CABINET

23 June 2015

Title: Treasury Management Annual Report 2014/15	
Report of the Cabinet Member for Finance	
Open	**For Decision**
Wards Affected: All	**Key Decision: Yes**
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Accountable Director: Jonathan Bunt, Chief Finance Officer	

Summary

Changes in the regulatory environment now place a greater onus on Elected Members for the review and scrutiny of treasury management policy and activities. This report (the Treasury Management Annual Report) is important in that respect, as it provides details of the outturn position for treasury activities, significant new borrowing proposed, and highlights compliance with the Council's policies previously approved by the Assembly prior to the start of each financial year.

This report presents the Council's outturn position in respect of its treasury management activities during 2014/15. The key points to note are as follows:

- Investment income for the year was £1.6m (2013/14: £1.3m);
- £89m was borrowed from the European Investment Bank to fund the urban regeneration and economic growth programme of Gascoigne Estate (East) Phase 1 and Abbey Road 2;
- There was no further General Fund borrowing in 2014/15 to finance the capital programme as the Council utilised internal borrowing;
- A £10m Public Works Loan Board was repaid during the year and was not replaced;
- The Council did not breach its 2014/15 authorised borrowing limit of £650m or its Operational Boundary limit of £500m; and
- The Council complied with all other set treasury and prudential limits.

Recommendation(s)

The Cabinet is asked to recommend the Assembly to:

(i) Note the Treasury Management Annual Report for 2014/15;

(ii) Note that the Council complied with all 2014/15 treasury management indicators;

(iii) Note £89m was borrowed from the European Investment Bank to fund an urban regeneration and economic growth programme of Gascoigne Estate (East) Phase 1 and Abbey Road 2;

(iv) Approve the actual Prudential and Treasury Indicators for 2014/15; and

(v) Maintain the delegated authority given to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to take into account the additional cash holdings resulting from the £89m borrowed from the European Investment Bank.

Reason(s)

This report is required to be presented to the Assembly in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.

1. Introduction and Background

1.1. The Council is required by regulations issued under the Local Government Act 2003 (as amended 2010) to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15.

1.2 The report has been produced in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services 2009 adopted by this Council on 16 February 2010 and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.3 For the 2014/15 period Assembly received the following reports:

- an annual treasury strategy in advance of the year (Assembly 19/02/2014);
- a mid-year (minimum) treasury update report (Assembly 25/11/2014); and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.4 This Annual Treasury Report covers:

- The Council’s treasury position as at 31 March 2015;
- Economic Factors and Interest rates in 2014/15;
- Investment Strategy and Performance in 2014/15;
- Borrowing Outturn;
- Treasury Management costs in 2014/15;
- Compliance with Treasury limits and Prudential indicators;
- Lending to Commercial and External Organisations; and
- Prudential Indicators for 2014/15.

2. Treasury Position as at 31 March 2015

2.1 The Council's treasury position at the start and end of 2014/15 can be found in Table 1:

Table 1: Council's treasury position at the start and end of 2014/15

	31-Mar-2014	Average Return	Average Life	31-Mar-2015	Average Return	Average Life
	£'000	**%**	**Yrs**	**£'000**	**%**	**Yrs**
Fixed Rate Debt						
PWLB	275,912	3.52	37.68	265,912	3.50	40.81
Market	40,000	4.01	54.61	40,000	4.02	53.61
EIB				**89,000**	**2.21**	**29.83**
Total Debt	**315,912**	**3.59**	**39.45**	**394,912**	**3.26**	**39.34**
Investments						
In-House*	121,258			217,926	1.08	
Total Investments	**121,258**	**0.98**		**217,926**	**1.08**	

* excludes a prepayment made to Elevate and external school cash balances.

2.2 The Council manages its debt and investment positions through its in-house treasury section in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

2.3 Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

3. The Economy and Interest rate in 2014/15

3.1 <u>Economic Outlook</u>

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in Q1 2015 as the unemployment rate had fallen 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 receded as growth remained dependent on 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 By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly turn negative. This made it clear that the MPC would have great difficulty in raising the 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.

3.2 <u>Interest Rate Forecast</u>

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved.

Another downward pressure on gilt yields was the announcement in January that the ECB would start 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 in 2013 and 2014 and good prospects for a continuation into 2015/16.

