SOUTH HOLLAND DISTRICT COUNCIL

Report of: **Assistant Director Finance (S151)**

To: **Governance and Audit 26 June 2014**

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

Subject: **Annual Treasury Management Review 2013/14**

Purpose: **To provide pre-decision scrutiny to the Annual Treasury Management Review 2013-14 being proposed**

Recommendation:

1) That the Governance and Audit Committee scrutinise the Annual Treasury Management Review 2013/14 and make any comments for consideration by Council when they consider this document at their meeting on 23 July 2014.

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 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 27/02/2013);
- a mid year (minimum) treasury update report (submitted to Governance and Audit 30/01/2014);
- 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. Member training on treasury management issues was undertaken during the year on 30/01/2014 in order to support members' scrutiny role.

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 2013/14

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.

£m General Fund	2012/13 Actual	2013/14 Estimate	2013/14 Actual
Capital expenditure	1,429	2,457	1,336
Financed in year	(1,429)	(2,457)	(1,336)
Unfinanced capital expenditure	-	-	-

£m Housing Revenue Account (HRA)	2012/13 Actual	2013/14 Estimate	2013/14 Actual
Capital expenditure	3,422	7,809	5,396
Financed in year	(3,422)	(7,809)	(5,396)
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 2013/14 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 2013/14 MRP Policy as required by Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2013/14 on 27/02/2013.

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

CFR (£m): General Fund	**31 March 2013 Actual**	**31 March 2014 Budget**	**31 March 2014 Actual**
Opening Balance	1,124	945	945
Add unfinanced capital expenditure (as above)	-	-	-
Less MRP	(179)	(205)	(205)
Closing Balance	945	740	740

CFR (£m): HRA	31 March 2013 Actual	31 March 2014 Budget	31 March 2014 Actual
Opening Balance	70,254	69,960	69,960
Add unfinanced capital expenditure (as above)	-	-	-
Less MRP and Revaluation losses on HRA non-dwellings	(294)	(63)	(309)
Closing Balance	69,960	69,897	69,651

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 (2013/14) plus the estimates of any additional CFR for the current (2014/15) 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 2013/14. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual	31 March 2014 Budget	31 March 2014 Actual
Gross Borrowing Position	£67.465m	£67.459m	£67.459m
CFR	£70.905m	£70.637m	£70.391m

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 2013/14 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.

	2013/14
Authorised limit	£74.456m
Maximum gross borrowing position	£67.465m
Operational boundary	£72.456m
Average gross borrowing position	£67.462m
Financing costs as a proportion of net revenue stream – Non HRA HRA	0.95% 25.08%

5.0 **TREASURY POSITION AS AT 31 MARCH 2014**

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 2013/14 the Council's treasury position including accrued interest was as follows:

	31/3/13 Principal £'000	Rate/ Return %	Average Life	31/3/14 Principal £'000	Rate/ Return %	Average Life
Fixed rate funding						
Salix loan	10	0.00	1 year	3	0.00	<1 year
PWLB	67,456	3.48	49years	67,456	3.48	48 years
Leases	284	n/a		34	n/a	
Total debt	**67,750**	**3.48**	**49 years**	**67,493**	**3.48**	**48 years**
CFR	70,905			70,391		
Over/(under) borrowing	3,155			2,898		
Cash and investments:						
short term	(7,000)	1.66	101 days	(10,100)	0.87	67 days
call and bank accounts	(4,899)	0.46	1 day	(7,612)	0.50	1 day
Total cash and investments	**(11,899)**	**1.20**	**60 days**	**(17,712)**	**0.66**	**38 days**
Net debt	**55,851**			**49,781**		

5.2 Investments held at 31 March 2014 were as follows:

Financial Institution	Amount £'000	Start Date	Maturity Date	Rate/ Return %
National Westminster Bank (Instant Access)	2,655	n/a	n/a	0.50
Svenska Handelsbanken	4,957	n/a	n/a	0.50
Lloyds Bank	1,800	03/04/13	02/04/14	1.10
Lloyds Bank	1,700	11/04/13	10/04/14	1.10
Nationwide Building Society	3,100	15/01/14	15/04/14	0.47
Goldman Sachs IB	2,500	14/02/14	11/08/14	0.73
Lloyds Bank	1,000	10/01/14	09/01/15	0.95
TOTAL	**17,712**			

5.3 As at 31 March 2014 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 with the exception of the Salix loan which matures within the next financial year.

