Meeting: Audit Committee
Council

Date: 25th June 2014
17th July 2014

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Outturn 2013/14

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1. Purpose and Introduction

1.1 This report informs Members of the performance of the Treasury Management function in supporting the provision of Council services in 2013/14 through management of cash flow, debt and investment operations and the effective control of the associated risks.

2. Proposed Decision

Audit Committee:

2.1 That the Treasury Management decisions made during 2013/14 as detailed in this report be endorsed.

Council:

2.2 That the Audit Committee recommends Council to endorse the Treasury Management decisions made during 2013/14, as detailed in the submitted report; and

2.3 That Council be recommended to approve the Prudential and Treasury Indicators as set out in Annex 1 to this report.

3. Reason for Decision

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

3.2 This report also meets the requirements of the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Supporting Information

4. Position

4.1 Treasury management is defined by the Code as:

"The management of the authority's investments and cash flows, it's 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".

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

- An annual treasury strategy in advance of the year (Council 6th February 2013)
- A mid-year review report (distributed to all Members on the Council's intranet site in December 2013)
- An annual report following the year describing the activity compared to the strategy (this report)

4.3 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 policies previously approved by Members.

4.4 The 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 Committee before they were reported to full Council.

4.5 A major element of the Treasury Management function is the implementation and control of the Council's borrowing decisions. Like all local authorities Torbay Council uses borrowing as a key source of funding for enhancing, purchasing or building assets within the approved capital plan.

4.6 Borrowing allows the repayment costs of capital expenditure to be spread over future years which means that the costs of roads, schools etc are more likely to be met by those who use the assets than would be the case if the full cost of providing these facilities were met by taxpayers at the time of their construction.

4.7 As part of the annual budget process the Council sets limits for the total amount of borrowing that it considers is affordable in terms of revenue resources available to make repayments. Treasury Management officers are tasked with maintaining borrowing within these levels and obtaining best value for the Council in terms of repayment rates and length of loans.

4.8 The Treasury Management team also carry out management of the Council's surplus cash balances arising from, for example:

- Short term revenue balances (working capital)
- Cash backed reserves
- Capital funding received in advance of commencement of schemes

Balances are invested with approved financial institutions and other local authorities to obtain the best return for periods which ensure cash is available when needed. Security of cash and liquidity are the absolute priorities in all investment decisions.

4.9 Treasury Management strategies were planned and implemented in conjunction with the Council's appointed advisors, Capita Asset Services although the Council officers were the final arbiters of the recommended approach.

5. Possibilities and Options

5.1 Not applicable

6. Fair Decision Making

6.1 Not applicable

7. Public Services (Social Value) Act 2012

7.1 Not applicable

8. Consultation

8.1 Not applicable

9. Risks

9.1 Not applicable

Appendices and Annexes

Appendix 1	Treasury Management Activities in 2013/14
Annex 1	Prudential and Treasury Indicators 2013/14
Annex 2	The Economy and Interest Rates in 2013/14
Annex 3	Counterparties with which funds have been deposited in 2013/14

Additional Information
Treasury Management Strategy 2013/14

Appendix 1

Treasury Management Activities in 2013/14

A1. Introduction

A1.1 This Appendix covers:

- Capital Expenditure and Financing 2013/14;
- Capital Financing Requirement;
- Treasury Position at year End;
- The Strategy for 2013/14;
- The Economy and Interest rates 2013/14;
- Borrowing Rates in 2013/14;
- Borrowing Outturn for 2013/14;
- Investment Rates in 2013/14;
- Investment Outturn for 2013/14;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation

A2 Capital Expenditure and Financing 2013/14

A2.1 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 (though the timing of borrowing may be delayed through the application of cash balances held by the Council).

A2.2 The actual capital expenditure forms one of the required prudential indicators and is shown in the table below. Other Prudential and Treasury Indicators are presented at Annex 1 to this report.