4. Investment Strategy and Performance in 2014/15

4.1 Annual Investment Strategy 2014/15

4.1.1 All investments were managed in-house and were invested with institutions of high credit standing listed in the Council's approved lending list and specified limits. The Council invested over a range of periods from overnight to two years and in some cases over two years dependent on the Council's cash flows, its treasury management adviser's view, its interest rate view and the interest rates on offer.

4.1.2 The Council meet quarterly with its Investment Adviser to discuss financial performance, objectives and targets in relation to the investments and borrowing managed on behalf of the Council. A monthly treasury meeting was held between the Chief Finance Officer (CFO) and the treasury section to discuss strategy and to ensure close monitoring of investment decisions.

4.1.3 The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy for 2014/15, approved by the Assembly on 19 February 2014. The policy sets out the Council's approach for choosing investment counterparties.

4.1.4 The key points relating to the annual investment strategy were:

- Eurozone sovereign debt difficulties remain, with concerns as to how these will be managed over the next few years. Counterparty risks remain elevated and as a result the Council's strategy of using higher quality UK Bank and Building Societies for shorter time periods will remain in place during 2014/15.

- Investment returns are forecast to remain low during 2014/15, with an average target return of 1% for the in-house Treasury section.

4.2 Investments decisions during 2014/15

4.2.1 When making investment decisions the Council must have regard to its investment priorities being:

(a) The **security** of capital;
(b) The **liquidity** of its investments; and

(c) **Yield** (after ensuring the above are met).

4.2.2 Using the above as the basis for investment decisions does mean that investment returns will be lower than would be possible were yield the only consideration. During 2014/15 the Council ensured that all investments were made with appropriately rated counterparties and that liquidity was maintained. On occasion short term borrowing was also used to allow the Council to take advantage of investment opportunities.

4.2.3 During 2014/15 rates of return offered by financial institutions continued to decline for the first part of the year. However as economic conditions improved, rates picked up towards the end of the year, presenting opportunities for the Council to invest over a longer duration at much improved rates.

4.2.4 For 2014/15 an investment return target of 1% was used by the treasury section.

4.2.5 The 2014/15 cash flow ended over £97m higher (£218m) than the 2013/14 closing cash balance of £121m. During the year £18m was transferred out of the Council's bank account and into the newly created pension fund bank account. As a result of this transfer, the Council no longer holds the pension fund cash but the treasury functions remain with the in-house treasury team

4.2.6 The main reasons for the increase in the cash balance include:

i. £89m of EIB borrowing;
ii. a reduced pre-payment to Elevate; and
iii. delays in capital expenditure.

4.2.7 During the year amounts available for investment varied due to:

- Investment maturity dates;
- Profile for the receipt of grants;
- Temporary use of internal cash to fund new capital projects rather than borrowing at periods of high borrowing interest rates; and
- Cash flow management.

Cash flow forecasts for 2015/16 indicate a more even distribution of income compared to previous years but also an increase in expenditure as the EIB borrowing is spent.

4.3 Strategy Changes in 2014/15

4.3.1 The Council's investment policy was agreed in the annual investment strategy approved by the Assembly on 19 February 2014. During the year Members agreed the following changes to the investment strategy:

- to increase the period the Council can invest with the Royal Bank of Scotland (RBS) from one year to a maximum of two years;

- approve the borrowing of up to £150m through a loan facility from the European Investment Bank (EIB) to fund the urban regeneration and economic growth programme described below; and

- To prevent the need to return to Cabinet to agree the increase and to ensure any increase in counterparty limits are linked to the increase cash available to invest, Cabinet are asked to delegate authority to the Chief Finance Officer in consultation with the Cabinet Member for Finance to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to take into account the potential additional £150m from the EIB.

4.3.2 Medium and long term investments

In relation to long term investments (investment over one year), the treasury strategy during 2014/15 was to take advantage of periods where rates were higher due to improved market sentiment regarding rate increases. This strategy resulted in a number of two years investments being made at rates between 1.1% and 1.5%.

As UK Government Gilts yields continued to fall throughout the year the Council sold its £5.8m holding in a 5 year Gilt, which it transferred from its external fund manager when the Council's investments were withdrawn towards the end of 2013. As a result as at 31 March 2015 the Council did not hold any UK government debt.

4.3.3 Short Term investments

To ensure that the Council maintained sufficient liquidity a number of investments were made in overnight and one year deposits. Returns over the shorter durations were low throughout the year and varied between 0.46 and 1.00%.

