Meeting: Audit Committee
Council

Date: 29th July 2015
24th September 2015

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Outturn 2014/15

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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 2014/15 through management of cash flow, debt and investment operations and the effective control of the associated risks.

1.2 The headline points of the report are:

- No new borrowing during the year to fund the Capital Investment Plan
- Capital expenditure of £4.5million funded from existing borrowing
- Annual investment rate achieved exceeded the market benchmark
- Treasury Management activities achieved a saving of £300,000 on the approved budget target

2. Proposed Decision

Audit Committee:

2.1 That the Treasury Management decisions made during 2014/15 as detailed in this report be noted.

Council:

2.2 That the Treasury Management decisions made during 2014/15, as detailed in the submitted report be noted; 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 2014/15.

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 2014/15 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 2014)
- A mid-year review report (distributed to all Members on the Council's intranet site in December 2014)
- An annual report following the year describing the activity compared to the strategy (this report)

4.3 The current 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 2014/15
Annex 1	Prudential and Treasury Indicators 2014/15
Annex 2	The Economy and Interest Rates in 2014/15
Annex 3	Counterparties with which funds have been deposited in 2014/15

Additional Information

Treasury Management Strategy 2014/15

Appendix 1

Treasury Management Activities in 2014/15

A1. Introduction

A1.1 This Appendix covers:

- The Strategy for 2014/15;
- Treasury Position at year End;
- The Economy and Interest rates 2014/15;
- Borrowing Rates in 2014/15;
- Borrowing Outturn for 2014/15;
- Investment Rates in 2014/15;
- Investment Outturn for 2014/15;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation

A2 The Strategy for 2014/15

A2.1 The central strategy for the medium term aimed to reduce the level of borrowing levels by a target of £10million over four years to reduce the credit risk and cost incurred by holding high levels of investment.

A2.2 The strategy acknowledged however that interest rate outlook anticipated very little opportunity to reduce borrowing during 2014/15 due to high repayment costs. The expectation for interest rates anticipated flat levels through most of the year with minimal rises at the back end, still well below the threshold for economic borrowing repayment.

A2.3 Investment strategy was strongly influenced by market and credit risk considerations and centred on secure longer term deposits (ie: one to two years), balanced by a proportion of funds maintaned in business reserve and notice accounts to ensure appropriate liquidity was maintained.

A3 Treasury Position at Year End

A3.1 The Council’s funding and investment positions at the beginning and end of year was as follows:

	31 March 2014 Principal		Rate/ Return	Average Life yrs	31 March 2015 Principal		Rate/ Return	Average Life yrs
Variable Rate Funding:		£0.0m				£0.0m		
Fixed rate funding:								
-PWLB[1]	£128.1m				£128.1m			
-Market	£10.0m	£138.1m	4.39%	25.0	£10.0m	£138.1m	4.39%	24.0
Total Borrowing		*£138.1m*	*4.39%*	*25.0*		*£138.1m*	*4.39%*	*24.0*
Other Long Term Liabilities		£8.8m	5.26%	13.5		£8.4m	5.26%	12.5
Total Borrowing/Other LTL		***£146.9M***	***4.44%***	***24.3***		***£146.5M***	***4.44%***	***23.3***
CFR[2]		***£135.1m***				***£135.3m***		
Borrowing in excess of CFR		***£11.8m***				***£11.2m***		
Approved borrowing in Capital Investment Plan		***£25m***				***£21m***		
Investments:								
- in house		£42.2m	1.25%			£39.7m	0.88%	
- with managers[4]		£29.8m	0.82%			£30.0m	0.88%	
Total investments		***£72.0m***	***1.11%***			***£69.7m***	***0.88%***	

[1] PWLB = The Public Works Loan Board,a government agency responsible for lending to Local Authorities and the Council's prime source of borrowing

[2] The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow to fund capital expenditure.

[3] Rates for investments reflect the average rate achieved over the full year.

