Assembly

17 September 2014

Title: Treasury Management Annual Report 2013/14	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
Report Author: David Dickinson, Group Manager Pensions and Treasury	**Contact Details:** Tel: 020 8227 2722 E-mail: david.dickinson@lbbd.gov.uk
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. 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 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 2013/14. The key points to note are as follows:

- Investment income for the year was £1.3m (2012/13: £1.9m);
- There was no General Fund borrowing in 2013/14 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; and
- The Council did not breach its 2013/14 authorised borrowing limit of £502m and complied with all other set treasury and prudential limits.

The Cabinet considered this report at its meeting on 4 August 2014 (Minute 6 refers) and endorsed the recommendations below. Recommendation (vi) relates to the "Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals" report approved by the Cabinet at that same meeting, which included proposals for new borrowing and lending arrangements. As a consequence of that decision, it will be necessary for elements of the Treasury Management Strategy Statement to be updated accordingly.

Recommendation(s)

The Assembly is recommended to:

(i) Note the Treasury Management Annual Report for 2013/14;

(ii) Note that the Council complied with all 2013/14 treasury management indicators;

(iii) Note that the Council did not borrow in 2013/14 to finance its capital programme but utilised internal cash in line with its strategy;

(iv) Agree to an increase in the period the Council can invest with the Royal Bank of Scotland (RBS) from one year to a maximum of two years, as outlined in section 4.5 of the report.;

(v) Approve the actual Prudential and Treasury Indicators for 2013/14; and

(vi) Delegate authority to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to approve appropriate amendments to the authorised and operational borrowing limits and proportionally amend the counterparty lending limits within the Treasury Management Strategy Statement, to reflect the decisions made by the Cabinet in respect of the "Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals" as detailed in paragraph 3.3.4 below.

Reason(s)

This report is required to be presented to the Council 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 2013/14.

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 2013/14 period Assembly received the following reports:

- an annual treasury strategy in advance of the year (Assembly 25/02/2013);
- a mid-year (minimum) treasury update report (Assembly 04/12/2013); 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 2014;
- Economic Factors and Interest rates in 2013/14;

- Investment Strategy and Performance in 2013/14;
- Borrowing Outturn;
- Treasury Management costs in 2013/14;
- Compliance with Treasury limits and Prudential indicators;
- Lending to Commercial and External Organisations; and
- Prudential Indicators for 2013/14 (Appendix 1).

2. Treasury Position as at 31 March 2014

2.1 The Council's treasury position at the start and end of 2013/14 can be found in Table 1:

Table 1: Council's treasury position at the start and end of 2013/14

	31 March 2014 £'000	Average Rate /Return	Average Life (yrs)	31 March 2013 £'000	Average Rate /Return	Average Life (yrs)
Fixed Rate Debt						
PWLB	275,912	3.52%	37.68	285,912	3.55%	38.75
Variable Rate Debt						
PWLB	0	0	0	0	0	0
Market	40,000	4.01%	54.61	40,000	4.02%	55.61
Total Debt	**315,912**	**3.59%**	**39.45**	**325,912**	**3.41%**	**40.45**
Investments						
In-House*	121,258			70,766		
External Managers:	0			39,088		
Total Investments	**121,258**	**0.98%**		**109,854**	**1.67%**	

* 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 2013/14

3.1 Growth and inflation

3.1.1 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, better than forecast growth in 2013, driven by consumer spending and the housing market, has led to positive forward surveys indicating that growth prospects are also strong for 2014 in all three main sectors: services, manufacturing and construction. There has been a sharp fall in inflation, with the Consumer Price Index (CPI) reaching 1.7% in February 2014. Forward indications are that inflation will continue to be subdued.

3.2 **Government Debt**

3.2.1 The return to growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget.

3.3 **Global Outlook**

3.3.1 The United States faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

3.3.2 Concerns subsided considerably in the Eurozone during 2013. However, sovereign debt difficulties have not gone away and major concerns could return in countries that do not address fundamental issues of low growth, uncompetitiveness and the need for overdue reforms of the economy. It is, therefore, possible that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries.

3.3.3 The economic situation within the Eurozone is characterised by the risk of long-term deflation. To encourage lending and economic growth the European Central Bank (ECB) has reduced its lending rates as follows: Marginal Lending Rate to 0.4%; its Main Refinancing Fixed rate to 0.15% and its Deposit Facility rate to minus 0.10%.

