0**	**0**	**0**

The Council's Overall Borrowing Need

4.3 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2014/15 and prior year's capital expenditure which has not yet been paid for by revenue or other resources.

4.4 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

4.5 Under treasury management arrangements, actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy. However, the Council is required to make an annual revenue charge to reduce the General Fund element of the CFR. There is no statutory requirement to reduce the HRA element of the CFR.

4.6 This statutory revenue charge is called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:

- The application of additional capital resources (such as unapplied capital receipts);
  Or
- Charging more than the statutory revenue charge (MRP amount) each year through an additional Voluntary Revenue Provision (VRP) from either the HRA or General Fund.

4.7 The Council's CFR at the year-end is shown in Table 2 below, and represents a key prudential indicator.

Table 2: Capital Financing Requirement

	31 March 2014 Actual £000	**31 March 2015 Original £000**	**31 March 2015 Actual £000**
CFR – General Fund	7,457	7,857	7,441
CFR - HRA	70,347	70,347	68,847
Total CFR	**77,804**	**78,204**	**76,288**

4.8 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit, as set out later in this report.

<u>The Council's Treasury Position at the Year End</u>

4.9 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

4.10 The treasury position as at 31 March 2015 compared with the previous year is shown below in Table 3:

Table 3: Year End Treasury Position

	31 March 2014		31 March 2015	
	Principal £m	**Average Rate**	**Principal £m**	**Average Rate**
Fixed Interest Rate Debt	£2.000	8.075%	£2.000	8.075%
HRA Subsidy Reform	£64.166	2.815%	£64.166	2.815%
Total Debt	**£66.166**		**£66.166**	
CFR – General Fund CFR - HRA	£7.457 £70.347		£7.441 £68.847	
Total CFR	£77.804		£76.288	
Over/(Under) Borrowing	(£11.638)		(£10.122)	
Investments				
Variable Interest Investments	£0.545	0.600%	£8.882	0.325%
Total Investments	**£0.545**	**0.600%**	**£8.882**	**0.325%**
Net Borrowing Position	**£65.621**		**£57.284**	

Debt decisions taken during 2014/15

4.11 The table below summarises the long term loans held at 31 March 2015. No additional long term borrowing was taken out during the year.

Table 4: Schedule Of Outstanding Loans 31 March 2015

Repayment Date	Period of Loan (Years)	Type of Loan	Fixed/Variable	Interest Rate	Amount Outstanding £'000
PWLB LOANS:					
28/03/2017	5	Maturity	Fixed	1.240%	5,000
28/03/2022	10	Maturity	Fixed	2.400%	5,000
28/03/2027	15	Maturity	Fixed	3.010%	10,000
08/01/2028	25	Maturity	Fixed	4.875%	400
28/03/2032	20	Maturity	Fixed	3.300%	15,000
28/03/2037	25	Maturity	Fixed	3.440%	15,000
28/03/2042	30	Maturity	Fixed	3.500%	14,166
24/02/2055	60	Maturity	Fixed	8.875%	800
30/04/2055	60	Maturity	Fixed	8.875%	800
TOTAL					**66,166**

4.12 **Short Term Borrowing** – the Council has no short terms loans outstanding as at 31 March 2015.

4.13 **Debt Rescheduling** – all of the council's long term borrowing is with the Public Works Loans Board (PWLB). Due to changes made by the PWLB in the way in which it calculates the premiums and discounts on premature loan repayments, it has become more expensive to undertake any debt rescheduling. Consequently no debt rescheduling opportunities were undertaken during the year.

Investment decisions taken during 2014/15

4.14 **Investment Policy** - the Council's Treasury Management Strategy Statement was approved by full Council on 5 March 2014. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

4.15 **Major Transactions** – the Council did not undertake any long term investments during 2014/15.

4.16 **Investments held by the Council** – the table below details the investments held by the Council at 31 March 2015.

Table 5: Schedule Of Outstanding Investments 31 March 2015

Date Invested	Date to be Repaid	Invested With	Interest Rate	Investment Amount £
Call Account	N/A	Royal Bank of Scotland	0.250%	4,222,000
Call Account	N/A	Lloyds	0.400%	4,600,000
TOTAL				**8,822,000**

Prudential Indicators and Compliance Issues

4.17 The Council is required by the Prudential Code to report the actual prudential indicators after the year end. These indicators provide either an overview or a limit on treasury activity.

4.18 **The Capital Financing Requirement (CFR)** - shows the Council's underlying need to borrow for capital purposes and should only increase in relation to capital expenditure that is not met from the Council's own resources, i.e. it is unfinanced. External borrowing should not exceed the CFR except in the short term under exceptional circumstances. Any borrowing in excess of the CFR would be deemed to be for revenue purpose, which is not allowed. This indicator aims to show that gross borrowing does not exceed the CFR. The gross borrowing position is the sum of external debt and finance lease liabilities. The table below demonstrates that the Council has complied with this requirement.

Table 6: Gross Borrowing and CFR Position

	31 March 2014 Actual £000	31 March 2015 Original £000	31 March 2015 Actual £000
Gross borrowing position (including finance leases)	68,261	67,319	66,209
Total CFR	77,804	78,204	76,288

4.19 **The Authorised Limit** – this is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. This represents a limit beyond which external debt is prohibited. The limit is set or revised by the full Council. The table below demonstrates that during 2014/15 the Council has maintained gross borrowing within this limit.

4.20 **The Operational Boundary** – this is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

4.21 **Actual financing costs as a proportion of net revenue stream** – this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 7: Other Prudential Indicators

	2014/15 £m
Authorised limit	87
Maximum gross borrowing position	68
Operational boundary	85
HRA Debt Limit	73
Financing costs as a proportion of net revenue stream: Non- HRA HRA	 0.95% 16.13%

Regulatory Framework, Risk and Performance

4.22 The Council's treasury management activities are regulated by a variety of professional codes, statute and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2014/15);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the Communities and Local Government (CLG) has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under Section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

4.23 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4.24 The Council is aware of the risks of passive management of the treasury portfolio (reduced investment income, counterparty risk etc) and, with the support of Capita Asset Services the Council's Treasury Management Advisers, has proactively managed the debt and investments over the year by continually reviewing market conditions, appraising investment and debt rescheduling opportunities and assessing their effects on the Council's balance sheet.

4.25 There is little risk of volatility of costs in the current debt portfolio as the interest rates are fixed, utilising long-term loans.

4.26 Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult and will continue to impact on the revenue accounts.

5. Reasons for Recommendation

5.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15.

6. References to Corporate Plan

6.1 Effective financial management underpins all of the Council's activities.

7. Implications

Financial Implications
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7.1 The financial implications are outlined within the report.

Legal Implications
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7.2 There are no direct legal implications arising from this report.

8. Background Papers

8.1 None

9. Appendices to this report

9.1 None

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