

# Appendix A

## Annual Treasury Management Review 2014/15

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English Local Authorities  
April 2015

## Contents

Purpose .....	3
Executive Summary .....	4
Recommendations.....	4
Introduction and Background .....	5
1. The Council’s Capital Expenditure and Financing 2014/15.....	5
2. The Council’s Overall Borrowing Need.....	6
3. Treasury Position as at 31 March 2015 .....	8
4. The Strategy for 2014/15 .....	10
5. The Economy and Interest Rates.....	11
6. Borrowing Rates in 2014/15 .....	12
7. Borrowing Outturn for 2014/15 .....	12
8. Investment Rates in 2014/15.....	13
9. Investment Outturn for 2014/15 .....	14
10. Other Issues .....	16

# Annual Treasury Management Review 2014/15

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## Purpose

This 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).

During 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 13/02/2014)
- a mid-year (minimum) treasury update report (Cabinet 16/12/14)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly treasury management update reports.

The regulatory environment places responsibility on 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.

This Council 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 Finance, Audit and Risk Committee before they were reported to the full Council.

## Executive Summary

During 2014/15, 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:

Prudential and treasury indicators	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Capital expenditure	11,526	7,864	4,532
Capital Financing Requirement:	-23,322	-23,322	-20,175
External debt	3,060	1,572	1,572
Investments			
• Longer than 1 year	7.75	0	7.75
• Under 1 year	29.78	35.75	27.97
• Total	37.53	35.75	35.72

Capital spend decreased during the year from an original budget of £7.86M to an actual of £4.53M. This was mainly due to the revision in the timetable for completion of schemes, and a net reduction on spend on other schemes.

Other prudential and treasury indicators are to be found in the main body of this report. The Strategic Director of Finance also confirms that no borrowing was undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2014/15 continued the challenging investment environment of previous years, namely low investment returns.

## Recommendations

The Council is recommended to:

1. Approve the actual 2014/15 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2014/15

## Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual 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;
- Detailed debt activity; and
- Detailed investment activity.

### 1. The Council's Capital Expenditure and Financing 2014/15

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.

£m General Fund	2013/14 Actual £000	2014/15 Working Budget £000	2014/15 Actual £000
<b>Capital expenditure</b>	<b>11,526</b>	<b>6,324</b>	<b>4,532</b>
Financed in year	1,866	2,509	1,367
<b>Unfinanced capital expenditure</b>	<b>9,660</b>	<b>3,815</b>	<b>3,165</b>

## 2. The Council's Overall Borrowing Need

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. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2014/15 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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 that 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.

**Reducing the CFR** – the Council's 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 has a negative CFR so is not required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. MRP is effectively a repayment of the borrowing need. 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).

The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 13/02/2014. Because the Council is in the unusual position of having a negative CFR there is no requirement currently to make an annual revenue charge (MRP).

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes finance leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m): General Fund	31 March 2014 Actual £000	31 March 2015 Actual £000
Opening balance	-32,982	-23,303
Add unfinanced capital expenditure (as above)	9,660	3,165
LAMS	0	0
Less MRP/VRP*	0	0
Less finance lease repayments	19	16
Closing balance	-23,303	-20,122

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

**Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2014/15) plus the estimates of any additional capital financing requirement for the current (2015/16) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2014 Actual	31 March 2015 Budget	31 March 2015 Actual
Gross borrowing position	£1.659m	£1.572m	£1.572m
CFR	-£23.30m	-£23.32m	-£20.122m

**The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2014/15 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.

	2014/15
Authorised limit	£8.0M
Maximum gross borrowing position	£3.06M
Operational boundary	£6.0M
Average gross borrowing position	£1.66M
Financing costs as a proportion of net revenue stream	-2.38%

### 3. Treasury Position as at 31 March 2015

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. 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 2014/15 the Council's treasury position was as follows:

TABLE 1	31 March 2014 Principal	Rate/ Return	31 March 2015 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£0.660M	8.39%	£0.572M	8.87%
-Market	<u>£2.400M</u>	9.09%	<u>£1.000M</u>	10.125%
Variable rate funding:				
-PWLB	£0M		£0M	
-Market	<u>£0M</u>		<u>£0M</u>	
<b>Total debt</b>	<b>£3.060M</b>	<b>8.53</b>	<b>£1.57M</b>	<b>8.54</b>
<b>CFR</b>	<b>-£23.30M</b>		<b>-£20.12M</b>	
<b>Over / (under) borrowing</b>	<b>£26.36M</b>		<b>£21.69M</b>	
Investments:				
- in house	£1.03M	0.50%	<u>£2.72M</u>	0.40%
- Cash Managers	£36.5M	1.52%	<u>£33.00M</u>	1.29%
<b>Total investments</b>	<b>£37.53m</b>	<b>1.52%</b>	<b><u>£35.72M</u></b>	<b>1.24%</b>



The exposure to fixed and variable rates was as follows:

	31 March 2014 Actual	2014/15 Original Limits	31 March 2015 Actual
Fixed rate (principal)	£33.50Mcr	£23.9Mcr - £34.1M	£32.72Mcr
Variable rate (principal)	£4.03Mcr	£0 - £10.9Mcr	£3.00Mcr

The maturity structure of the debt portfolio was as follows:

	31 March 2014 actual	2014/15 original limits	31 March 2015 actual
Under 12 months	£1.487M	£0.023M	£0.023M
12 months and within 24 months	£0.057M	£0.017M	£0.017M
24 months and within 5 years	£1.076M	£0.036M	£0.036M
5 years and within 10 years	£0.093M	£0.022M	£0.022M
10 years and above	£0.347M	£0.474M	£0.474M

The maturity structure of the investment portfolio was as follows:

	2013/14 Actual £000	2014/15 Actual £000
Investments		
Longer than 1 year	7.75	7.75
Under 1 year	29.78	27.97
Total	37.53	35.72

## 4. The Strategy for 2014/15

The strategy in 2014/15 was to continue only lending to UK banks and building societies. Only UK banks with a credit rating, for longer term deals, greater than “BBB” and F3 or above for short term credit ratings were on the Council’s lending list. (These are Fitch definitions of ratings). Not all building societies are credit rated but this did not preclude them from the lending list as lending to a building society was dependant on their asset size. Where a society did have a rating, this was considered at the time of the deal taking into account the amount of investment and the length of the deal. As well as imposing maximum limits with each counter party, the overall percentage of outstanding investments with each counterparty was assessed to ensure a reasonable spread of investments.

**Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2014/15, approved by the Council on 13/02/2014, was not subjected to any revision during the year.

