Appendix A

Annual Treasury Management Review
2013/14

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Purpose

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2013/14. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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

- an annual treasury strategy in advance of the year (Council 6th February 2013)
- a mid-year (minimum) treasury update report (Council 11th December 2013)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Members have received quarterly treasury management update reports as part of the Members Newsletter.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council 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 Budget & Strategic Planning Working Group before they were reported to the full Council. Member training on treasury management issues has also been undertaken in order to support members' scrutiny role.

Executive Summary

During 2013/14, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2012/13 Actual £000	2013/14 Original £000	2013/14 Actual £000
Capital expenditure • Non-HRA • HRA • Total	 3.472 1.055 4.527	.1.3481.601 2.949	 1.542 2.011 3.553
Capital Financing Requirement: • Non-HRA • HRA • Total	 0.176 31.89 32.066	 0.176 31.89 32.066	 0.163 31.876 32.039
Gross borrowing	31.861	31.861	31.861
External debt	31.861	31.861	31.861
Investments • Longer than 1 year • Under 1 year • Total	Investments of £13.6m are for less than one year	N/A	Investments of £14.7m are for less than one year
Net borrowing	18.261	N/A	17.161

Other prudential and treasury indicators are to be found in the main body of this report. The Head of Central Services also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2013/14 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2013/14

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2013/14

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.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2012/13 Actual £m	2013/14 Estimate £m	2013/14 Actual £m
Capital expenditure	**3.472**	**1.348**	**1.542**
Financed in year	3.472	1.348	1.542
Unfinanced capital expenditure	**0**	**0**	**0**

HRA	2012/13 Actual £m	2013/14 Estimate £m	2013/14 Actual £m
Capital expenditure	**1.055**	**1.601**	**2.011**
Financed in year	1.055	1.601	2.011
Unfinanced capital expenditure	**0**	**0**	**0**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2013/14 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

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 2013.

CFR : General Fund	31 March 2013 Actual £m	31 March 2014 Budget £m	31 March 2014 Actual £m
Opening balance	0.189	0.176	0.176
Add unfinanced capital expenditure (as above)	0	0	0
Less MRP/VRP*	-0.013	-0.013	-0.013
Less PFI & finance lease repayments	0	0	0
Closing balance	0.176	0.163	0.163

CFR : HRA	31 March 2013 Actual £m	31 March 2014 Budget £m	31 March 2014 Actual £m
Opening balance	31.904	31.890	31.890
Add unfinanced capital expenditure (as above)	0	0	0
Less VRP*	-0.014	-0.014	-0.014
Less PFI & finance lease repayments	0	0	0
Closing balance	31.890	31.876	31.876

** Includes voluntary application of capital receipts*

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2013/14) plus the estimates of any additional capital financing requirement for the current (2014/15) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2013/14. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual £m	31 March 2014 Budget £m	31 March 2014 Actual £m
Gross borrowing position	31.861	31.861	31.861
CFR	32.066	32.039	32.039

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2013/14 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.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2013/14 £m
Authorised limit	44.000
Maximum gross borrowing position	31.861
Operational boundary	32.040
Average gross borrowing position	31.861
Financing costs as a proportion of net revenue stream-GRF	-1.24%
Financing costs as a proportion of net revenue stream-HRA	15.83%

3. Treasury Position as at 31 March 2014

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2013/14 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows*:*

TABLE 1	31 March 2013 Principal £m	Rate/ Return %	Average Life yrs	31 March 2014 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	31.861	3.68	35	31.861	3.68	34
-Market	0	0	0	0	0	0
Variable rate funding:						
-PWLB	0	0	0	0	0	0
-Market	0	0	0	0	0	0
Total debt	***31.861***	***3.68***	***35***	***31.861***	***3.68***	***34***
CFR	***32.066***	***N/A***	***N/A***	***32.039***	***N/A***	***N/A***
Over / (under) borrowing	***-0.205***	***N/A***	***N/A***	***-0.178***	***N/A***	***N/A***
Investments:						
- in house	13.6	0.58	Under 1 yr	14.7	0.42	Under 1 yr
- with managers	0	0	N/A	0	0	N/A
Total investments	***13.6***	***0.58***	***Under 1 yr***	***14.7***	***0.42***	***Under 1 yr***

The maturity structure of the debt portfolio was as follows:

	31 March 2013 Actual £m	31 March 2014 Actual £m
Under 12 months	0	0.448
12 months and within 24 months	0.448	0
24 months and within 5 years	0	0
5 years and within 10 years	0	0
10 years and within 20 years	4.698	4.698
20 years and within 30 years	5.000	5.000
30 years and within 40 years	10.34	10.340
40 years and within 50 years	11.375	11.375