	2012/13 Actual £m	2013/14 Revised £m	2013/14 Actual £m
Total capital expenditure	19	22	17

A3 Capital Financing Requirement

A3.1 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 net 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 2013/14 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been financed by revenue or other resources.

A3.2 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.

A3.3 **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 is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively the reserving of funds for repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. 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 6th February 2014.

A3.4 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).

A3.5 Following the transfer of Local Government reorganisation debt from Devon County Council in 2010/11 the Council now budgets £0.5m per annum to reflect a provision for the repayment of this debt on maturity (similar to MRP) and all payments to 31st March 2014 have been made.

A3.6 The Council's CFR for the year represents a key prudential indicator analysed at Annex 1 and summarised below. This includes PFI schemes on the balance sheet, which increase the Council's long term liabilities. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m)	31 March 2013 Actual	31 March 2014 Revised Indicator	31 March 2014 Actual
CFR at Year End	136	136	135

A3.7 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit presented at Annex 1 to this report.

A4 Treasury Position at Year End

A4.1 The Council’s funding and investment positions at the beginning and end of year was as follows:

	31 March 2013 Principal		Rate/ Return	Average Life yrs	31 March 2014 Principal		Rate/ Return	Average Life yrs
Fixed rate funding:								
-PWLB	£138.1m				£128.1m			
-Market	<u>£10.0m</u>	£148.1	4.33%	26.9	<u>£10.0m</u>	£138.1m	4.39%	25.8
Variable rate funding:								
-PWLB	£0.00m				£0.0m			
-Market	<u>£0.00</u>	£0.00m	0%		<u>£0.0m</u>	<u>£0.0m</u>	<u>0%</u>	
Total Borrowing		*£148.1*	*4.33%*	*26.9*		*£138.1m*	*4.39%*	*25.8*
Other Long Term Liabilities		£9.3M	5.26%	14.5		£8.8M	5.26%	13.5
Total Borrowing/Other LTL		***£157.4M***	***4.39%***	***24.9***		***£146.9M***	***4.44%***	***24.3***
CFR		***£135.7m***				***£135.1m***		
Borrowing in excess of CFR*		***£21.7m***				***£11.8m***		
Investments**								
- in house		£52.1m	2.03%			£42.2m	1.25%	
- with managers***		£29.8m	1.40%			£29.8m	0.82%	
Total investments		***£81.9m***	***1.81%***			***£72.0m***	***1.11%***	

* The Capital Investment Plan approved in February 2014 requires £25m to support approved schemes over the next four years.
** Rates for investments reflect the average rate achieved over the full year.
*** The principal for external management of funds reflects the original amount applied to the contract in 2007 and subsequent additions and withdrawals

A4.2 The total borrowing figure at year end of £138.1m includes borrowing supported by central government. The Local Government Finance Settlement for 2013/14 (available on the Communities and Local Government website) recognises a figure of £90m on which central funding is based for interest payments and MRP.

A4.3 The outturn against approved treasury limits is analysed at Annex 1 to this report.

A5. The Strategy for 2013/14

A5.1 The central strategy aimed to reduce the level of borrowing levels in order to reduce the credit risk and cost incurred by holding high levels of investment.

A5.2 The economic outlook for 2013/14 however, expected little opportunity to repay borrowing due to high costs. The expectation for interest rates anticipated continuing low levels with only a gradual rise in the latter part of the year.