3.3.4 To support economic and social development the European Union (EU) actively invests in urban regeneration projects through the European Investment Bank (EIB). The bank is wholly owned by the EU and provides low-cost funding to support projects which contribute to achieving economic growth and social objectives throughout the EU. EIB investment is available to the Council and terms have been negotiated to fund an urban regeneration and economic development programme in the borough. These proposals were considered by the Cabinet at its meeting on 4 August 2014 (Minute 16 refers) and the following was agreed:

(i) To borrow £66m from the European Investment Bank within the General Fund to finance the development and ownership of the Shared Ownership and Affordable Rent tenures in the Gascoigne Estate (East) Phase 1 re-development project;

(ii) To borrow £4.5m from the PWLB to fund 50% of 51 private for sale units to be developed and sold jointly by the Council and East Thames Group via a limited company;

(iii) That £23m be borrowed from the EIB within the General Fund to finance the development and ownership of the Affordable Rent tenures in the Abbey Road Phase 2 development project;

(iv) To the reallocation of £2m from the Budget Support Reserve to create an EIB Development Period Reserve to meet the costs of interest payment during the development period to enable taking the borrowing at the earliest opportunity and at the lowest rate;

(v) To develop and own Abbey Road Phase 2 within the Special Purpose Vehicle to be established for the redevelopment of Gascoigne Phase 1, pursuant to Minute 123 (viii) of the Cabinet on 30 June 2014;

(vi) To delegate authority to the Chief Executive, in consultation with the Head of Legal and Democratic Services, the Chief Financial Officer and the Cabinet Members for Finance and Regeneration, to negotiate terms and agree the contract documents to fully implement and effect the projects; and

(vii) To authorise the Head of Legal and Democratic Services, or an authorised delegate on her behalf, to execute all of the legal agreements, contracts and other documents on behalf of the Council.

3.4 Interest Rate Forecast

3.4.1 Improved UK growth resulted in unemployment falling below the threshold of 7%, set by the MPC last August, before it said it would consider any increases in Bank Rate. In the February 2014 Inflation Report, the MPC therefore broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of indicators.

3.4.2 Markets have priced in a first increase in early 2015, though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in labour productivity before a Bank Rate rise. The Council's treasury advisor, Capita Asset Services, forecasts a first increase in Bank Rate in quarter 4 of 2015 (previously quarter 2 of 2016).

4. Investment Strategy and Performance in 2013/14

4.1 Annual Investment Strategy 2013/14

4.1.1 All in-house investments are made with institutions of high credit standing listed in the Council's approved lending list and specified limits. The Council invests 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 meets 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 is 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 approved by the Assembly on 25 February 2013. 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:

- That the challenging economic outlook, the use by central banks of quantitative easing and the UK government's funding for lending scheme mean that investment returns are likely to remain relatively low during 2013/14;
- That the Council and its cash managers adhere to the procedures set for use of different classes of asset (specified and non-specified) and the maximum periods which funds can be committed and adhere to its counterparty limits; and
- That the Council maintains a balance of funding at shorter-term rates to match short-term investments thus maintaining balanced treasury risk.

4.2 **Investments decisions during 2013/14**

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 2013/14 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 Throughout 2013/14 rates of return offered by financial institutions continued to decline, especially in investments with a maturity of less than 95 days. However, due to improvements in economic conditions, from the end of May 2013 the cost of borrowing did start to increase significantly, presenting opportunities for the Council to lend to public sector bodies.

4.2.4 An investment return target of 1% was used by the treasury section for the year.

4.2.5 The amount of cash available held by the Council as at 1 April 2013 totalled £110m. This figure was made up of a range of balances including, revenue reserves and general operational cash balances. The amount available for investment varies throughout the financial year depending on:

- 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.

At 31 March 2014 the level of investments had increased by £11m to £121m, all of which was internally managed.

4.3 **Strategy Changes in 2013/14**

4.3.1 Historically the Council has used an external cash manager to allow for greater diversification of investments within the investment strategy. However, following poor performance and due to management costs significantly reducing net returns, cash invested by the external cash manager was brought back in-house in December 2013.

4.3.2 To accommodate the increase in internally invested cash, on 4 December the Assembly agreed to three changes to the investment strategy, including:

1. Change the variable counterparty limit for Lloyds Bank, which was the higher of £40m or 40% of total investable cash, to a fixed limit of £50m;

2. Allow the in-house treasury section to manage (hold and sell), but not purchase, UK government debt with maturities in excess of one year and up to a maximum maturity period of five years; and

3. Allow the in-house treasury section to invest in non-UK banks that meet the minimum credit rating colour band up to a maximum of £10m per counterparty and up to a total limit of £30m for all non-UK banks.

Medium and long term investments

4.3.3 In October 2013 through to December 2013, an increase in the cost of medium term borrowing presented an opportunity for the Council to invest over a longer time frame with public sector bodies at higher than average rates and at very low risk. As a result £25m was invested over durations of between eighteen months to two year at rates between 1% and 1.1%. This provided a secure base of investment income for the Council until mid 2015, which is when interest rates are expected to start to increase.

