SOUTH HOLLAND DISTRICT COUNCIL

Report of: **Executive Director - Place (S151)**

To: **Governance and Audit Committee - 25 June 2015**

(Author: **Sean Howsam – Finance Manager – Treasury (CPBS))**

Subject: **Annual Treasury Management Review 2014/15**

Purpose: **To provide pre-decision scrutiny to the Annual Treasury Management Review 2014-15 being proposed**

Recommendation:

1) That the Governance and Audit Committee scrutinise the Annual Treasury Management Review 2014/15 and make any comments for consideration by Council when they consider this document at their meeting on 29 July 2015.

1.0 **BACKGROUND**

1.1 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 26/02/2014);
- a mid year (minimum) treasury update report (submitted to Governance and Audit 18/12/2014);
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.2 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.

1.3 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to treasury management reports by the Governance and Audit Committee before they were reported to the full Council.

1.4 The Treasury Management function is administered by Compass Point Business Services on behalf of the Council.

2.0 **INTRODUCTION**

2.1 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.

3.0 **THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2014/15**

3.1 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.

3.2 The actual capital expenditure forms one of the required prudential indicators. The following tables show the actual capital expenditure and how this was financed.

£'000 General Fund	**2013/14 Actual**	**2014/15 Estimate**	**2014/15 Actual**
Capital expenditure	1,336	2,683	2,863
Financed in year	(1,336)	(1,171)	(1,356)
Unfinanced capital expenditure	-	1,512	1,507

£'000 Housing Revenue Account (HRA)	**2013/14 Actual**	**2014/15 Estimate**	**2014/15 Actual**
Capital expenditure	5,396	7,723	5,815
Financed in year	(5,396)	(7,723)	(5,815)
Unfinanced capital expenditure	-	-	-

4.0 THE COUNCIL'S OVERALL BORROWING NEED

4.1 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 indebtedness. The CFR results from the capital activity of the Council and resources 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.

4.2 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 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.

4.3 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-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).

4.4 The Council's 2014/15 MRP Policy as required by Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2014/15 on 26/02/2014.

4.5 The Council's CFR for the year is shown below, and represents a key prudential indicator:

CFR (£'000): General Fund	**31 March 2014 Actual**	**31 March 2015 Budget**	**31 March 2015 Actual**
Opening Balance	945	741	741
Add unfinanced capital expenditure (as above)	-	1,512	1,507
Less MRP	(204)	(46)	(37)
Closing Balance	741	2,207	2,211

CFR (£'000): HRA	31 March 2014 Actual	31 March 2015 Budget	31 March 2015 Actual
Opening Balance	69,960	69,653	69,653
Add unfinanced capital expenditure (as above)	-	-	-
Less MRP and Revaluation losses on HRA non-dwellings	(307)	-	(47)
Closing Balance	69,653	69,653	69,606

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

4.6 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 CFR in the preceding year (2014/15) plus the estimates of any additional CFR 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 (£'000)	31 March 2015 Budget (£'000)	31 March 2015 Actual (£'000)
Gross Borrowing Position	67,459	67,456	67,456
CFR	70,394	71,860	71,817

4.7 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 following table demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit.

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	£75.456m
Maximum gross borrowing position	£67.459m
Operational boundary	£72.456m
Average gross borrowing position	£67.456m
Financing costs as a proportion of net revenue stream – Non HRA HRA	-0.63% 22.83%

5.0 **TREASURY POSITION AS AT 31 MARCH 2015**

5.1 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 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 including accrued interest was as follows:

	31/3/14 Amount £'000	Rate/ Return %	Average Life	31/3/15 Amount £'000	Rate/ Return %	Average Life
Fixed rate funding						
Salix loan	3	0.00	<1 year	-	-	-
PWLB	67,456	3.48	48 years	67,456	3.48	47 years
Leases	34	n/a		13	n/a	
Total debt	**67,493**	**3.48**	**48 years**	**67,469**	**3.48**	**47 years**
CFR	70,394			71,817		
Over/(under) borrowing	(2,901)			(4,348)		
Cash and investments:						
long term	0	n/a	n/a	(50)	n/a	n/a
short term	(10,146)	0.87	67 days	(14,315)	0.84	119 days
call and bank accounts	(7,859)	0.50	1 day	(9,091)	0.44	1 day
Total cash and investments	**(18,005)**	**0.66**	**38 days**	**(23,456)**	**0.69**	**73 days**
Net debt	**49,448**			**44,013**		