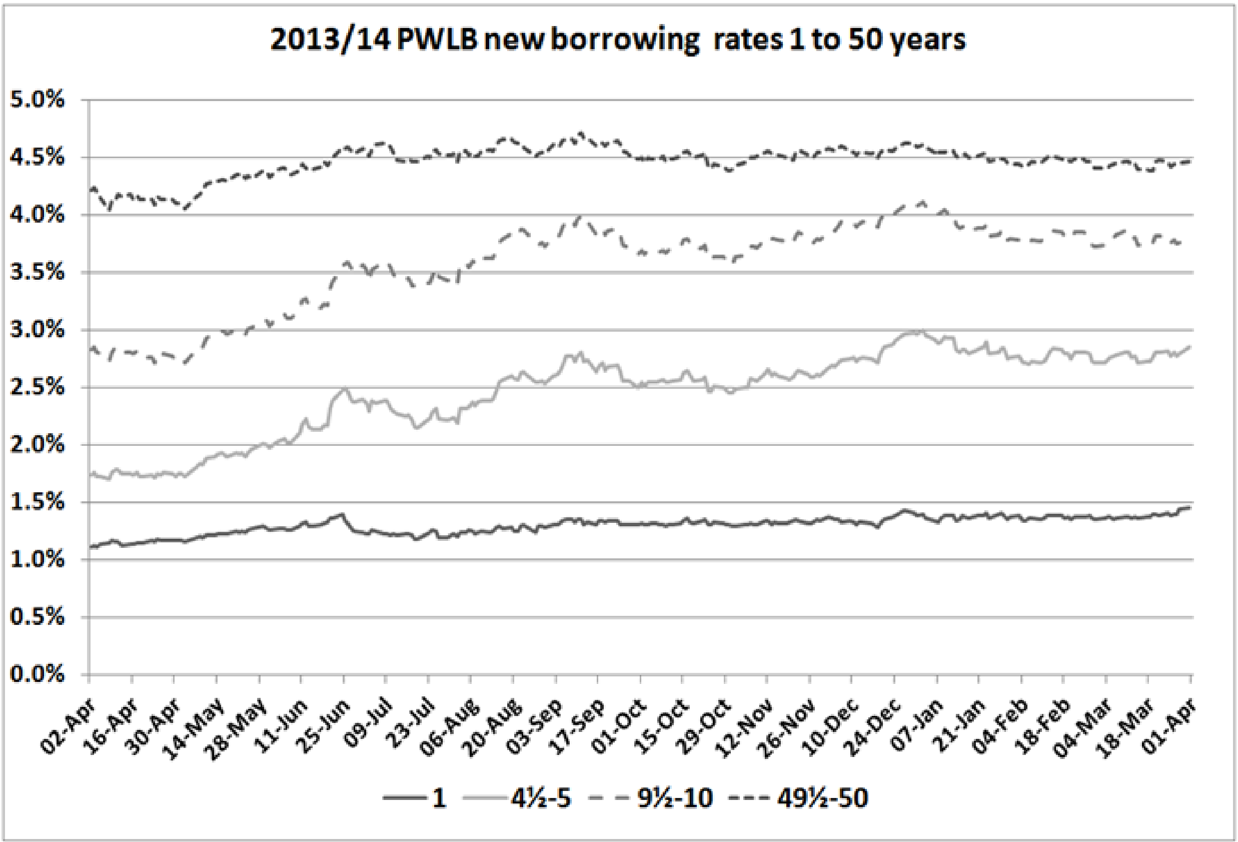
A5.3 Investment strategy was strongly influenced by market and credit risk considerations with deposits planned primarily in UK part-nationalised banks, balanced by a proportion of funds deposited in business reserve and notice accounts to ensure appropriate liquidity was maintained.

A6 The Economy and Interest Rates 2013/14

A6.1 A commentary of the economic factors prevalent in 2013/14 is given at Annex 2.

A7. Borrowing Rates in 2013/14

A7.1 The graph below shows a marginal rise in the historically low levels in PWLB certainty (new borrowing) rates during the year.



A7.2 Despite the slight shift up in new borrowing rates the separate tier of rates for repayments remain much lower than new borrowing levels and continue to limit the opportunities for early repayment of loans.