4.3.4 In December the Council recalled the cash invested in an external manager. Part of the recalled cash was an investment of £5.78m in UK government debt (GILTS), with a maturity date of 18 July 2018. Following agreement by the Assembly on 4 December 2013 authorising the in-house treasury section to manage (hold and sell) GILTS, the GILTS were transferred to the Council's custodian, King and Shaxson. The intention is to hold the GILTS, which have a return of 1.25%, until they mature in 2018.

4.3.5 Again, following the changes in strategy agreed by the Assembly, a total of £50m was invested with Lloyds Banking Group during the year with maturities of one year. £10m was invested with Goldman Sachs International Bank with a six month maturity at a rate of 0.8%

Short Term investments

4.3.6 To ensure that the Council maintained sufficient liquidity a number of investments were made in overnight and 95 day notice accounts. Returns over the shorter durations were low throughout the year and varied between 0.41 and 0.80%.

4.4 **Performance Measurement in 2013/14**

4.4.1 The Council earned £1.32 million, gross of fees, in interest from its investments in 2013/14, which was £20k higher than the interest income budget set of £1.30m. This represents an average return for the year of 0.98%, against a benchmark rate of 0.4% for 3 Month LIBID (uncompounded) and a target return of 1%.

Cash Manager

4.4.2 Approximately £39m of the Council's cash was managed by a cash manager, Investec, during the year. For the period they were funded, Investec returned 0.54% net of fees. The cash manager return does not include an unrealised market loss of £160k from the £5.78m UK GILT investment that was transferred to the Council in December 2013. If this loss is taken into account then the net return would be 0.12%.

In–House Treasury section

4.4.3 The in-house treasury section returned an average of 1.05% for the year against a target return of 1.0%. A negative contributor to the average return was the need to hold short term cash to manage the Council's liquidity.

4.5 **Investment Strategy changes proposed for 2014/15**

4.5.1 The Council's investment policy was agreed in the annual investment strategy approved by the Assembly on 19 February 2014. Members are asked to agree a change to investment restrictions outlined in the report. The changes requested are:

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

- to delegate authority to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to approve appropriate amendments to the authorised and operational borrowing limits and proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement, to reflect the decisions made by the Cabinet in respect of the "Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals" as detailed in paragraph 3.3.4 above.

4.5.2 RBS Duration

The reason for this request is that it is likely that RBS will remain part nationalised until at least 2015 and even then the reduction in the Government's holding will be over an extended time period.

Currently the Council does not hold any investments with RBS due to the rates of return being offered for investments under a year not being competitive. RBS provide competitive rates over a two year period which, if they remain competitive, the treasury section would like to include within its investment counterparty and duration options.

4.5.3 European Investment Bank Funding

The EIB is the funding institution of the European Union and is constituted as a non-profit making bank. The objective of the EIB is to support economic growth and employment through investment in the following priority areas:

- Innovation and skills

- Access to finance for smaller businesses
- Climate action
- Strategic infrastructure

4.5.4 To deliver these objectives the Greater London Authority (GLA) and the EIB are promoting the ‘London Green Fund Co-financing Loan’ to fund urban regeneration and growth programmes within the London area. The Cabinet report (4 August 2014) entitled “Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals” set out the implications from a treasury management perspective of the proposals to fund the Phase 1 redevelopment.

4.5.5 Although Cabinet approved the proposals to borrow from the EIB, there will be a delay between the Council receiving the money from the EIB and paying for the various projects. The Council will therefore hold a significantly higher cash balance than originally forecast.

4.5.6 The Council’s Treasury Investment Strategy was based on an average cash balance of approximately £150m. It is likely that the amount of cash the Council holds will increase above £200m and it is therefore recommended that the current counterparty limits are increased in proportion with the EIB tranche payments.

4.5.7 To ensure that any increase in counterparty limits are linked to the increase cash available to invest, it is recommended that the Chief Finance Officer be authorised, in consultation with the Cabinet Member for Finance, to approve appropriate amendments to the authorised and operational borrowing limits and proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to reflect the decisions made by the Cabinet, as detailed in paragraph 3.3.4 above