5.2 Investments held at 31 March 2015 including accrued interest were as follows:

Financial Institution	Amount £'000	Start Date	Maturity Date	Rate/ Return %
Local Capital Finance Company Ltd	50	n/a	n/a	n/a
National Westminster Bank (Instant Access)	2	n/a	n/a	0.25
Svenska Handelsbanken	4,987	n/a	n/a	0.48
CCLA Money Market Fund	4,102	n/a	n/a	0.39
Lloyds Bank	1,817	02/04/14	01/04/15	0.95
Lloyds Bank	1,716	10/04/14	09/04/15	0.95
Lloyds Bank – Thornfields S106	248	31/03/15	30/04/15	0.28
Royal Bank of Scotland	3,020	01/08/14	31/07/15	1.01
Royal Bank of Scotland	1,510	15/08/14	14/08/15	1.00
Nationwide Building Society	2,001	27/02/15	28/08/15	0.66
Nationwide Building Society	2,001	13/03/15	11/09/15	0.66
Nationwide Building Society	1,000	16/03/15	16/09/15	0.66
Lloyds Bank	1,002	09/01/15	08/01/16	1.00
TOTAL	**23,456**			

5.3 As at 31 March 2015 the maturity structure of the investment portfolio was all under one year. The whole of the borrowing is due for repayment on 28 March 2062.

5.4 All borrowing is at fixed rates and cash/investment holdings are split £14.365m fixed and £9.091m variable.

5.5 The Council has a long term investment of £50,000 with the Local Capital Finance Company Ltd which has been created by the Municipal Bonds Agency.

6.0 **THE STRATEGY FOR 2014/15**

6.1 The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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.

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

6.3 The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

7.0 **THE ECONOMY AND INTEREST RATES**

7.1 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 European Central Bank (ECB) was going to do too little too late to ward off the threat of deflation and recession in the Eurozone (EZ).

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 Monetary Policy Committee (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.

7.2 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 European Union (EU) and the ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the EZ 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.

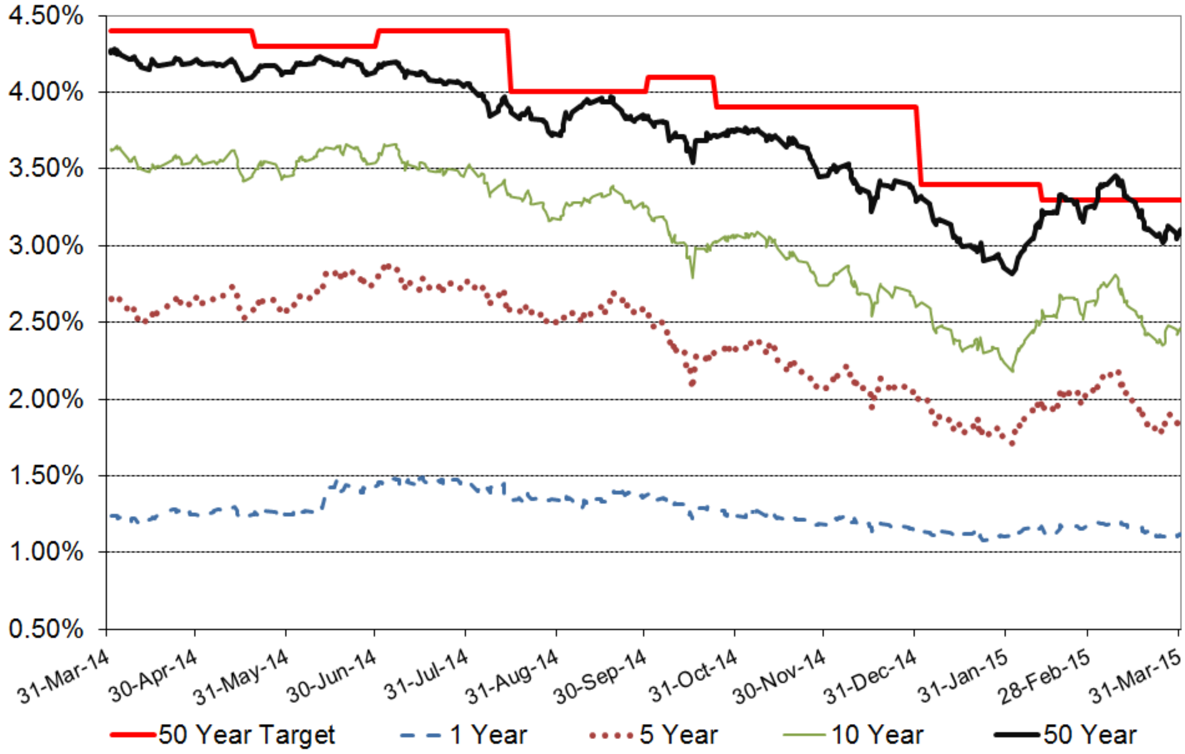
7.3 The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing throughout 2014/15.

