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Report for:	**Corporate Committee** 26th June 2014	**Item number**	

Title:	Treasury Management 2013/14 Outturn

Report authorised by :	Kevin Bartle, Assistant Director – Finance (CFO)

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Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 This is a report to Members on treasury management activity and performance during 2013/14 in accordance with the CIPFA Treasury Management Code of Practice. It is a requirement of the Code for this to be reported on to Council once Corporate Committee has considered it.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That Members note the treasury management activity and performance during 2013/14.

4. Other options considered

4.1 None.

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5. Background information

5.1 The Council's treasury management activity is 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. CIPFA has defined Treasury management 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."

5.2 The Code recommends that members are informed of treasury management activities at least twice a year. Formulation of treasury policy, strategy and activity is delegated to the Corporate Committee and this Committee receives reports quarterly.

5.3 However, overall responsibility for treasury management remains with the Council and the Council approved the Treasury Management Strategy Statement and set the Prudential Indicators for 2013/14 on 27th February 2013.

5.4

his outturn report is a requirement of the Code and it summarises the activity during 2013/14.

5.5

ith regard to investments, Government guidance on local authority treasury management states that local authorities should consider the following factors in the order they are stated:

Security – Liquidity – Yield

The Treasury Management Strategy reflects these factors and is explicit that the priority for the Council is the security of its funds. However, no treasury management activity is without risk and the effective identification and management of this risk are integral to the Council's treasury management activities.

5.6

his report has been written in consultation with the Council's treasury management advisers, Arlingclose.

6. Comments of the Chief Financial Officer and financial implications

6.1 The treasury management strategy in 2013/14 was to continue to maximise internal borrowing and, therefore, to minimise cash balances. This policy not only reduced credit risk in the year but also reduced the cost of borrowing. In addition, the policy of taking short term borrowing from other local authorities instead of long term also saved interest costs during 2013/14. This active management of the debt portfolio realised savings of £1.8m in the year.

7. Head of Legal Services and Legal Implications

7.1 The contents and recommendation of this report are in accordance the Treasury Management Strategy Statement and consistent with legislation governing the financial affairs of the Council. In considering the report Members must take into account the expert financial advice available to it and any further oral advice given at the meeting of the Committee.

8. Equalities and Community Cohesion Comments

8.1 Not applicable.

9. Head of Procurement Comments

9.1 Not applicable.

10. Policy Implications

10.1 None.

11. Use of Appendices

11.1 Appendix 1: Summary of Treasury Management activity and performance
Appendix 2: Prudential Indicators

12 Local Government (Access to Information) Act 1985

12.1 Not applicable.

13. Economic and treasury portfolio background in 2013/14
(prepared by Arlingclose)

13.1 At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a 'triple-dip' alongside falling real wages and the paucity of business investment were a concern for the Bank of England. The Eurozone had navigated through a turbulent period and the likelihood of a near-term disorderly collapse had significantly diminished.

13.2 The recovery in the UK surprised with strong economic activity and growth. Q1 2014 GDP showed year-on-year growth of 2.7%. Much of the improvement was down to the dominant service sector, and an increase in household consumption. However, business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth. Worries of a housing bubble were tempered by evidence that net mortgage lending was up by only around 1% annually.

13.3 CPI fell from 2.8% in March 2013 to 1.8% in April 2014. Although the fall in unemployment (down from 7.8% in March 2013 to 6.8% in April 2014) was faster than forecast, it hid a stubbornly high level of underemployment. Importantly, average earnings growth remained muted. The Bank of England implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

13.4 The Office of Budget Responsibility's 2.7% forecast for economic growth in 2014 forecast a quicker fall in public borrowing over the next few years.

13.5 The Federal Reserve announcement in May 2013 that the Fed's quantitative easing (QE) programme may be 'tapered' caught markets by surprise. 'Tapering' (a slowing in the rate of QE) began in December 2013. The impact went further than a rise in the dollar and higher US Treasury bond yields. Gilt yields also rose as a consequence and emerging markets, which had previously benefited as investors searched for yield through riskier asset, suffered large capital outflows in December and January.

13.6 With the Eurozone struggling to show sustainable growth, the European Central Bank cut main policy interest rates an all time low of 0.15% and the deposit rate which it pays banks for parking funds overnight to -0.1%.

13.7 Gilt yields ended the year higher than the start in April. The peak in yields was during autumn 2013. The biggest increase was in 5-year gilt yields which increased by nearly 1.3% from 0.70% to 1.97%. 10-year gilt yields rose by nearly 1% ending the year at 2.73%. The increase was less pronounced for longer dated gilts; 20-year yields rose from 2.74% to 3.37% and 50-year yields rose from 3.23% to 3.44%.

