BODY:	**CABINET**
DATE:	**3rd September 2014**
SUBJECT:	**Treasury Management Annual Report 2013-14**
REPORT OF:	**Chief Finance Officer**

Ward(s):	All
Purpose:	To report on the activities and performance of the Treasury Management service during 2013/2014
Decision Type	
Contact:	Alan Osborne, Chief Finance Officer, Financial Services Telephone Number 01323 415149.
Recommendations:	Cabinet is recommended to: 1. Agree the annual treasury management report for 2013/14. 2. Specifically approve the 2013/14 prudential and treasury indicators included.

1.0 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2013/14. 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).

During 2013/14 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 5 February 2014)
- a mid year (minimum) treasury update report (Council 11 December 2013)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee.

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is 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.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 23 March 2010 in order to support Members' scrutiny role.

1.2 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;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.

2.0 <u>The Council's Capital Expenditure and Financing 2013/14</u>

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.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2012/13 Actual £m	2013/14 Estimate £m	2013/14 Actual £m
Non-HRA capital expenditure	5.14	13.90	6.04
HRA capital expenditure	7.14	8.90	8.84
LAMS	-	1.00	1.00
Total capital expenditure	**12.28**	**23.80**	**15.88**
Resourced by:			
• Capital receipts	2.45	3.90	0.14
• Capital grants & Contributions	4.77	9.50	1.14

• Revenue	0.09	1.10	0.50
Use of internal balances	**2.96**	**2.80**	**7.65**

3.0 The Council's overall borrowing need

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.4 The Council's 2013/14 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2013/14 on 6 February 2013.

The Council's CFR for the year is shown below, and represents a key prudential indicator. The figures include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	31 March 2013 Actual £m	31 March 2014 Original Indicator £m	31 March 2014 Actual £m
Opening balance	53.65	56.60	55.90
Add unfinanced capital expenditure (as above)	2.96	2.80	7.65
Less MRP	(0.71)	(1.00)	(1.06)
Closing balance	55.90	58.40	62.49

3.5 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2013/14 plus the expected changes to the CFR over 2014/15 and 2015/16. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2013/14. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual £m	31 March 2014 Original £m	31 March 2014 Actual £m
Net borrowing position	33.54	35.34	41.49
CFR	55.90	58.40	62.49

The authorized limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2013/14 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary 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.

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.

	2013/14
Authorized limit	£73.4m
Maximum gross borrowing position	£42.4m
Operational boundary	£58.4m
Average gross borrowing position	£37.9m
Financing costs as a proportion of net revenue stream: Non HRA HRA	 6.61% 10.26%

4.0 Treasury Position as at 31 March 2014

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2013/14 the Council's treasury position was as follows:

TABLE 1	31 March 2013 Principal	Rate/Return	31 March 2014 Principal	Rate/Return
Fixed rate funding:				
-PWLB	£28.71m		£27.19m	
-Market	£10.50m		£14.00m	
- Serco Paisa	£1.49m		£1.25m	
Total debt	**£40.70m**	**5.11%**	**£42.44m**	**4.95%**
CFR	£55.90m		£62.49m	
Over/ (under) borrowing	(£15.20)		(£20.05m)	
Total investments	**£6.7m**	**1.35%**	**£0.95m**	**0.69%**

All investments were for under one year.

4.2 The maturity structure of the debt portfolio excluding Serco Paisa was as follows:

	31 March 2013 Actual £m	2013/14 Original limits £m	31 March 2014 Actual £m
Under 12 months	4.52	2.66	5.16
12 months and within 24 months	4.64	5.98	5.98
24 months and within 5 years	7.00	10.00	7.00
5 years and within 10 years	12.02	12.40	12.40
10 years and above	11.03	10.65	10.65

The exposure to fixed and variable rates was as follows:

	31 March 2013 Actual £m	2013/14 Original Limits £m	31 March 2014 Actual £m
Principal - Debt Fixed rate	40.70	58.40	42.44
Principal – Investments Variable rate	(6.70)	N/a	(0.95)

5.0 **The Strategy for 2013/14**

5.1 The expectation for interest rates within the strategy for 2013/14 anticipated low Bank Rate until quarter 4 of 2014. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk.

The actual movement in interest rates broadly followed the expectations in the strategy; rates have continued to remain low and are not expected to rise until quarter 1 of 2015.