The maturity structure of the investment portfolio was as follows:

	2012/13 Actual £m	2013/14 Original £m	2013/14 Actual £m
Investments Longer than 1 year Under 1 year Total	13.6 under one year	N/A	14.7 under one year

The exposure to fixed and variable rates was as follows:

	31 March 2013 Actual £m	2013/14 Original Limits £m	31 March 2014 Actual £m
Fixed rate (principal or interest)	24	37	18.5
Variable rate (principal or interest)	-6	8	-3.5

Both rows above expressed as net principal sums outstanding of borrowing and investments

4. The Strategy for 2013/14

The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to avoid the cost of holding higher levels of investments and to reduce counterparty risk, although this was not relevant to this Council

The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

Change in strategy during the year – the strategy adopted in the original Treasury Management Strategy Report for 2013/14 and approved by the Council has not been subject to revision during the year.

The wording contained in the following section has been provided by the Council's Treasury Management Advisors.

5. The Economy and Interest Rates

The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While 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.

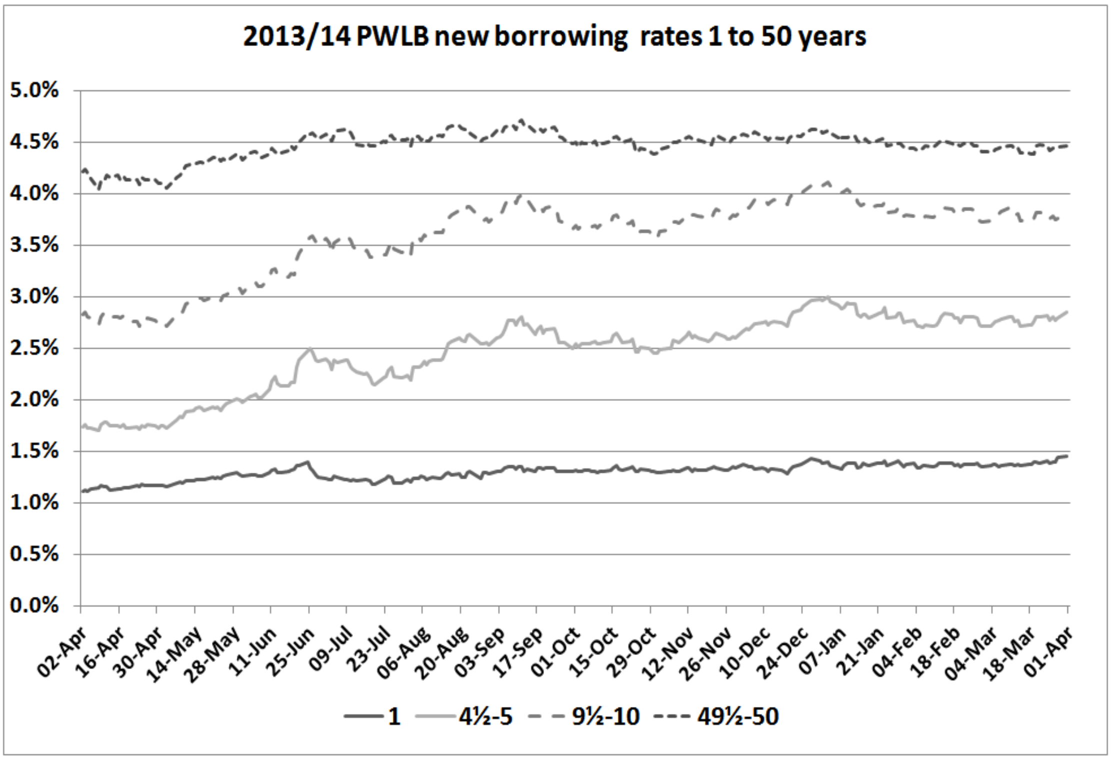
Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then 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.

6. Borrowing Rates in 2013/14

PWLB borrowing rates - the graphs and table for PWLB certainty maturity rates below, and in appendix 3, show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



7. Borrowing Outturn for 2013/14

Treasury Borrowing – there was no requirement for any short term borrowing during the year.

Borrowing – The Council had no requirement to undertake any borrowing due to the current high level of receipts maintained.