[4] The principal for external management of funds reflects the original amount applied to the contract in 2007 and subsequent additions and withdrawals

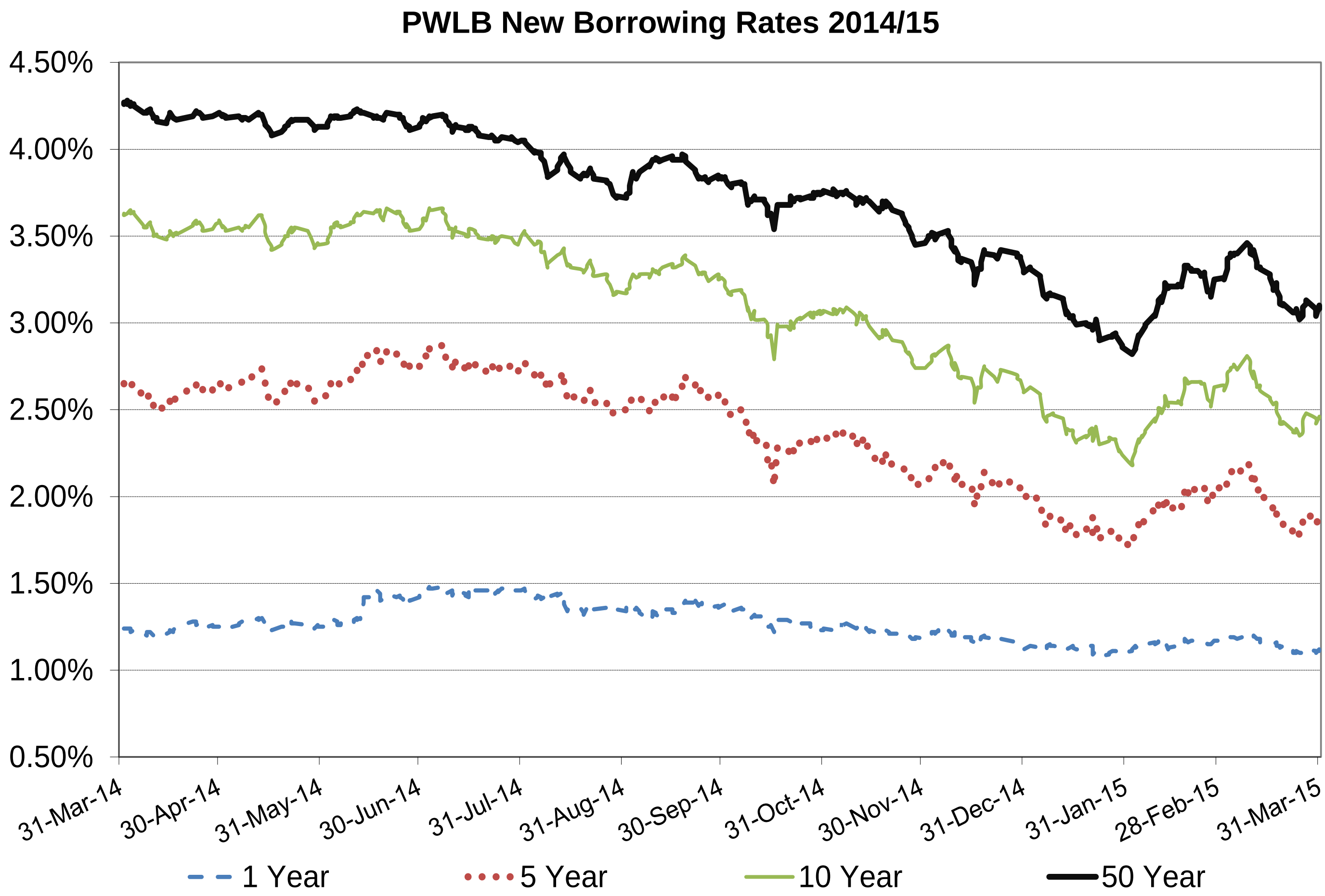
A3.2 The Council is required by the specific codes of practice to measure the outturn performance against approved treasury and prudential indicators and this is detailed at Annex 1 to this report.

A4 The Economy and Interest Rates 2014/15

A4.1 A commentary of the economic factors prevalent in 2014/15 is given at Annex 2.

A5. Borrowing Rates in 2014/15

A5.1 The graph below illustrates the fall of PWLB new borrowing rates to historically very low levels during the year, before rising on the announcement of quantitative easing by the European Central Bank. Repayment rates are around 1% lower on those illustrated.



A6 Borrowing Outturn for 2014/15

A6.1 As anticipated, the falling in borrowing rates did not allow any opportunity to early repay any of the Council's PWLB loans.