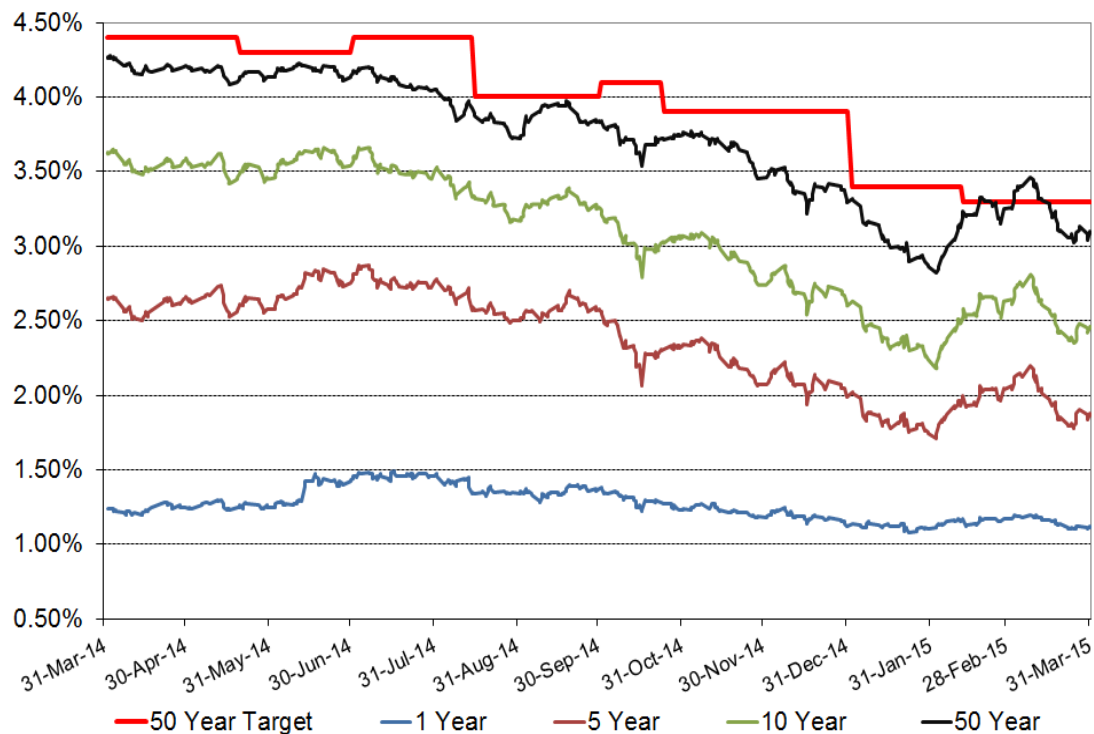
## 5. The Economy and Interest Rates

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. 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. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably 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 concerns around political risk from the general election due in May 2015.

## 6. Borrowing Rates in 2014/15

**PWLB borrowing rates** - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



## 7. Borrowing Outturn for 2014/15

**Borrowing** - A temporary loan of £0.57M was taken out on 14th April for one day to cover a shortfall in cashflow with a rate of 0.61%. The shortfall occurred as £8.7M of expenditure (County Precept, Benefits and Salaries) was paid on the 14th whilst £4.2M of income (Housing Subsidy Grant and Council Tax) was not received until the 15th. Interest paid on this loan was £9.53.

The loan drawn was:

Lender	Principal	Type	Interest Rate	Maturity
Rhondda Cynon Taff County Borough Council	£0.57m	Fixed Interest Rate	0.61%	1 Day

The loans repaid were:

Lender	Principal	Type	Interest Rate	Maturity
Rhondda Cynon Taff County Borough Council	£0.57m	Fixed interest rate	0.61%	1 Day
PWLB	£0.087m	Fixed interest rate	Various	Various

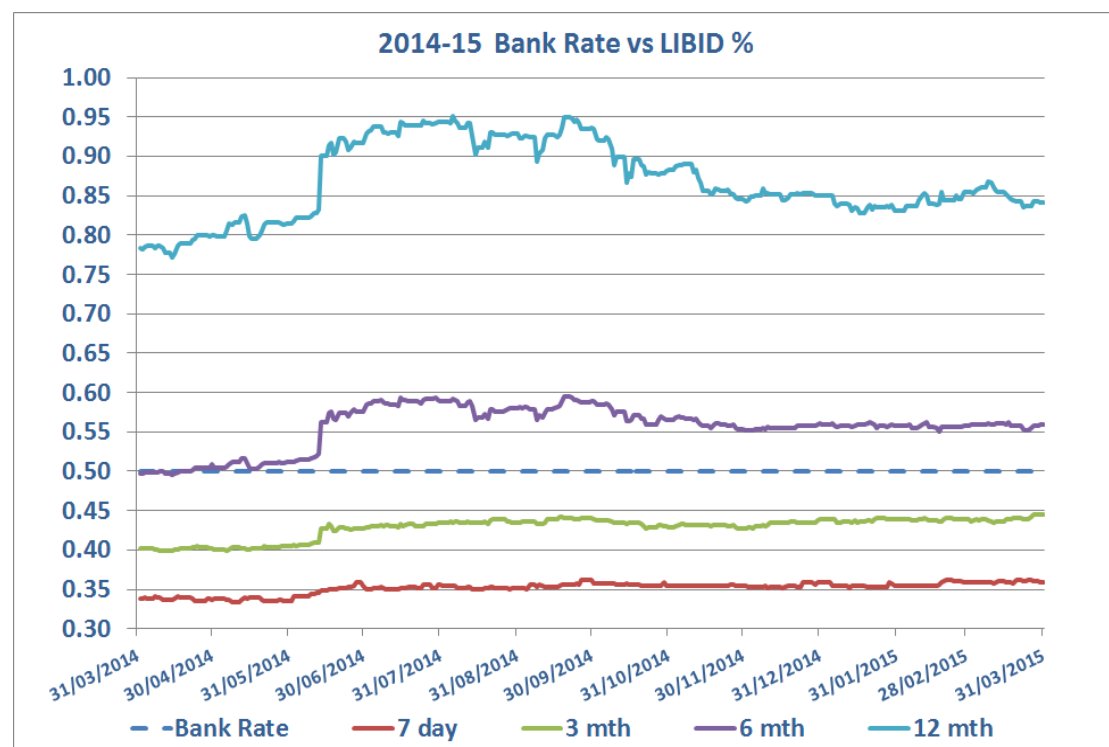
The average borrowing rate increased from 9.15% to 9.95% due to loans maturing during the year with relatively low interest rates.

### Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

## 8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



## 9. Investment Outturn for 2014/15

**Investment Policy** – the Council’s investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 13/02/14. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the Fitch credit rating agency for banks and asset size for building society investments. This is supplemented by spreading the investments over a number of counterparties.

The investment activity during the year conformed to the approved strategy apart from the Council did exceed it’s investment limit with the Council’s general banking provider, Lloyds Banking Group, for a small number of days. This will not occur again as Members approved a change to the 2015/16 Treasury Strategy where by balances held in the Council’s current account are not subject to counter party limits.

**Investments placed by Cash Managers** – the Council used two external cash managers to invest its cash balances. At the start of the year, Sterling had £16.5m to invest, Tradition £20m. During the year three investments were not reinvested when they matured to fund the capital programme. Sterling ended their contract in December and as their investments have matured, Tradition have placed the investments. At year end, outstanding investments placed by Sterling were £13m and Tradition had £20m. The performance of the managers against the benchmark return was:

Cash Manager	Investments Placed	Interest	Return	Benchmark*
Sterling	£16.5M - £13M	£0.193M	1.20%	0.54%
Tradition	£20M	£0.272M	1.36%	0.32%
Total	£36.5M - £33M	£0.465M	1.29%	

\*Ave 3 Month LIBID Rate 0.54%

Ave 7 days notice Rate 0.32%

This compares with an original budget of £0.645M.

