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COUNCIL

Wednesday, 23 September 2015

TREASURY MANAGEMENT OUTTURN REPORT 2014-15 AND MID YEAR REPORT 2015/16 (REP1235)

EXECUTIVE SUMMARY

1. The Treasury Management Policy Statement for 2014/15 requires an annual report and mid year report to be produced by 30 September 2015, and approved at Council.
2. The report reviews performance of the treasury management function including prudential indicators in 2014/15 and incorporates a look into the first half of 2015/16.

<u>2014/15 Summary:</u>

- Investments totalled £23.6m as at 31 March 2015.
- Interest received during the year totalled £162k compared to £86k in 2013/14.
- The Council maintained its policy of investing short term rather than longer term (greater than one year) due to market conditions.
- During 2014/15, £4m of short term borrowing for the London Road North Complex was replaced by a long term Public Works Loan Board (PWLB) Loan as planned.
- The loans portfolio totalled £93.22m as at 31 March 2015, of which £78.4m relates to the Housing Revenue Account (HRA).
- The Council operated within its approved Prudential Indicator Limits for 2014/15.

<u>2015/16 Summary to date:</u>

- Investments totalled £32.7m as at 31 August 2015.
- Interest received to 31 August 2015 totalled £74.7k.
- The Council has operated within its approved Prudential Indicator Limits to date.

Is the report Open or Exempt?	Open

Wards Affected:	All

Cabinet Member:	Councillor Mike Barnard Cabinet Member for Resources & Welfare Reforms

Supporting Officer:	Homira Javadi Chief Finance Officer (01394) 444529 homira.javadi@eastsuffolk.gov.uk

1 INTRODUCTION

1.1 Treasury Management in Local Government is governed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in the Public Services and in this context is the "management of the Council's cash flows, its banking and its capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks". This Council has adopted the Code and complies with its requirements.

1.2 The Council approves a strategy report at the beginning of each financial year, which identifies how it proposes to borrow and invest in the light of capital spending requirements, interest rate forecasts and economic conditions. The Cabinet monitors the implementation of the treasury strategy and reports are received quarterly during the year. The Audit & Governance Committee are responsible for ensuring scrutiny of the treasury management activities.

1.3 Under the Prudential Code for Capital Finance in Local Authorities, the Council determines at a local level its capital expenditure and can borrow or use alternative financing methods to finance capital spending provided that capital plans are demonstrably affordable, prudent and sustainable. The Code requires prudential indicators to be set and monitored, some of which are limits.

1.4 By the end of September each year, councils must report on their Treasury Management activities that have taken place over the year to Full Council. The remainder of this report summarises the year's activities and performance and provides an update on the activities that have taken place during the first half of the next financial year.

TREASURY MANAGEMENT OUTTURN 2014/15

2 ECONOMIC BACKGROUND

2.1 UK growth was robust in the first quarter of the year largely as a result of strong household spending and confidence reached the highest levels seen since 2005 according to the Gesellschaft fur Konsumforschung (GfK) consumer confidence survey. GfK is the largest market research company in Germany and the fourth largest in the world.

2.2 Gross Domestic Product (GDP) posted a 3% annual increase over 2014 and forward looking indicators such as the Purchasing Managers Index (PMI) were all in the positive territory for the year for both Manufacturing and Services. Unemployment continued its fall over the year, dropping from 6.6% in April 2014 to 5.5% in February 2015. A large contributor of this growth was consumer spending, which was supported by very strong Consumer Confidence Surveys; the GfK figure for March showed the strongest seen for 13 years.

2.3 Oil had an interesting year, initially increasing on Q1 2014/15 as geopolitical risks in the Middle East caused worries over supply. However, this was reversed over the following quarter as concerns over growth in China as well as a strengthening dollar exerted downward pressure. Over the rest of 2014 the decline steepened as North American attempts at fracking and extracting from Oil Sands reduced their overall demand from global markets. The decision taken by Saudi Arabia to maintain market share and allow the price to drop was a major contributor. Despite a small recovery in Q1 2015, Oil ended up at approximately half the value it started the year at.

2.4 This had a direct bearing on inflation, with the Consumer Price Index (CPI) reaching a 12 year low in November 2014 of 1%. The decline continued, reaching zero in February 2015 and remaining at that level in March.

2.5 The market began the year with the expectation that interest rates would be unlikely to be raised until 2015 and despite strongly positive messages from the Bank of England Governor, Mark Carney, suggesting rate rises would be sooner than the market expects and that the point at which interest rates begin to normalise was getting closer. The dipping of CPI proved more of a driving force behind the markets and the consensus at the year-end was for the expectation of the first rate rise to occur in Q3 2016. Longer term rates fell over the course of 2014 and had a small bounce back in Q1.

3 BORROWING

3.1 During 2014/15 the Council extended its £5m of short term Local Authority borrowing for a further year. Borrowing of £4m previously undertaken in 2013/14 from Local Authorities to finance the purchase of the London Road North complex was replaced with Public Works Loan Board (PWLB) equal instalments of principal borrowing during 2014/15 as planned. The decisions have been taken following advice from the Council's Treasury Advisors and Brokers.