A6.2 A dialogue was opened with Barclays to discuss a potential for repayment of the market loan with the bank but this too was hampered by the market conditions and the repayment costs was significantly unaffordable

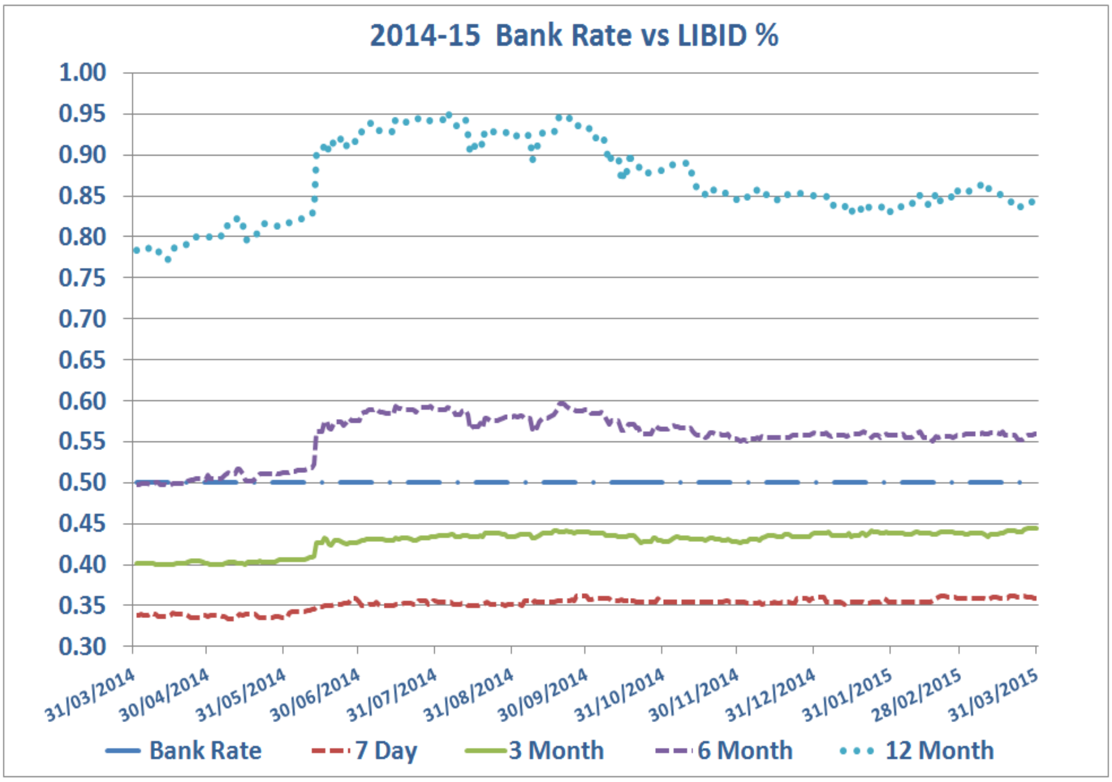
A6.3 The borrowing portfolio (excluding other long term liabilities) remains at £138.1million and the average rate of interest paid on all loans in 2014/15 was 4.39% with an average maturity of 25 years.

A7 Investment Rates in 2014/15

A7.1 Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. At the start of the year the market anticipated the rise would occur during quarter 1 2015 but was revised to around quarter 3 2016 by the end of the year.

A7.2 Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme (government supply of cheap funding to Banks to on-lend to businesses).

A7.3 The following graph illustrates the path of Bank Rate against market investment rate movements during 2014/15. The affect of the changing sentiment on Bank Rate can be seen in the longer term rates (6 month/1 year) with Funding for Lending contributing to very flat levels in the short terms.
("LIBID = the representative rates which Banks will pay to each other for funding)



A8 Investment Outturn for 2014/15

A8.1 **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 2014 and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data.

A8.2 Due to the continuing concerns around EU sovereign debt an exclusion of Eurozone Banks from the approved counterparty list, determined by the Chief Finance Officer, remained in place throughout the year.

A8.3 The limits imposed on creditworthiness gave rise to a limiting number of acceptable and practical counterparties in which to invest during the year.

A8.4 In line with the approved strategy a number of one and two year deals were made with the part-nationalised banks (Lloyds Bank and Royal Bank of Scotland) locking into higher returns with a low risk of market rate increases. Remaining cash was generally deposited in lower yielding short term accounts to maintain liquidity and balance the risk of the overall investment portfolio.

A8.5 Going forward, officers are conscious that the new government is likely to step up the divestment of Lloyds Bank and accordingly have recently re-classified the Bank to a higher risk level within the counterparty policy.

A8.6 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.

A8.7 ***Externally Managed Investments*** – Aberdeen Asset Management manages a proportion of the Council's to add value by way of market knowledge and exposure to a greater diversity of investments and counterparties.