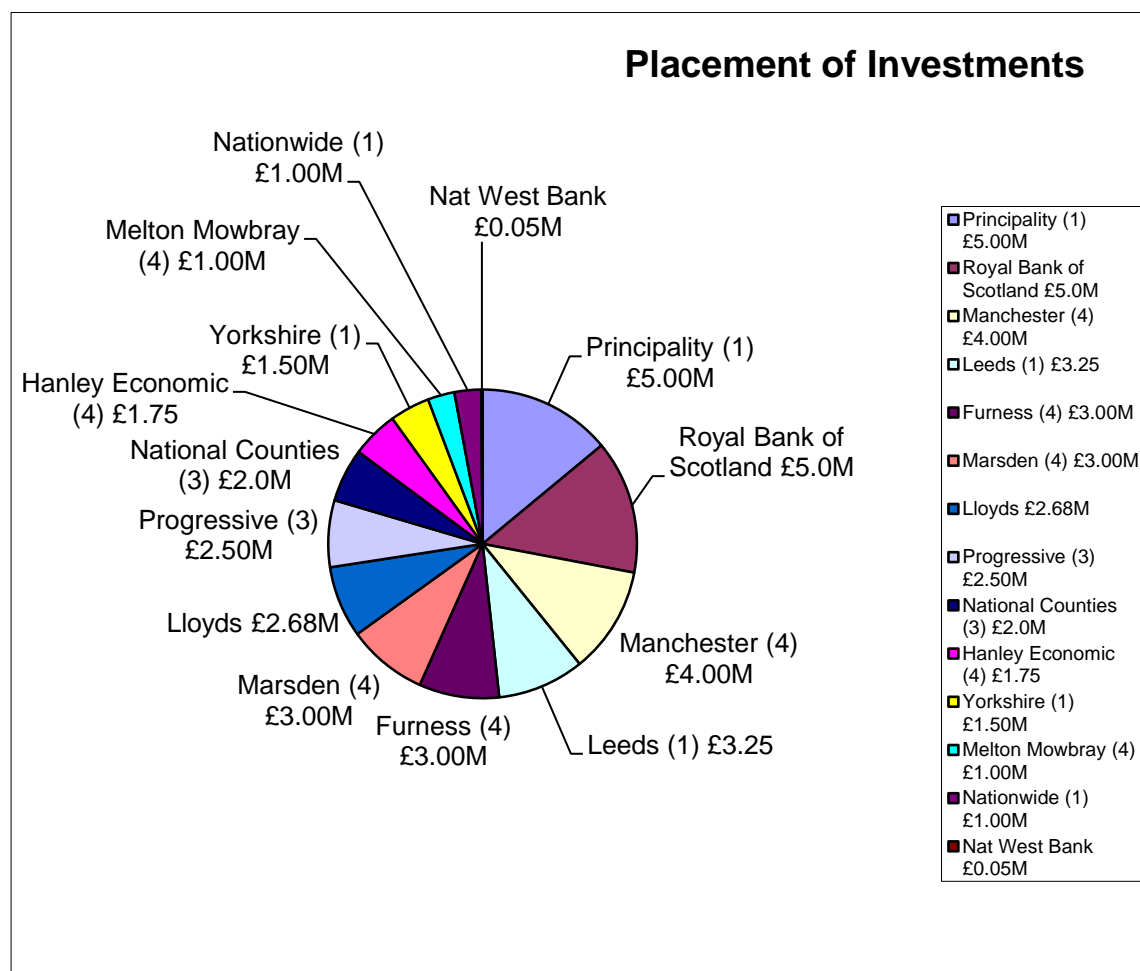
	Ave. Int. Rate Deals made in 1 <sup>st</sup> Qtr %	Ave. Int. Rate Deals made in 2nd Qtr%	Ave. Int. Rate Deals made in 3rd Qtr %	Ave. Int. Rate Deals made in 4th Qtr %	Ave. Int. Rate Deals made in Year	Ave. Int. Rate for All Investments during Year %
NHDC	0.42	0.39	0.36	0.37	0.40	0.4
Sterling	0.97	0.95	1.13	0	1.03	1.20
Tradition	1.33	0.88	0.80	1.16	1.20	1.36

The table below summaries where investments were held at 31 March:

	Investments 31 March 2014	Investments 31 March 2015
Banks	£7.03m	£7.72m
Building Societies	£30.50m	£28.00m
Local Authorities	-	-
Total	£37.53m	£35.72m

The pie chart below shows the spread of investment balances as at 31 March 2015. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

- (1) Building Societies with Assets over £4.5bn
- (2) Building Societies with Assets between £2.5bn - £4.5bn
- (3) Building Societies with Assets between £1.0bn - £2.5bn
- (4) Building Societies with Assets between £0.3bn - £1.0bn



The average daily balance of investments was £38.086m with balances varying between £33.05m and £44.87m.

£0.489m of interest was generated from investments during the year. This is slightly more than the estimated interest of £0.484m.