7.4 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

7.5 The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK and its banking system has little direct exposure to Greece, it is much more difficult to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the EZ and cause major damage to their banks.

8.0 BORROWING RATES IN 2014/15

8.1 PWLB certainty maturity borrowing rates - the following graph shows PWLB certainty maturity rates for a selection of maturity periods throughout the financial year.



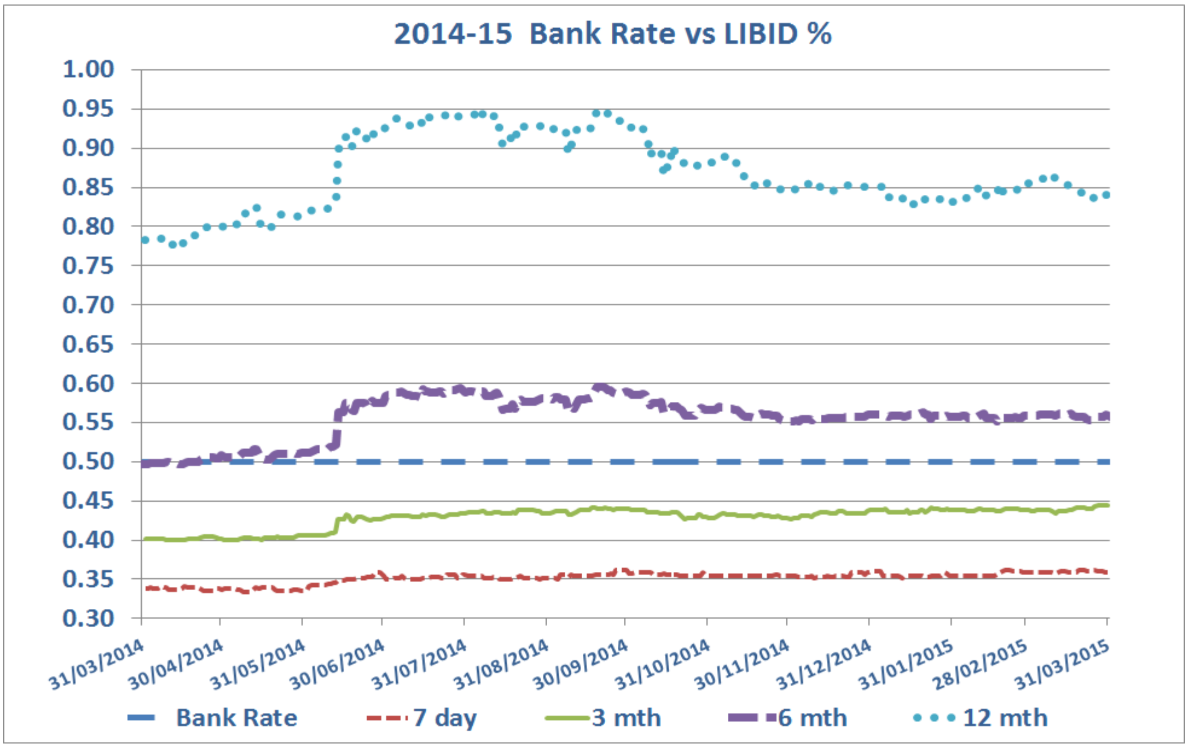
9.0 **BORROWING OUTTURN FOR 2014/15**

9.1 Due to investment concerns, both counterparty risk and low investment returns, no new borrowing was undertaken during the year.