A8.8 ***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)	Capita Benchmarking Club		Market Benchmark/ Target Return
				Peer LA Comparison	English Unitaries	
Internally Managed	£54million	0.88%		0.77%	0.86%	0.35%
Externally Managed	£30million	0.88%	0.68%			0.35%

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.

A8.9 In interest terms, the in-house treasury function contributed an additional £286,000 to the General Fund over and above what would have been attained from the benchmark return. SWIP's net return achieved an additional £87,000 over their target return level of 10% above benchmark.

A10 Revenue Budget Performance

A10.1 The effect of the decisions outlined in this report on the approved revenue budget is outlined in the table below.

	Revised Budget 2014/15	Actual 2014/15	Variation
	£M	**£M**	**£M**
Investment Income	(0.5)	(0.7)	(0.2)
Interest Paid on Borrowing	6.1	6.1	0.0
Net Position (Interest)	**5.6**	**5.4**	**(0.2)**
Minimum Revenue Provision (MRP)	4.3	4.2	(0.1)
MRP re: PFI	0.5	0.5	0.0
PFI Grant re: MRP	(0.5)	(0.5)	0.0
Net Position (Other)	**4.3**	**4.2**	**(0.1)**
Net Position Overall	**9.9**	**9.6**	**(0.3)**

A10.2 The changing position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

A11 Reporting Arrangements and Management Evaluation

A11.1 The management and evaluation arrangements identified in the annual strategy and followed for 2014/15 were as follows:

- Monthly monitoring report to Executive Lead for Finance, Chief Financial Officer and Group Leaders
- 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 both the CIPFA and Capita Treasury Services Benchmarking Club (the CIPFA membership has not been renewed in 2015/16)

Annex1

Prudential and Treasury Indicators 2014/15

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

The actual capital expenditure forms one of the required prudential indicators and is shown in the table below.

	2013/14 Actual £m	2014/15 Revised Budget £m	2014/15 Actual £m
Total capital expenditure	17	23	20

Capital Financing Requirement

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 2014/15 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been financed 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 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 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 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 6th February 2014.

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 CFR for the year represents a key prudential indicator analysed 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 2014 Actual	31 March 2015 Revised Indicator	31 March 2015 Actual
CFR at Year End	136	135	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.

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 2014/15 plus the expected changes to the CFR over 2015/16 and 2016/17. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. 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 2014 Actual	31 March 2015 Actual
Opening balance	135.7	135.0
Capital expenditure in year funded from borrowing	3.9	4.9
Minimum Revenue Provision	(4.6)	(4.6)
Repayment of Deferred Liabilities	0	0
CFR at Year End	**135.0**	**135.3**
Net borrowing position	**74.9**	**68.2**

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

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.

	2014/15
Authorised limit*	£231m
Maximum gross borrowing position	£146m
Operational boundary	£161m
Average gross borrowing position	£147m
Financing costs as a proportion of net revenue stream	8.60%

*The approved Authorise Limit allowed for the Energy from Waste PFI scheme which was not opened by 31st March 2015

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 2015 Actual	31 March 2015 Proportion	2014/15 Original Limits Upper-Lower
Up to 10 years	£16M	17%	5% - 50%
10 to 20 years	£24M	23%	5% - 50%
20 to 30 years	£40M	26%	10% - 60%
30 to 40 years	£28M	25%	10% - 50%
Over 40 years	£30M	9%	0% - 50%

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.

	2013/14 Actual	2014/15 Limit	2014/15 Actual
Investments of 1 year and over	£15M	£45m	£27m

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 exposure to fixed and variable rates was as follows:

	31 March 2014 Actual %	2014/15 Upper Limits %	31 March 2015 Actual %
Limits on fixed interest rates: • Debt only • Investments only	 100 36	 100 80	 100 52
Limits on variable interest rates • Debt only • Investments only	 0 63	 20 60	 0 47

Annex 2

The Economy and Interest Rates 2014/15

By Capita Asset Services April 2015

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 cap 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 European Union and the European Central Bank (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 Eurozone 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.

Annex 3

Counterparties with which funds were deposited (April 2014 – March 2015)

Banks and Building Societies

Goldman Sachs International Bank
Lloyds Bank
Nationwide Building Society
Royal Bank of Scotland/National Westminster
Santander UK
Svenska Handelsbanken

Local Authorities

Greater London Authority
Newport City Council

Other Approved Institutions

Public Sector Deposit Fund
Goldman Sachs Sterling Fund
Aberdeen Asset Management