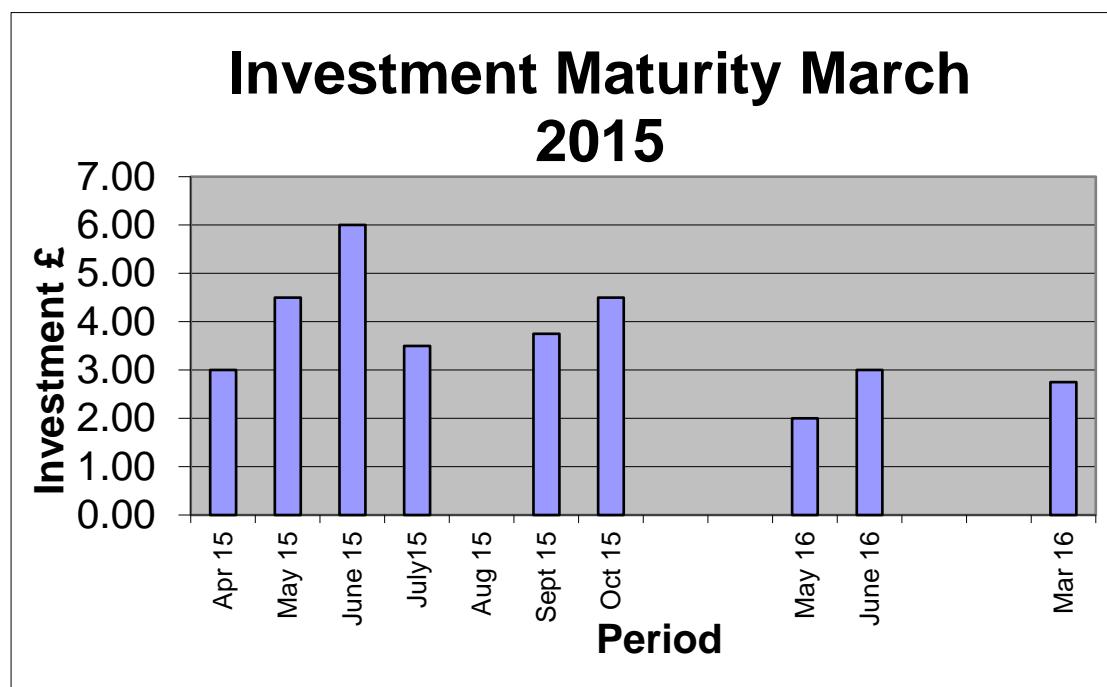
	Interest Accrued to 31 March £	Interest Received by 31 March £	Total Interest for the Year £
NHDC	1,195	23,152	24,347
Sterling	84,056	108,949	193,005
Tradition	126,640	145,094	271,734
<b>Total</b>	<b>211,891</b>	<b>277,195</b>	<b>489,086</b>

**Investments held by the Council** - the Council maintained an average balance of £6.01m of internally managed funds. The internally managed funds earned £24k of interest with an average rate of return of 0.40%.

**Investments held by Sterling** - Sterling maintained an average balance of £16.12M managed funds. This generated £0.193M interest and earned an average rate of return of 1.20%.

**Investments held by Tradition** – Tradition maintained an average balance of £20M managed funds. This generated £0.272M interest and earned an average rate of return of 1.36%.

The graph below shows the maturity profile of investments at 31<sup>st</sup> March 2015.



## 10. Other Issues

### **Sterling**

When the housing stock was transferred to North Herts Homes in 2003, the Council employed two Cash Managers (Sterling and Tradition) to arrange investments from the proceeds. This arrangement continued successfully until December when Sterling gave notice that they would be terminating the contract from 31st December. As the funds managed by Sterling reach maturity, some of the funds will be managed by Tradition with the remainder being managed in house by Officers. Sterling investments totalling £3.5M matured in the final quarter of 2014/15 and were retained in house to fund Capital spend. This left a balance of £13M placed by Sterling. Of this, £8.5M was allocated to Tradition providing them with a balance of £28.5M with the remaining £4.5M retained in house to fund Capital expenditure in 2015/16.