9.2 The table in paragraph 5.1 provides a summary of borrowing as at 31 March 2015.

10.0 **INVESTMENT RATES IN 2014/15**

10.1 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.



11.0 **INVESTMENT OUTTURN FOR 2014/15**

11.1 Investment Policy – the Council's investment policy is governed by the CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 26 February 2014. 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).

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

11.3 Resources - the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£'000)	31 March 2014	31 March 2015
Balances	10,466	12,545
Earmarked reserves	8,083	9,474
Usable capital receipts	1,410	1,907
Total	**19,959**	**23,926**

11.4 Investments held by the Council - the Council maintained an average balance of £26.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.645%. The comparable performance indicator is the average 3 Month LIBID rate, which was 0.43%.

11.5 Actual investment interest earned during 2014/15 was £169,529 against an original budget of £114,300.

12.0 **OPTIONS**

12.1 That the Committee scrutinises the information and provides comments for consideration by the Council.

12.2 To do nothing.

13.0 **REASONS FOR RECOMMENDATION**

13.1 To comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2011.

14.0 **EXPECTED BENEFITS**

14.1 The report provides Members with a summary of the economy, the effect it has had on financial markets and the treasury activity during 2014/15. The report requires scrutiny prior to submitting to Council for approval.

15.0 **IMPLICATIONS**

15.1 **Carbon Footprint / Environmental Issues**

15.1.1 Carbon Footprint and Environmental issue implications have been considered, and in the opinion of the report author, there are none.

15.2 **Constitution & Legal**

15.2.1 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 and the CIPFA Prudential Code for Capital Finance in Local Authorities.

15.2.2 The report has no implications which would affect the constitution and does not therefore warrant a further change in the constitution.

15.3 **Contracts**

15.3.1 Contract implications have been considered, and in the opinion of the report writer, there are none.

15.4 **Corporate Priorities**

15.4.1 Corporate Priority implications have been considered, and in the opinion of the report writer, there are none.

15.5 **Crime and Disorder**

15.5.1 Crime and disorder implications have been considered, and in the opinion of the report writer, there are none.

15.6 **Equality and Diversity and Human Rights**

15.6.1 Equality and Diversity and Human Rights issues have been considered, and in the opinion of the report writer, there are none.

15.7 **Financial**

15.7.1 This annual treasury management review provides details of the treasury activity for the 2014/15 financial year.

15.8 **Risk Management**

15.8.1 The Council's priority is the security of its investments.

15.9 **Staffing**

15.9.1 Staffing implications have been considered and in the opinion of the report author, there are none.

15.10 **Stakeholders / Consultation / Timescales**

15.10.1 Stakeholder/Consultation/Timescale implications have been considered, and in the opinion of the report author, there are none.

16.0 **WARDS/COMMUNITIES AFFECTED**

16.1 None

17.0 **ACRONYMS**

- CPBS – Compass Point Business Services
- CIPFA – Chartered Institute of Public Finance and Accountancy
- HRA – Housing Revenue Account
- CFR – Capital Financing Requirement
- PWLB – Public Works Loan Board
- MRP – Minimum Revenue Provision
- VRP – Voluntary Revenue Provision
- CLG – Communities and Local Government
- ECB – European Central Bank
- EZ – Eurozone
- MPC – Monetary Policy Committee
- EU – European Union
- LIBID – London Inter Bank Bid Rate

Background papers: - SHDC Treasury Management Strategy Statement 2014/15

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Key Decision: No

Exempt Decision: No

Appendices attached to this report: None