A8 Borrowing Outturn for 2013/14

A8.1 In line with the overall strategy of reducing borrowing levels, Officers reacted to advantageous movements in PWLB rate levels to repay £10milion of loans during the year with an advance interest payment of £805k absorbed within the overall Treasury Management costs. The resultant net interest savings represent a payback of these costs by March 2016.

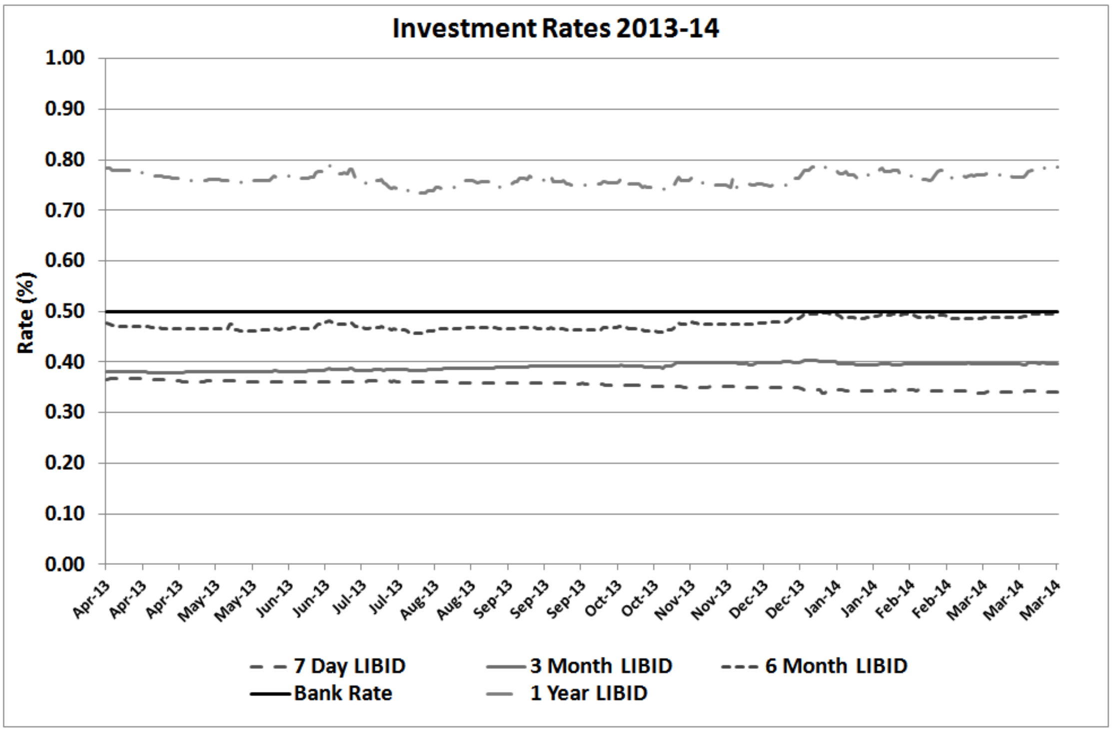
A8.2 ***Borrowing Performance*** – The average rate of interest paid on all loans in 2013/14 was 4.37%. Total borrowing was reduced from £148.1 million to £138.1 million during the year generating ongoing annual revenue budget savings, less expected investment returns in 2014/15, estimated at £300k.

A9 Investment Rates in 2013/14

A9.1 Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations of the start of monetary tightening ended up unchanged with a first rise forecast for early 2015.

A9.2 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.

A9.3 The following graph below illustrates the path of investment rate movements during 2013/14. The effect of the Funding for Lending scheme is clearly illustrated.



A10 Investment Outturn for 2013/14

A10.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance which emphasises the priorities of security and liquidity of funds and requires Local Authorities to set out their approach for selecting suitable counterparties. The policy was approved by Council within the Annual Investment Strategy on 6th February 2013 and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data.

A10.2 In line with the Strategy investments were made within a tight counterparty selection framework with significant sums kept in liquidity accounts and fixed term deposits up to one year.