The Council holds a high percentage of its investments with the two part government owned banks, Lloyds and RBS. Both banks provided competitive returns throughout the year. It is likely that during 2015/16 the government will sell its remaining holdings in Lloyds of approximately 20% and as it is likely that the Council's total exposure to Lloyds will be reduced accordingly.

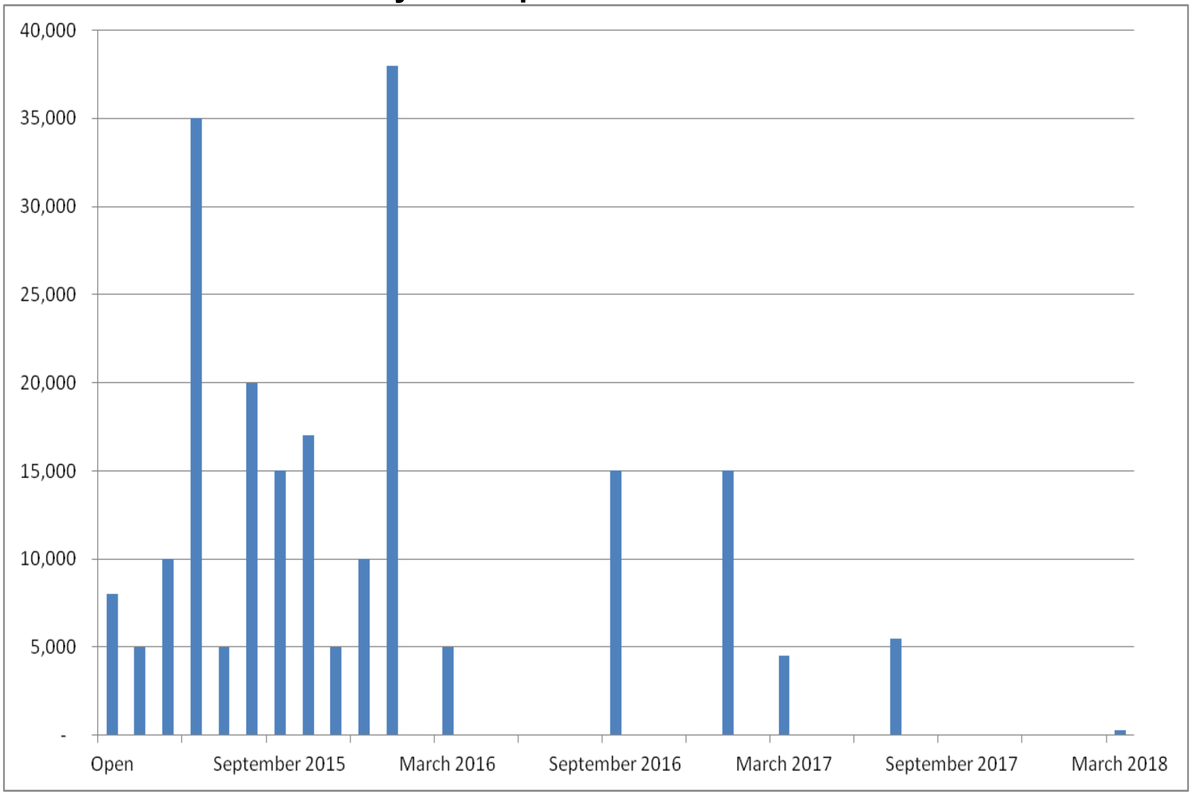
4.4 Performance Measurement in 2014/15

The interest return for the year was 1.08% on an average cash balance of £150m resulting in gross interest of £1.60m, £0.5m higher than budget. The increase in interest income was negated by the increase in borrowing costs from the £89m borrowed from the EIB. The interest earned was distributed as follows:

- £920k to the General Fund;
- £593k to the Housing Revenue Account; and
- £100k to Schools.

4.5 The maturity profile of the Council's investments is shown in the Chart below. Some longer term investments at higher rates of return were made in 2014/15. The higher rates achieved with these longer dated investments will support treasury to achieve the more challenging return target for 2015/16. There is an expectation that rates will start to increase in the coming months and the reinvestment rates of maturing investments should improve.

Investment Profile for the year 1 April 2015



4.6 Investments Held as at 31 March 2015

A schedule of the investments held by the Council as at 31 March 2015 as set out at **Appendix 1**.