5.4 All borrowing is at fixed rates and cash/investment holdings are split £10.1m fixed and £7.612m variable.

6.0 **THE STRATEGY FOR 2013/14**

6.1 The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. 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 were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

7.0 **THE ECONOMY AND INTEREST RATES**

7.1 The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While Consumer Price Index (CPI) inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

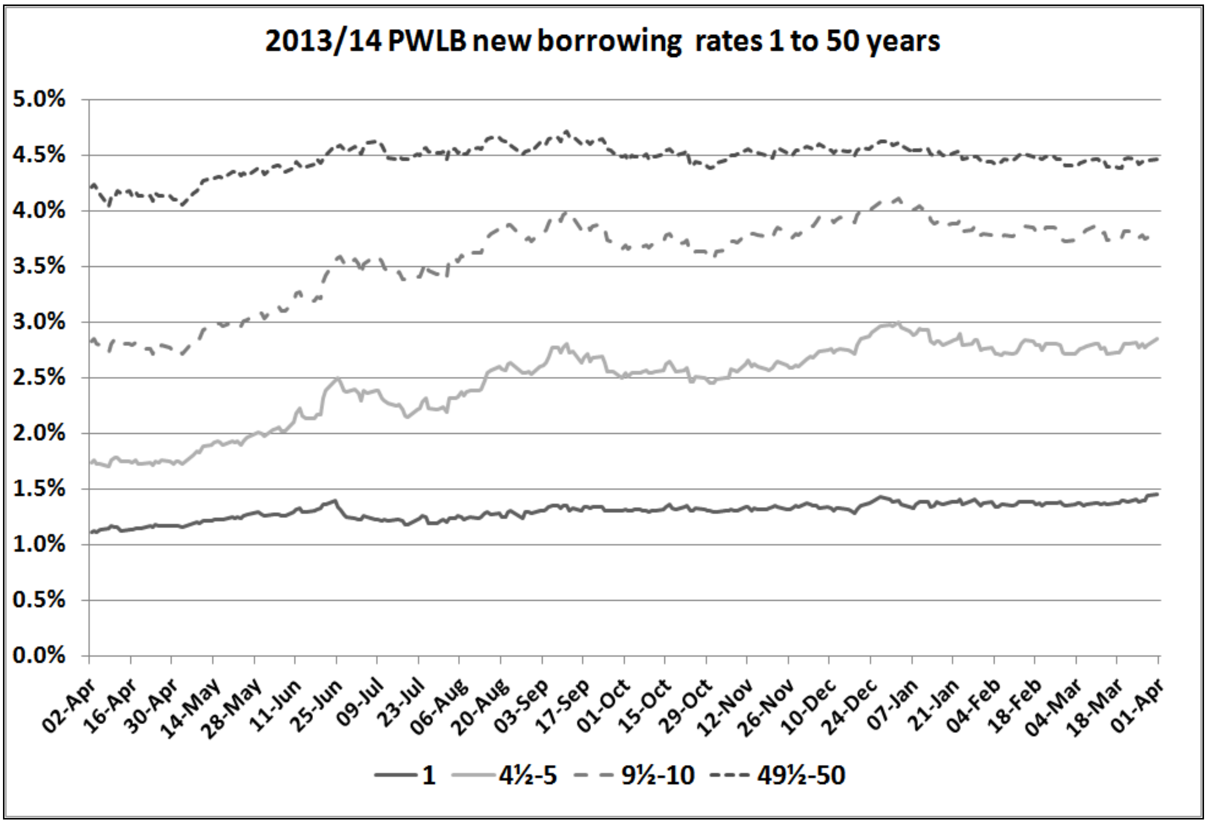
7.2 Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 6.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

7.3 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative (in the Autumn Statement and the March Budget) reduction in the forecasts for total borrowing of £97bn over the next five years, culminating in a £5bn surplus in 2018/19.

7.4 The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the European Central Bank (ECB) statement in July 2012 that it would do "whatever it takes" to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