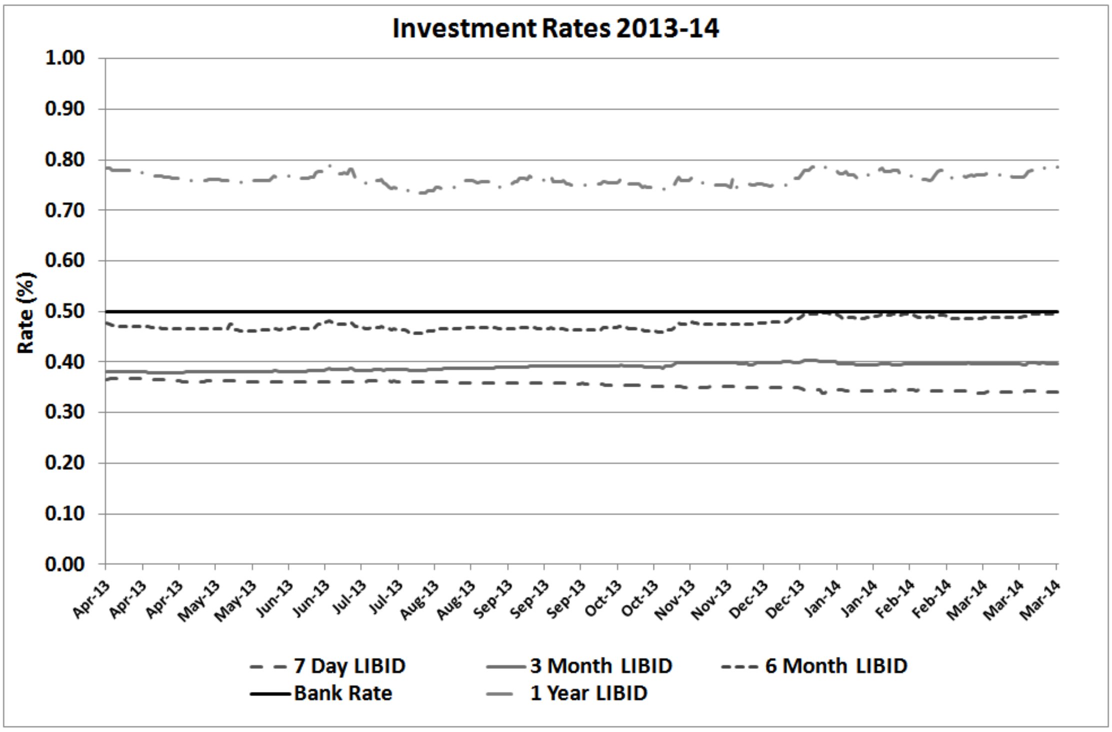
Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
No sums fell due for repayment during the year

Summary of debt transactions – the average interest rate on the debt portfolio was unchanged at 3.68%.

8. Investment Rates in 2013/14

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



9. Investment Outturn for 2013/14

Investment Policy – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 6th February 2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£m)	31 March 2013 £m	31 March 2014 £m
Balances	**1.909**	**2.206**
Earmarked reserves	**3.670**	**4.784**
Provisions	**0**	**0.259**
Usable capital receipts	**7.594**	**6.823**
Total	**13.173**	**14.072**

Investments held by the Council - the Council maintained an average balance of £17.2m of internally managed funds. The internally managed funds earned an average rate of return of 0.42%. The comparable performance indicator is the average 7-day money market rate, which was 0.30%. This compares with a budget assumption of £11.65m investment balances earning an average rate of 0.5%.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investment activities. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

This service has set the following performance indicators:

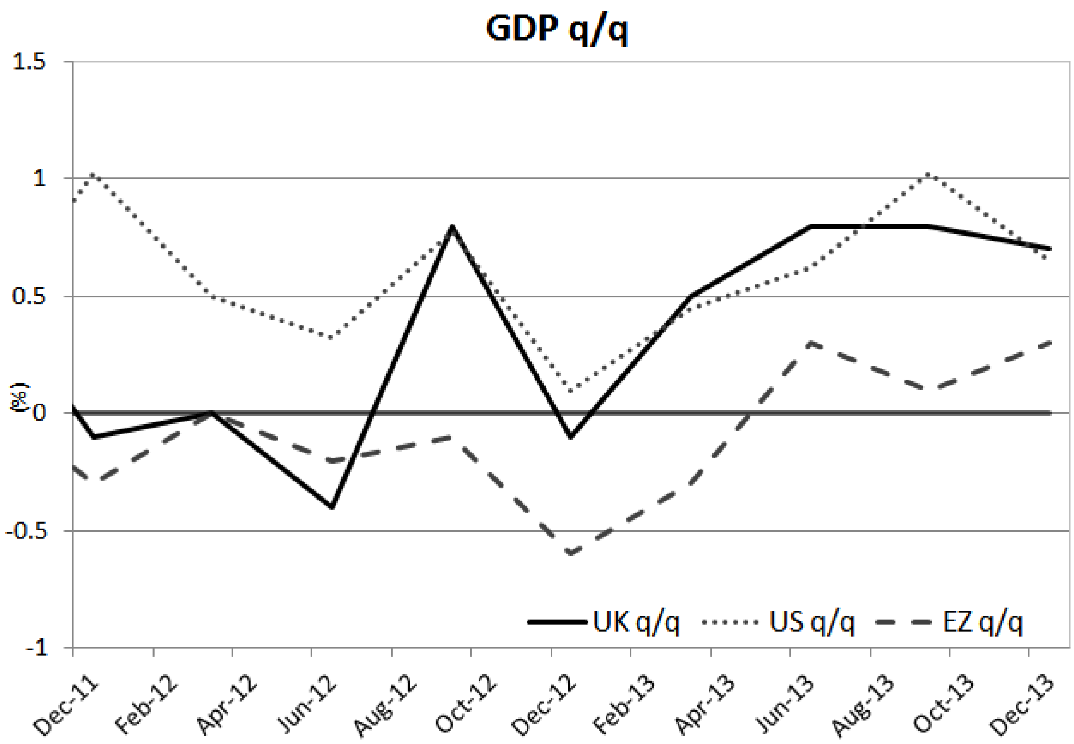
- Investments-to achieve a return on external investments in excess of the seven day money market rate. In 2013-14 the rate of return was 0.42% (+£18,857) compared to the money market rate of 0.30%.

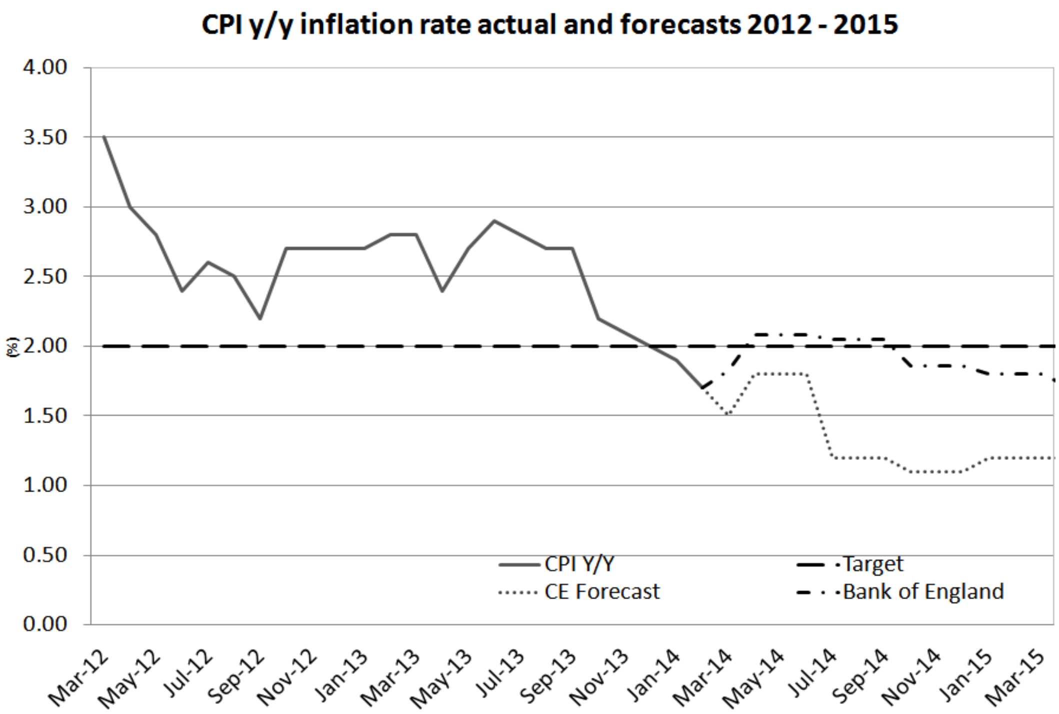
11. Other Issues

Following the last meeting of the Budget & Strategic Planning Working Group it was requested to discuss with the Council's treasury consultants the possibility of placing funds with an external fund manager. The use of fund managers would be a longer term option and the Council would need to deposit funds for a reasonable length of time in order to take advantage of market movements. Currently and in the present economic climate any funds placed would use a combination of cash and gilts. Cash would be kept short and the fund manager would not use gilts in present market conditions. It is also necessary when considering this option to recognise the fee payable.

The investment portfolio has now changed to incorporate more diversification in terms of both counterparty and maturity. As interest rates are currently at low levels it is not a good time to be locking funds into very long term investments and therefore the recent lengthening of the portfolio out to twelve months is currently as far as is reasonable.