13.8 3-month, 6-month and 12-month Libid rates remained at levels below 1% through the year.

13.9 The position of the treasury portfolio at the end of the financial year compared to the previous financial year end is shown in the table below. This shows a net reduction of £24.5m in long term PWLB borrowing and £30m in short term borrowing from other local authorities arising from the repayment of maturing debt and further use of cash balances in lieu of borrowing. The sections which follow describe the activity in the borrowing and investment portfolios in more detail.

Treasury Portfolio	Position at 31/03/13 £'000	Position at 31/03/14 £'000
Borrowing		
PWLB fixed maturity	192,178	170,540
PWLB fixed EIP	7,746	5,809
PWLB variable EIP	6,778	5,810
Market loans	125,000	125,000
Other local authorities	30,000	0
Total External Borrowing	361,702	307,159
Investments		
Fixed term deposits	7,100	0
Money market funds	7,095	0
Bank balances	0	9,570
Total Investments	14,195	9,570

14. Borrowing

14.1 During the year the Council continued its policy of undertaking limited external long term borrowing and maximising the use of internal balances in lieu. The reason for this was to continue to minimise the "cost of carry" associated with external borrowing and thus to reduce overall borrowing costs. The cost of carry is the difference between the interest rate paid for long term borrowing and the rate of interest which can be earned from temporarily investing the funds borrowed which has amounted to 3-4% over the last year. As a result, £54.5m of maturing loans were repaid and no permanent borrowing undertaken. On two occasions, short term loans (aggregate £3.8 million) of a few days duration were required to cover cash flow mismatches, but these were promptly repaid from income.

14.2 To minimise the risks associated with interest rate changes, 98% of the Council's loans portfolio is held at fixed rates.

14.3 The Council has £125m of market loans which are LOBO loans (Lender's Options Borrower's Option) and all of them are in their call periods. A LOBO is called when the lender exercises its right to amend the interest rate on the loan at which point the borrower can accept the revised terms or reject them and repay the loan without penalty. Whilst none of the LOBOs had been called they do represent a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion. At present the PWLB 50 year rate of 4.22% is lower than the LOBO interest rate of 4.7%, such that any calls could be refinanced at a saving to the Council. Any LOBO called will be discussed with the Council's treasury advisers prior to acceptance of revised terms.

14.4 The average maturity of the debt portfolio shown in table 3 of appendix 1 is 29.8 years. If the LOBO loans are treated as repayable at their next 6 monthly call date, the average maturity falls to 11.1 years.

14.4 The table below summarises the transactions undertaken during the year:

	1/4/12 £'000	**Maturing loans £'000**	**New loans £'000**	**31/3/13 £'000**
PWLB fixed maturity	192,178	(21,638)	0	170,540
PWLB fixed EIP	7,746	(1,937)	0	5,809
PWLB variable EIP	6,778	(968)	0	5,810
Market loans	125,000	0	0	125,000
Other local authorities	30,000	(33,800)	3,800	0
Total borrowing	361,702	(58,343)	3,800	307,159

14.5 At the end of the financial year the average interest payable on the borrowing portfolio had increased marginally to 5.45% from 5.38% as at 1 April 2013 due to the repayment of the short term local authority debt. The interest paid in 2013-14 of £17.9 million is £1.8 million lower than the previous year. Looking forward, there is £55 million of debt with a coupon of 9-11% maturing by 2022 that offers further scope for savings.

15. Investments – activity and performance

15.1 The Council held average cash balances of £39.6m during the year. The balances represented working cash balances and the Council's reserves. The Council invested these funds in accordance with the Treasury Management Strategy Statement agreed for 2013/14. All investments made during the year complied with the Council's agreed Treasury Management Strategy and Treasury Management Practices. Maturing investments were repaid to the Council in full and in a timely manner.

Credit Risk

15.2 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long term counterparty rating of A- Fitch, Standard and Poors and Moody's); credit default swaps; any potential support mechanisms from the UK Government and share price. The Council has sought to minimise its security risks by setting limits on each institution on the lending list. The Council has complied with all these limits during 2013/14.

15.3 There were no significant changes in credit rating impacting on the Council's counterparties during the year. More recently, Moody's downgrading of RBS by one level to Baa1 in April 2014, which is below minimum required credit rating and use of RBS as a counterparty has been suspended. The Council moved its banking arrangement from RBS to Barclays from September 2013, although we are still in the process of closing the residual RBS accounts.