5. Borrowing Outturn

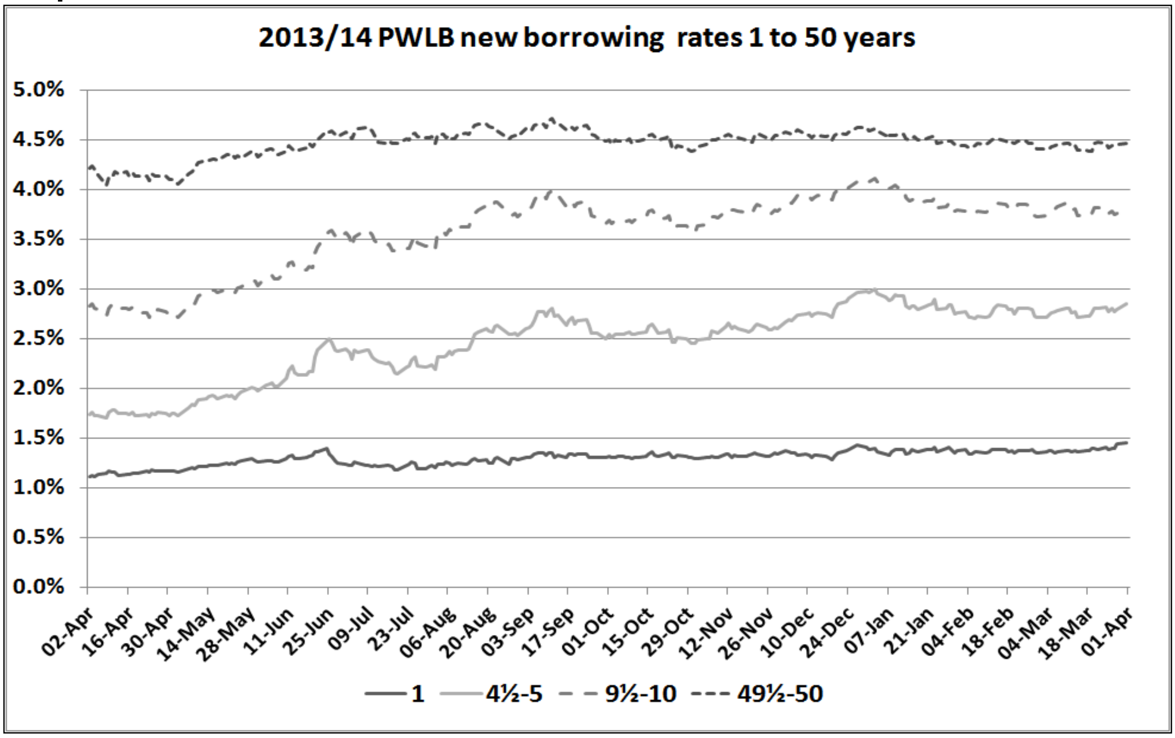
5.1 The key points relating to the 2013/14 borrowing strategy, as agreed within the TMSS, were:

- To set an authorised borrowing limit of £499m for 2013/14;
- The Council’s borrowing strategy 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**

Graph 1 below shows how the PWLB rates increased, especially over the medium to long term during 2013/14.

Graph 1: PWLB rates 2012/13



5.3 **Debt Rescheduling, Repayment and New Borrowing**

On 29 April 2013 a £10m PWLB loan at an average rate of 4.07% was repaid and was not refinanced. This helped reduce the borrowing costs by £373k for the year.

As investment rates remained low during the year and the cash flow forecasts remained strong, the treasury management continued using cash balances rather than borrowing, which helped to keep borrowing costs low and also meant reduced counterparty risk on the investment portfolio. Consequently no new borrowing took place in 2013/14. This strategy provided treasury management budget savings as investments rates were on average over 3% lower than new borrowing rates.

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. Treasury management costs are summarised in table 2 below:

Table 2: Treasury Management costs for 2013/14

Salary Recharge	30,600
Software and other costs	8,627
Capita Treasury Limited	17,000
Investec Asset Management	40,692
	96,919

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 1 to this report. In 2013/14, the Council did not breach its authorised limit on borrowing of £499m.

7.3 The Operational limit set in the 2013/14 TMSS was £429m, 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. Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals

9.1 At the 4 August 2014 Cabinet a report was presented on the Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 funding proposals. Cabinet agreed with the recommendations that the European Investment Bank offered the most economically advantageous funding solution, acknowledging that alternative funding via the Public Works Loan Board was necessary for the development of private sale properties.

9.2 As this borrowing was not included in the Prudential Indicators (PIs) agreed by Council on 19 February 2014 as part of the Treasury Management Strategy Statement, it is necessary for Council to agree revised PIs. Agreeing to an increase in the PIs will prevent any breach of the operational and approved borrowing limits, within which the Council needs to restrict its borrowing.

10. Conclusions

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

a) That the Council complied with prudential and treasury indicators in 2013/14;
b) That the value of investments as at 31 March 2014 totalled £121.2 million; and

c) That value of long term borrowing as at 31 March 2011 totalled £315.9m. This comprised both market and PWLB loans.

11. Options Appraisal

11.1 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).

12. Consultation

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

13. Financial Implications

Implications completed by: Jonathan Bunt, Chief Finance Officer

13.1 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.

14. Legal Implications

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

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

15. Other Implications

15.1 **Risk Management** 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.

Background Papers Used in the Preparation of the Report:

- Treasury Management Strategy Statement - Assembly Report 25 February 2013 and 19 February 2014
- 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 - Treasury Management Outturn Report 2013/14
Appendix 2 - Glossary of Terms