5. Borrowing Outturn

5.1 The key points relating to the 2014/15 borrowing strategy, as agreed within the TMSS, were:

- To set an authorised borrowing limit of £650m for 2014/15;
- The Council will borrow up to £89m from the EIB to fund the urban regeneration and economic growth programme of Gascoigne Estate (East) Phase 1 and Abbey Road 2
- The Council's borrowing strategy, excluding EIB borrowing, will give consideration to the following when deciding to take-up new loans:
    - Use internal cash balances, while the current rate of interest on investments remain low, with consideration given to weighing the short term advantage of internal borrowing against potential long term costs if long term borrowing rates begin to increase more than forecast;
    - Using a range of durations for long term fixed rate market loans where rates were significantly less than PWLB rates for the equivalent maturity period;
    - Use short dated PWLB variable rate loans where rates are expected to be significantly lower than rates for longer period;

- ○ Ensure that new borrowing, if required, is timed at periods when rates are expected to be low; and

- ○ Consider the issue of stocks and bonds if appropriate.

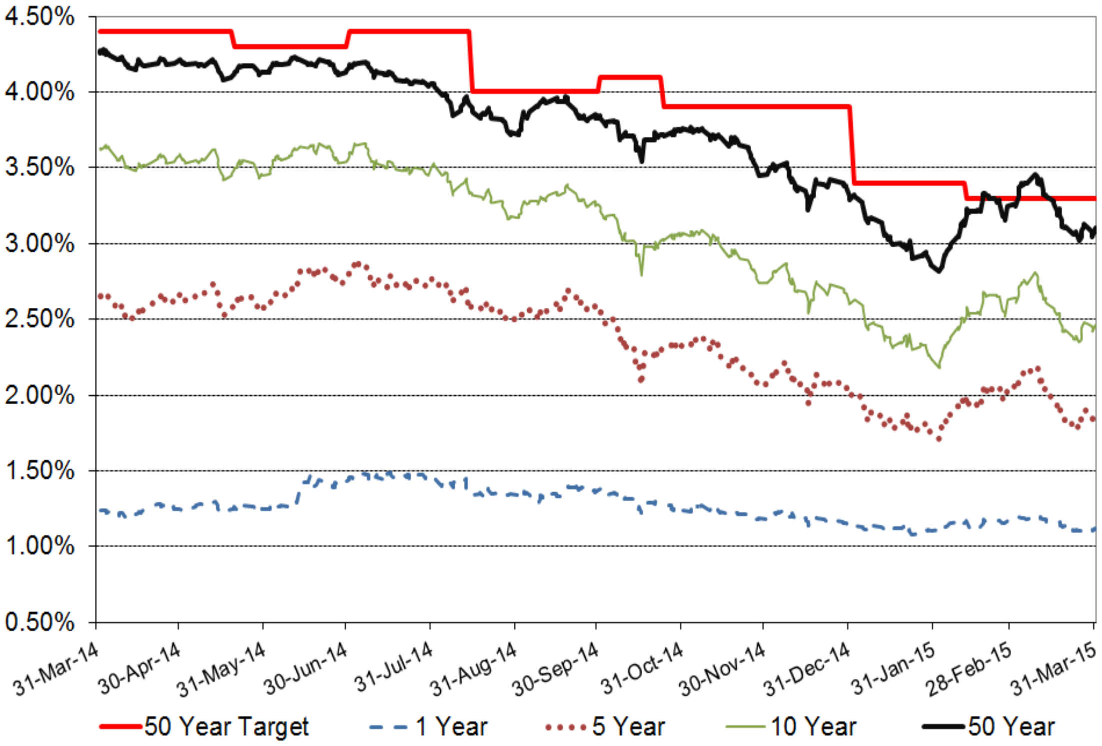
- The Council will continue to utilise internal borrowing rather than external borrowing as the opportunity arises.

5.2 PWLB borrowing rates

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

The Council borrowed £89m from the EIB, with a duration of 30 years, in January 2015. As outlined in the graph below, January 2015 was a period when longer term rates were particularly competitive.

Graph 1: PWLB rates 2014/15



5.3 Debt Rescheduling, Repayment and New Borrowing

On 28 April 2014 a £10m PWLB loan at an average rate of 4.25% was repaid and was not refinanced. This helped reduce the borrowing costs by £393k for the year.

On 15 January 2015 the Council entered into a contractual agreement with the EIB to borrow £89m at a rate of 2.207%, with first and full distribution received on 30 January 2015.