15.4 The credit ratings of the Council's main bank, Barclay's, is long term A (minimum A-). Credit rating agencies are looking at the impact of new rules under which depositors will be required to contribute to bank losses before governments are permitted to support banks, known as bail-in provisions. As a consequence of the weaker government support, credit ratings for banks could fall further.

15.5 The main counterparties in use during the year and the balances as at 31st March 2014 are shown in the table below.

Institution	**Long term credit rating**	**Amount (£'000)**	**% of total deposits**
Deutsche MMF	AAA	0	0
RBS MMF	AAA	0	0
JP Morgan MMF	AAA	0	0
Invesco MMF	AAA	0	0
Goldman Sachs MMF	AAA	0	0
BlackRock MMF	AAA	0	0
Debt Management Office	AA+	0	0
Barclays Bank	A	9,570	100
Royal Bank of Scotland	Baa1	0	0
TOTAL		9,570	100.0

The Debt Management Office does not have a credit rating, therefore the UK sovereign rating is used.

15.6 The only outstanding balance at the year end was an overnight deposit with Barclay's Bank.

15.7 Throughout 2013-14 credit risk scores have been reported to Committee based on a methodology devised by Arlingclose. The scores show credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0-2
Target score	AA to A+	Score 3-5
Below target	Below A+	Score over 5

The scores during 2013-14 are shown below:

	Quarter 1 2013/14	Quarter 2 2013/14	Quarter 3 2013/14	Quarter 4 2013/14
Value weighted	3.3	3.5	5.6	6.0
Time weighted	1.9	2.1	5.0	6.0

Investment balances during the year varied between nil and £86 million, being £10 million at the year end. As the balances decreased during the year, a higher proportion was retained at Barclay's to aid banking liquidity, and as a consequence the credit rating score deteriorated, although because balances are low at the year end, credit risk is also reduced.

Liquidity

15.8 In keeping with the Government's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of bank deposit accounts, Money Market Funds and Debt Management Office investments which operate on an instant access basis. The weighted average maturity of the investment portfolio at the year end is one day.

Yield

15.9 The Council sought to optimise returns commensurate with its objectives of security and liquidity. £129,000 was earned on the Council's investments during 2013/14 at an average rate of 0.32%, 0.18% below the Bank of England Base Rate. The DMO pay 0.25%, money market funds 0.3-0.4% and deposits with RBS and Barclays averaged around 0.5%.

16. Update on Investments with Icelandic Banks

16.1 Further distributions of £9.5 million were received from the Icelandic deposits in the year, bringing total distributions to £34.8 million, compared with the original deposits of £36.9 million. Future recoveries are estimated at £0.9 million.

16.2 The residue of the Landsbanki claim was sold by way of auction and the remaining balances relate to deposits held in escrow in Iceland (£0.5 million) and possible future distributions estimated at £0.4 million.

17. Compliance with Prudential Code indicators

17.1 The Council set prudential indicators for 2013/14 in February 2013. The set of indicators is made up of those which provide an indication of the likely impact of the planned capital programme and those which are limits set on treasury management activity. Appendix 2 sets out the approved indicators for 2013/14 and the final position for each of the capital indicators and the year end position on each of the treasury management limits.

17.2 Borrowing is well within the operational and authorised limits and has steadily decreased throughout the year in line with the policy of using internal cash balances to fund the capital programme.

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Appendix 1: Summary of Treasury Management Activity and Performance

1. Treasury Portfolio

	Position March 2014 £000	Position December 2013 £000	Position September 2013 £000	Position June 2013 £000
	182,159			196,683
Long Term Borrowing PWLB	125,000	195,715	195,715	125,000
Long Term Borrowing Market	0	125,000	125,000	0
Short Term Borrowing		0	0	
Total Borrowing	307,159	320,715	320,715	321,683
Investments: Council	9,570	17,260	40.960	40,085
Investments: Icelandic deposits in default	2,177	8,069	8,331	12,455
Total Investments	11,747	25,329	49,291	52,540
Net Borrowing position	295,412	295,386	271,424	269,143

2. Security measure

	Quarter 4 2013/14	Quarter 3 2013/14	Quarter 2 2013/14	Quarter 1 2013/14
Credit score – Value weighted	6.0	5.58	35	3.3
Credit score – Time weighted	6.0	4.96	2.1	1.9

3. Liquidity measure

	Quarter 4 2013/14	Quarter 3 2013/14	Quarter 2 2013/14	Quarter 1 2013/14
Weighted average maturity: deposits (days)	1.0	1.0	4.5	14.4
Weighted average maturity: borrowing (years)	29.8	28.9	29.1	29.5

4. Yield measure

	Quarter 4 2013/14	Quarter 3 2013/14	Quarter 2 2013/14	Quarter 1 2013/14
Interest rate earned	0.32	0.32	0.32	0.32
Interest rate payable	5.45	5.44	5.44	5.83

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Appendix 2: Prudential Indicators

The Prudential indicators are designed to demonstrate the affordability of current and forecast borrowing. There is no 'correct' value in each table and the trend is at least as important as the absolute numbers. Debt is used to finance the capital programme and each decision to incur capital expenditure will consider how it is to be funded.