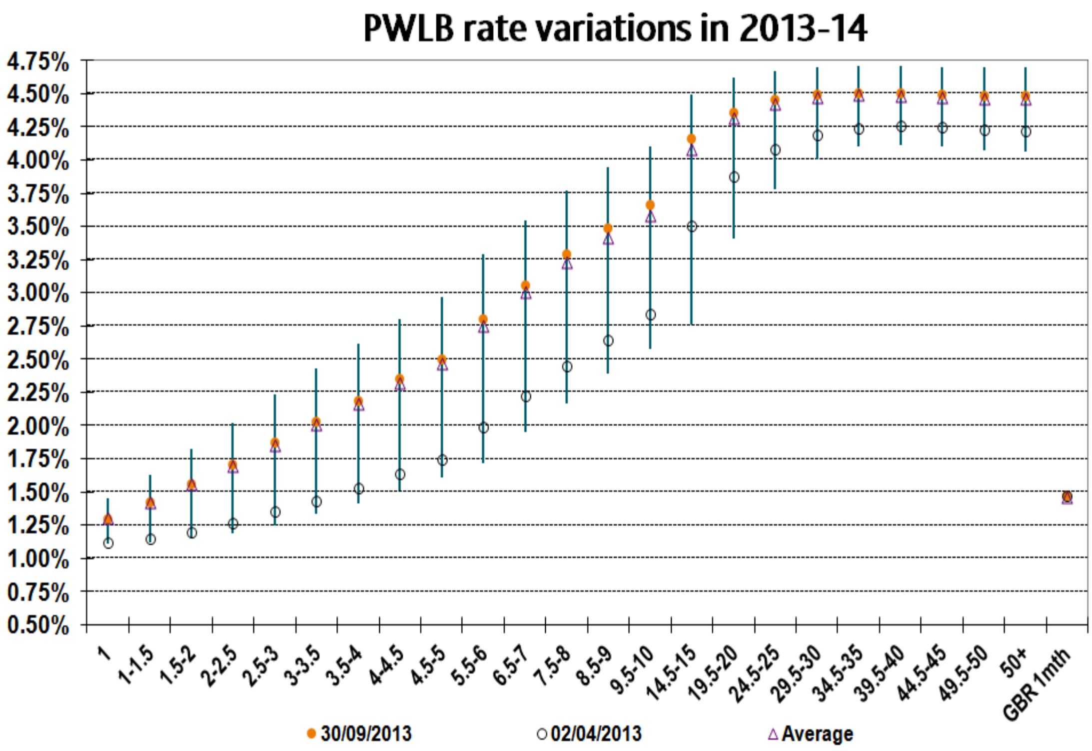
Appendix 2: Graphs





Appendix 3: Borrowing and investment rates

The PWLB rates are based on the certainty rate.



PWLB borrowing rates 2013/14 for 1 to 50 years									
	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
2/4/13	1.120%	1.150%	1.350%	1.530%	1.750%	2.840%	4.080%	4.230%	1.470%
30/9/13	1.300%	1.420%	1.870%	2.190%	2.500%	3.660%	4.450%	4.480%	1.470%
High	1.450%	1.630%	2.230%	2.620%	2.970%	4.100%	4.670%	4.700%	1.480%
Low	1.110%	1.120%	1.250%	1.410%	1.610%	2.580%	3.780%	4.070%	1.450%
Average	1.305%	1.421%	1.853%	2.164%	2.469%	3.584%	4.427%	4.467%	1.466%
Spread	0.340%	0.510%	0.980%	1.210%	1.360%	1.520%	0.890%	0.630%	0.030%
High date	31/3/14	31/3/14	27/12/13	27/12/13	27/12/13	2/1/14	10/9/13	10/9/13	9/4/13
Low date	5/4/13	15/4/13	15/4/13	15/4/13	15/4/13	19/4/13	19/4/13	3/5/13	10/5/13

	Money market investment rates 2013/14					
	overnight	7 day	1 month	3 month	6 month	1 year
1/4/13	0.361	0.365	0.371	0.382	0.478	0.784
31/3/14	0.321	0.342	0.363	0.397	0.497	0.786
High %	0.361	0.368	0.371	0.403	0.498	0.790
Low %	0.258	0.338	0.357	0.379	0.457	0.734
Average %	0.347	0.354	0.364	0.391	0.475	0.762
Spread %	0.104	0.029	0.015	0.023	0.041	0.056
High date	1/4/13	2/4/13	1/4/13	24/12/13	31/12/13	24/6/13
Low date	31/12/13	26/3/14	18/3/14	17/4/13	31/7/13	1/8/13