5.4 Borrowing Owed as at 31 March 2015

The Council held the following loans as at 31 March 2015

Counterparty	Loan Type	Start Date	Maturity Date	Principal	Interest Rate (%)
Barclays	LOBO loan - Fixed	30-May-08	30-May-78	10,000,000	3.98
Dexia	LOBO loan - Fixed	30-Jun-08	30-Jun-77	10,000,000	3.98
RBS	LOBO loan - Fixed	26-Mar-10	27-Feb-60	10,000,000	4.07
RBS	LOBO loan - Fixed	26-Mar-10	26-Mar-59	10,000,000	4.05
PWLB	PWLB loan - Maturity	28-Mar-12	28-Mar-42	50,000,000	3.50
PWLB	PWLB loan - Maturity	28-Mar-12	28-Mar-62	65,912,000	3.48
PWLB	PWLB loan - Maturity	28-Mar-12	28-Mar-61	50,000,000	3.49
PWLB	PWLB loan - Maturity	28-Mar-12	28-Mar-52	50,000,000	3.52
PWLB	PWLB loan - Maturity	28-Mar-12	28-Mar-60	50,000,000	3.49
European Investment Bank	Loan - Fixed	30-Jan-15	31-Mar-44	89,000,000	2.21
				394,912,000	

6. Treasury Management Costs

6.1 The costs associated with the Treasury Management function comprise of a recharge of a proportion of the internal team's salary, software, treasury management advisers fees and external managers fees.

6.2 A one off cost of £120k was paid in fees to complete the EIB borrowing.

6.3 Treasury management costs are summarised in table 2 below:

Table 2: Treasury Management costs for 2014/15

Salary Recharge	30,800
Software and other costs	8,245
Capita Treasury Limited	17,000
EIB Charges	120,000
	176,045

7. Compliance with Treasury limits and Prudential Indicators

7.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordable limits) are included in the approved Treasury Management Strategy (TMSS).

7.2 During the financial year to date the Council has operated within and complied with the treasury limits and Prudential Indicators set out in the Council's annual TMSS. The Council's prudential indicators are set out in **Appendix 2** to this report. In 2014/15, the Council did not breach its authorised limit on borrowing of £650m.

7.3 The Operational limit set in the 2014/15 TMSS was £500m, which was not breached.

8. Lending to commercial and external organisations

8.1 As part of the Council's mitigation of risk strategies around delivering and continued value for money services with external organisations, the Council should from time to time have the ability to make loans to external organisations.

8.2 Section 2 of the Local Government Act 2000 (power of well-being) gives authorities the power to lend as part of promotion or improvement of economic /social wellbeing of the Borough. The guidance encourages local authorities to use the well-being power as the power of first resort removing the need to look for powers in other legislation. Further the power provides a strong basis on which to deliver many of the priorities identified by local communities and embodies in community strategies. The Chief Finance Officer determines the rates and terms of such loans.

9. Conclusions

9.1 The key conclusions to draw from this report are as follows:

a) That the Council complied with prudential and treasury indicators in 2014/15;

b) That the value of investments as at 31 March 2015 totalled £217.9 million; and

c) That value of long term borrowing as at 31 March 2015 totalled £394.9m. This comprised market, PWLB and EIB loans.

10. Options Appraisal

10.1 There is no legal requirement to prepare a Treasury Management Annual Report, however, it is good governance to do so and 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).

11. Consultation

11.1 The Chief Finance Officer has been informed of the approach, data and commentary in this report.

12. Financial Implications

Implications completed by: Jonathan Bunt, Chief Finance Officer

12.1 This report sets out the outturn position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

13. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

13.1 The legal and governance provisions have been incorporated in the body of this report. There are no further legal implications to highlight.

14. Risk Management

14.1 The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income throughout the past year.

14.2 EIB funded urban regeneration programme

The urban regeneration programme will be governed by a programme delivery board established in the Regeneration department. A programme manager will be identified within the Council who will be responsible for delivering each scheme within the investment programme.

Background Papers Used in the Preparation of the Report:

- Treasury Management Strategy Statement - Assembly Report 19 February 2014 and 24 February 2015
- Capita Asset Management Economic and Interest Rate Report
- CIPFA – Revised Treasury Management in the Public Sector
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities

List of appendices:

- **Appendix 1** – Investments Held as at 31 March 2015
- **Appendix 2** - Treasury Management Outturn Report 2014/15: Prudential Code
- **Appendix 3** - Glossary of Terms