	Prudential Indicator	**2013/14 Original Indicator**	**Position/Actual at 31/3/2014**
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	47,811	41,510
	HRA	34,202	32,074
	TOTAL	82,013	73,584

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 tax and housing rent levels.

Capital expenditures is lower than projected, which helps explain the decrease in borrowing

2	**Ratio of financing costs to net revenue stream**	**2013/14 Original Indicator**	**Actual as at 31 March 2014**
	General Fund	2.62%	2.38%
	HRA	12.94%	11.89%

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

The indicators show a marginally lower impact of capital expenditure on budgets.

3	**Capital Financing Requirement**	**2013/14 Original Indicator (£'000)**	**Actual as at 31 March 2014 (£'000)**
	General Fund	277,726	272,753
	HRA	271,096	271,096
	TOTAL	548,822	543,849

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The above is the maximum external borrowing requirement representing the remaining cost of capital expenditure. The out-turn is in line with the start of year projections.

4	**Incremental impact of capital investment decisions**	**2013/14 Original Indicator (£)**	**Actual as at 31 March 2014 (£)**
	Band D Council Tax	8.77	11.59
	Weekly Housing rents	0.13	0.09

This is an indicator of affordability and shows the impact of capital investment decisions on Council tax and housing rent levels. The increase in the Council tax impact is due to capital receipts being lower than projected.

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	Prudential Indicator	2013/14 Original Indicator		2013/14 Position/Actual at 31/3/2014
TREASURY MANAGEMENT LIMITS				
5	Borrowing Limits	£'000		£'000
	Authorised Limit	671,293		307,159
	Operational Boundary	537,280		307,159
Actual borrowing is considerably lower than the limit set for the year.				
6	HRA Debt Cap	£'000		£'000
	Headroom	55,824		56,442
The capacity of HRA to incur additional borrowing is in line with projections.				
7	Gross debt compared to CFR	£'000		£'000
	Gross Debt	393,972		307,159
	CFR	548,822		551,938
		72%		56%
Gross debt is less than previous projections due to use of internal balances to finance capital expenditure.				
8	Upper limit – fixed rate exposure	100%		98%
	Upper limit – variable rate exposure	40%		2%
With no new borrowing in the year, the vast majority of debt remains fixed rate.				
9	Maturity structure of borrowing (U: upper, L: lower)	L	U	**As at 31 March 2014**
	under 12 months	0%	40%	4.3%
	12 months & within 2 years	0%	35%	3.5%
	2 years & within 5 years	0%	35%	11.6%
	5 years & within 10 years	0%	35%	15.3%
	10 yrs & within 20 yrs	0%	35%	0.7%
	20 yrs & within 30 yrs	0%	35%	7.2%
	30 yrs & within 40 yrs	0%	35%	16.8%
	40 yrs & within 50 yrs	0%	50%	16.2%
	50 yrs & above	0%	50%	24.4%
The maturity profile of debt is shown above. The ranges set have been complied with and there is a spread of maturities.				

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	Prudential Indicator	2013/14 Original Indicator	2013/14 Position/Actual at 31/3/2014
10	Sums invested for more than 364 days	£0	£0
11	Adoption of CIPFA Treasury Management Code of Practice	√	√

12 LOBO Adjusted Maturity Structure for Debt			
Maturity structure of borrowing (U: upper, L: lower)	L	U	**As at 31st March 2014**
under 12 months	0%	55%	45.0%
12 months & within 2 years	0%	40%	3.5%
2 years & within 5 years	0%	40%	11.6%
5 years & within 10 years	0%	35%	15.3%
10 yrs & within 20 yrs	0%	35%	0.7%
20 yrs & within 30 yrs	0%	35%	3.9%
30 yrs & within 40 yrs	0%	35%	3.8%
40 yrs & within 50 yrs	0%	50%	16.2%
50 yrs & above	0%	50%	0%

The above table restates table 9 showing the earliest data on which the interest rate on LOBO loans (see 14.3) can change as the maturity date. The impact is to restate 40% of debt previously classified as between 20 years and 50+ years to less than one year.