A10.3 Despite some easing in the EU sovereign debt crisis during the year the Chief Finance Officer remains concerned of the potential impact on Eurozone Banks and as such these institutions are still excluded from the approved counterparty list regardless of their individual credit ratings.

A10.4 The limits imposed on creditworthiness gave rise to a very low number of acceptable and practical counterparties in which to invest during the year. Significant deposits were made in the part nationalised Banks where security is maintained through the implicit government guarantee.

A10.5 In light of recent reductions in the governments' share of Lloyds Banking Group the maturity structure of fixed deposits will be managed to ensure exposure to part nationalised Banks can be minimised in the event that government backing ends and the prevailing credit ratings fall below the Council's requirements.

A10.6 During the year a number of enhanced rate products available to local authorities were reduced or withdrawn (a probable consequence of the Funding for Lending scheme). This situation is continuing into the new financial year and going forward the Council will be limited to rates reflecting the normal low market levels.

A10.7 A list of those institutions with which the in-house team invested funds during the year is provided at Annex 3. No institutions with which investments were made showed any difficulty in repaying investments and interest in full during the year.

A10.8 ***Externally Managed Investments*** – Scottish Widows Investment Partnership (SWIP) was appointed to manage a proportion of the Council's cash on 21st June 2007. The CFO reviewed and adjusted the maximum limit for externally managed investments to maintain the existing holding with SWIP in light of reducing cash levels.

A10.9 This ensures the Council continues to have an appropriate proportion of investments exposed to a diverse range of instruments and counterparties.

A10.10 Despite reducing opportunities SWIP continued to make good use of quality credit assets and longer dated deposits to enhance returns.

A10.11 On 1st April 2014, Scottish Widows Investment Partnership was acquired by Aberdeen Asset Management. There will be no resultant change in the management criteria of the Council's holding and no increase in risk.

A10.12 ***Performance Analysis* -** Detailed below is the result of the investment strategy undertaken by the Council. Despite the continuing difficult operating environment the Council's investment returns remain well in excess of the benchmark.

	Average Investment Principal	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark/ Target Return
Internally Managed	£61,847,148	1.25%	na	0.354%
Externally Managed	£30,094,932	0.85%	0.70%	0.356%

The benchmark for internally managed funds is the average 7-day LIBID rate (uncompounded).
The benchmark for externally managed funds is the 7-day LIBID rates, averaged for the week and compounded weekly.

A10.13 In interest terms, the in-house treasury function contributed an additional £554,000 to the General Fund over and above what would have been attained from the benchmark return. SWIP's net return achieved an additional £92,000 over their target return level of 10% above benchmark.

A11 Revenue Budget Performance

A11.1 The effect of the decisions outlined in this report on the approved revenue budget is outlined in the table below.

	Revised Budget 2013/14	Actual 2013/14	Variation
	£M	**£M**	**£M**
Investment Income	(0.9)	(1.0)	(0.1)
Interest Paid on Borrowing	6.6	6.2	(0.4)
Advance interest on early repayment of Borrowing	0.0	0.8	0.8
Net Position (Interest)	**5.7**	**6.0**	**0.3**
Minimum Revenue Provision	4.2	4.2	0.0
MRP re: PFI	0.4	0.4	0.0
PFI Grant re: MRP	(0.4)	(0.4)	0.0
Net Position (Other)	**4.2**	**4.2**	**0.0**
Net Position Overall	**9.9**	**10.2**	**0.3**

A11.2 The Revenue Grant settlement 2013/14 formula includes notional funding of £9.8m for interest payments and MRP related to supported borrowing within the above figures.