During 2013/14 the Council used internal balances and temporary borrowing at historically low interest rates to ensure new borrowing was taken at the most advantageous rates. Temporary borrowing of £3m taken in March 2013 was repaid in April 2013. New borrowing of £4m was taken in December2013 and a further £2.5m in March 2014.

6.0 Borrowing Outturn for 2013/14

6.1 **Treasury Borrowing**.

Borrowing – two new loans totaling £6.5m were drawn down in December 2013 and March 2014 to fund the net unfinanced capital expenditure. The loans drawn were all fixed rate as follows:

Lender	Principal	Interest Rate	Maturity
Neath Port Talbot County Borough	£4m	2.20%	19/6/18
Portsmouth CC	£2.5m	0.35%	30/4/14

This compares with a budget assumption of borrowing at an interest rate of 3.25%.

Rescheduling – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.

Repayment – £3m of temporary debt was repaid on maturity during the year.

Summary of debt transactions – the overall position of the debt activity resulted in a fall in the average interest rate by 0.16%, representing a saving to the General Fund.

7.0 Interest Rates in 2013/14

7.1 The tight monetary conditions following the 2008 financial crisis continued through 2013/14 with little material movement in the shorter term deposit rates.

7.2 Bank Rate remained at its historical low of 0.5% throughout the year. Investment rates dropped and continued to be very low. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns was limited. The investment rates at the beginning and end of the year are provided below.

Investment Term	Interest Rate March 2014	Interest rate April 2013
Overnight	0.40%	0.40%
1 Month	0.40%	0.40%
3 Months	0.50%	0.45%
6 Months	0.55%	0.55%
9 Months	0.70%	0.70%
12 Months	0.80%	0.80%

The PWLB rates at the beginning and end of the year are provided below.

Loan Term	Interest Rate	Interest rate

	March 2014	April 2013
1 Year	1.44%	1.13%
5 Years	2.99%	1.75%
10 Years	3.94%	3.84%
20 Years	4.42%	4.07%
50 Years	4.47%	4.22%

8.0 Investment Outturn for 2013/14

8.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 6 February 2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2013 £m	31 March 2014 £m
Balances	3.92	4.69
Earmarked reserves	3.44	5.84
HRA	2.18	2.70
Major Repairs Reserve	2.67	0.31
Capital Grants & Contributions	5.00	4.20
Usable capital receipts	3.45	5.01
Total	**20.66**	**22.75**

8.4 **Investments held by the Council** - the Council maintained an average balance of £8.13m of internally managed funds. The internally managed funds earned an average rate of return of 0.9%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%. This excludes the Council's investment with Lloyds Bank of £1m for 5 years at 3.03% which supports the Local Authority Mortgages Scheme (LAMS).

9.0 The Economy and Interest Rates Forecast

9.1 Economic background:

- After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, and 0.8% in Q1 2014, it appears very likely that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, now broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Accordingly, markets are expecting a first increase around the end of 2014.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed in this quarter.
- In June, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $35bn and are expected to stop by Q3 201, providing strong economic growth continues this year. First quarter GDP figures were depressed by exceptionally bad winter weather, but growth rates since then look as if they are recovering well.
- The Eurozone is facing an increasing threat from deflation. In May, the inflation rate fell further, to reach 0.5%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June to loosen monetary policy in order to promote growth.

9.2 The Council's treasury advisor, Capita, provides the following forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

The Capita central forecast is for the first increase in Bank Rate to be in the March 2015.

9.3 **Summary Outlook**

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and the first quarter of 2014 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for the rest of 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy has been that wage inflation has been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during this year, especially if there is also a recovery in growth in labour productivity (leading to increases in pay rates). With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international un-competitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

10.0 Executive Summary and Conclusion

10.1 During 2013/14, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2012/13 Actual £m	2013/14 Original £m	2013/14 Actual £m
Actual capital expenditure	12.28	23.804	15.88
Total Capital Financing Requirement:			
• Non-HRA	19.16	21.66	25.02
• HRA	36.74	36.74	37.47
• Total	55.90	58.40	62.49
Net borrowing	34.00		41.49
External debt	40.70		42.44
Investments (all under 1 year)	6.70		0.95

Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

The financial year 2013/14 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

11.0 Consultation

Not applicable

Background Papers:

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code

Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.

To inspect or obtain copies of background papers please refer to the contact officer listed above.