8.0 **BORROWING RATES IN 2013/14**

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



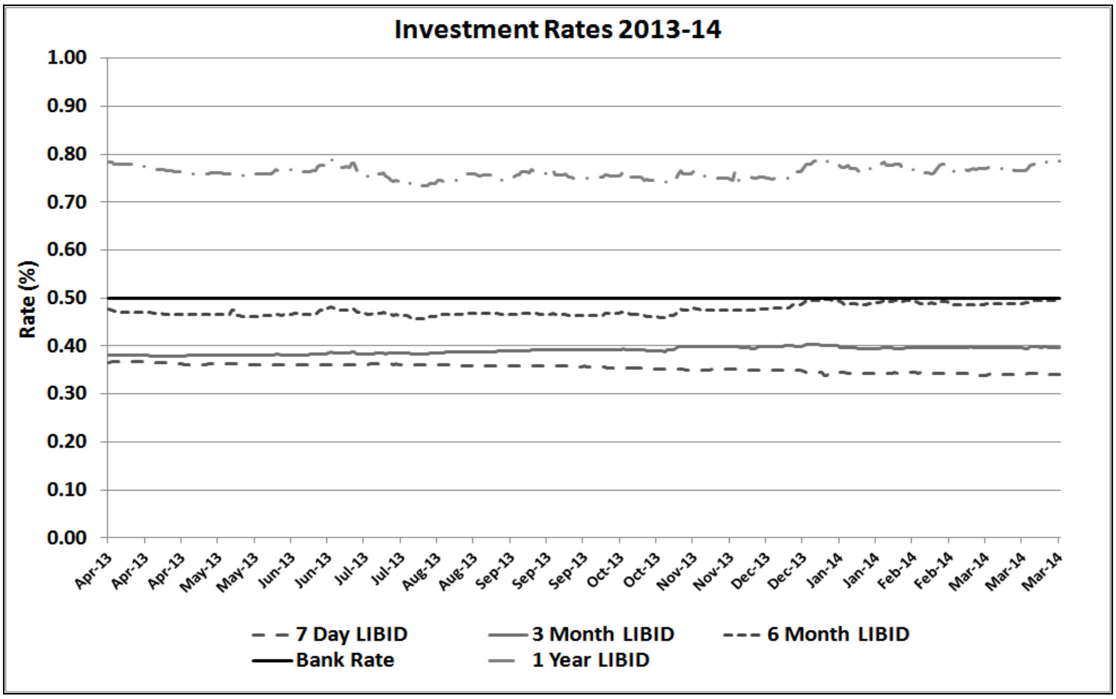
9.0 **BORROWING OUTTURN FOR 2013/14**

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 2014.

10.0 **INVESTMENT RATES IN 2013/14**

10.1 Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening ended up almost unchanged at around the end of 2014 / start of 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed during the whole of the year, although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.



11.0 INVESTMENT OUTTURN FOR 2013/14

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 27 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).

11.2 The investment activity during the year generally 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 (£m)	31 March 2013	31 March 2014
Balances	8,890	10,481
Earmarked reserves	5,209	8,083
Usable capital receipts	1,419	1,410
Total	**15,518**	**19,974**

11.4 Investments held by the Council - the Council maintained an average balance of £21.8m of internally managed funds. The internally managed funds earned an average rate of return of 0.655%. The comparable performance indicator is the average 3 Month LIBID rate, which was 0.39%.

11.5 Actual investment interest earned during 2013/14 was £142,888 against an original budget of £62,500.

12.0 **OPTIONS**

12.1 There are no alternative options presented

13.0 **REASONS FOR RECOMMENDATION(S)**

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 2013/14. The report requires scrutiny prior to submitting to Council for approval.

15.0 **IMPLICATIONS**

15.1 **Carbon Footprint / Environmental Issues**

15.1.1 It is the opinion of the Report Author that there are no implications.

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 2013/14. 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 priorities have been considered, and in the opinion of the report writer, there are no implications.

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 It is the opinion of the Report Author that there are no implications.

15.7 **Financial**

15.7.1 This annual treasury management review provides details of the treasury activity for the 2013/14 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 It is the opinion of the Report Author that there are no implications.

15.10 **Stakeholders / Consultation / Timescales**

15.10.1 It is the opinion of the Report Author that there are no implications

16.0 **WARDS/COMMUNITIES AFFECTED**

16.1 None

17.0 **ACRONYMS**

17.1 CPBS – Compass Point Business Services
17.2 CIPFA – Chartered Institute of Public Finance and Accountancy
17.3 HRA – Housing Revenue Account
17.4 CFR – Capital Financing Requirement
17.5 PWLB – Public Works Loan Board
17.6 MRP – Minimum Revenue Provision
17.7 VRP – Voluntary Revenue Provision
17.8 DCLG – Department for Communities and Local Government
17.9 FOMC – Federal Open Market Committee (Fed.)
17.10 GDP – Gross Domestic Product
17.11 CPI – Consumer Price Index
17.12 ECB – European Central Bank

Background papers:- (a) SHDC Treasury Management Strategy Statement 2013/14
(b) Capita's Annual Treasury Management Review 2013/14 Template

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Director / Officer who will be attending the Meeting:
Mark Finch (Assistant Director Finance (S151)

Key Decision: No

Exempt Decision: No

Appendices attached to this report: None