A11.3 The changing position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

A12 Reporting Arrangements and Management Evaluation

A12.1 The management and evaluation arrangements identified in the annual strategy and followed for 2013/14 were as follows:

- Monthly monitoring report to Executive Lead for Finance and Chief Finance Officer
- Monthly meeting of the Treasury Manager and Chief Accountant to review previous months performance and plan following months activities
- Regular meetings with the Council’s treasury advisors
- Regular meetings with the Council’s appointed Fund Manager
- Membership and participation in the CIPFA Benchmarking Club

Annex1

Prudential and Treasury Indicators 2013/14

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 needs in 2013/14. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

CFR (£m)	31 March 2013 Actual	31 March 2013 Revised Q3 Indicator	31 March 2014 Actual
Opening balance	137.1	135.7	135.7
Capital expenditure in year funded from borrowing	3.6	6.9	4.0
Minimum Revenue Provision	(5.0)	(4.6)	(4.6)
Repayment of Deferred Liabilities	0	0	0
CFR at Year End	**135.7**	**138.0**	**135.1**
Net borrowing position	**75.5**	**76.2**	**74.9**

The authorised 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 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. Borrowing levels were maintained well below the operational boundary throughout the year.

	2013/14
Authorised limit	£192m
Maximum gross borrowing position	£157m
Operational boundary	£173m
Average gross borrowing position	£142m

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 liabilities net of investment income) against the net revenue stream.

	2013/14
Total Financing Costs	**£10.2m**
Net Revenue Stream	£127.0m
Ratio – Including Revenue Contributions to Capital	9.25%
Ratio - Excluding Revenue Contributions to Capital	**8.03%**

Treasury Indicators:

Maturity Structure of the fixed rate borrowing portfolio - This indicator assists Authorities avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time.

	31 March 2014 Actual	31 March 2014 Proportion	2013/14 Original Limits Upper-Lower
Under 12 months	£0	0%	5% - 0%
12 months and within 24 months	£0	0%	20% - 0%
24 months and within 5 years	£6M	4%	20% - 0%
5 years and within 10 years	£10M	7%	50% - 0%
10 years and within 25 years	£45M	33%	100% - 0%
25 years to 40 years	£48M	35%	100% - 0%
Over 40 years	£29M	21%	80% - 0%

Principal sums invested for over 364 days - The purpose of this indicator is to contain the Council's exposure to the possibility of losses that might arise as a result of it having to seek early repayment or redemption of principal sums invested. The 2013/14 Actual applies administered by the external Fund Manager.

	2012/13 Actual	2013/14 Limit	2013/14 Actual
Investments of 1 year and over	£19M	£66m	£15m

Exposure to Fixed and Variable Rates - The Prudential Code requires the Council to set upper limits on its exposure to the effects of changes on interest rates.
The fixed rate limit set allows for the Council's entire borrowing to be locked out at affordable levels. The variable limit reflects the use of Liquidity Accounts for investing cash. (The negative Actual net values reflects the extensive use of these variable rate instruments due to attractive rates and counterparty concerns), netted against a zero level of variable debt.)

	31 March 2013 Actual	2013/14 Upper Limits	31 March 2014 Actual
Net principal re fixed rate borrowing / investments	£104m	£150m	£82m
Net principal re variable rate borrowing / investments	-£38m	£41m	-£16m
Limits on fixed interest rates: • *Debt only* • *Investments only*	*148* *44*	*163* *70*	*138* *56*
Limits on variable interest rates • *Debt only* • *Investments only*	*0* *38*	*41* *59*	*0* *16*

The Economy and Interest Rates 2013/14

By Capita Asset Services April 2014

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. 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 2013/14. 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 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.

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 4.) 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.

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.

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 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.

Annex 3

Counterparties with which funds were deposited (April 2013 – March 2014)

Banks and Building Societies

Bank of Scotland
Lloyds TSB
Nationwide Building Society
Royal Bank of Scotland/National Westminster
Svenska Handelsbanken

Local Authorities

Blackpool Borough Council

Other Approved Institutions

Public Sector Deposit Fund
Royal Bank of Scotland Money Market Fund
Scottish Widows Investment Partnership