	Principal £m	**Type**	**Rate %**	**Maturity Term (years)**
Loans repaid during 2014-15				
Local Authority Fixed Rate Maturity Loans	5.0	Fixed	0.45	1.0
Local Authority Fixed Rate Maturity Loans	4.0	Fixed	0.40	0.3
Loans Borrowed during 2014-15				
Local Authority Fixed Rate Maturity Loans	5.0	Fixed	0.55	0.8
PWLB Fixed Rate EIP Loan	4.0	Fixed	3.69	25.0

3.2 Given the large differential between short and longer term interest rates, which is likely to remain a feature for some time as well as the pressure on Council finances, the debt management strategy sought to lower debt costs within an acceptable level of volatility (interest rate risk). Loans that offered the best value in the prevailing interest rate environment were PWLB variable interest rates loans. This supported the case for maintaining the Council's variable rate debt portfolio.

3.3 Given the significant cuts to local government funding putting pressure on Council finances, the strategy followed was to minimise debt interest payments without compromising the longer-term stability of the portfolio. The use of internal resources in lieu of borrowing was judged to be the most cost effective means. The 2014/15 borrowing requirement for the General Fund capital programme was £4.64m for which cash balances were utilised. If the Council would have sought to borrow this amount on a short term one year basis this would have attracted an interest cost of approximately £61k at a rate of 1.32%. The average interest amount lost by not having this amount invested would have been approximately £39k at 0.85%, therefore making a saving of £22k.

3.4 The current debt portfolio of the Council can be seen in the table below and is summarised by £78.4m attributable to the HRA which includes £68.3m of Self-Financing loans taken out in 2011/12 and £14.82m of General Fund loans.

Loans as at 31/3/2015	**Principal £m**	**Rate Range %**	**Maturity Range (years)**
PWLB Fixed Rate Maturity Loans	64.00	3.01 - 8.38	0.80- 43.0
PWLB Variable Rate Maturity Loans	20.22	0.52 – 0.54	7.0
Local Authority Fixed Rate Loans	9.00	0.35 - 0.50	0.60 - 1.0
Total	**93.22**	**0.35 - 8.38**	**0.60 - 43.0**

4 INVESTMENT ACTIVITY

4.1 The Council's investment policy for 2014/15 is governed by DCLG guidance, which was implemented in the annual investment strategy approved by the Council on 22 January 2014. 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 DCLG's Investment Guidance requires local authorities to focus on security and liquidity, rather than yield.

4.2 The Council held an average cash balance of £24.1m during the year and received investment income of £162k against a budgeted amount of £127k for 2014/15. During the year the Council placed investments across both liquidity accounts (instant access), realising an average rate of 0.44% and fixed term deposits, realising an average rate of 0.97%.

	Balance at 01/4/2014 £m	Investment made £m	Investments repaid £m	Balance at 31/3/2015 £m
INVESTMENTS				
Short Term Investments (liquidity & term <12 months)	14.3	97.2	-87.9	23.6

4.3 As at 31 March 2015 the investment profile of the Council was as follows.

INVESTMENTS	Balance at 31/3/2015 £m
Liquidity Investments	12.6
Short Term investments	
April 2014 to April 2015	3.0
July 2014 to July 2015	1.0
Dec 2014 to Dec 2015	2.0
Jan 2015 to Jan 2016	4.0
March 2015 to March 2016	1.0
Total	**23.6**

4.4 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15.

4.5 Investments during the year included Call accounts and deposits with Banks and Building Societies within the UK. During the year there were no investments placed with counterparties outside of the UK.

4.6 The limit to be placed with each counterparty remained at £8 Million. The Council also operated a 'group limit', whereby the collective investment exposure to individual banks within the same banking group was restricted to a group total set at £12 Million.

4.7 All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators and Treasury Management Practices and prescribed limits. Maturing investments were repaid to the Council in full and in a timely manner.

4.8 Counterparty credit quality was assessed and monitored with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. The minimum long-term counterparty credit rating determined for the 2014/15 treasury strategy was F1 Short term and A- Long term across rating agencies Fitch, S&P and Moody's.

4.9 The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% throughout the year.

5 COMPLIANCE WITH PRUDENTIAL INDICATORS

5.1 The Council complied with its Prudential Indicators for 2014/15, which was approved on 22 January 2014. The Prudential Indicators for 2014/15 can be found in Appendix A.

6 OTHER ITEMS

6.1 PWLB Certainty Rate - during 2014/15 every Local Authority in the UK could re-apply for a discounted rate from the PWLB which provided a reduction on new borrowing of 0.2%. The Council was successful in obtaining this rate.

TREASURY MANAGEMENT MID YEAR REVIEW 2015/16

7 TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY UPDATE

7.1 The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved at Council on 21 January 2015 and there have been no policy changes to date.

8 DAILY CASH MANAGMENT

8.1 The Council's counterparty list (lending list) is continuously reviewed and updated taking into account published credit rating information, financial accounts, share prices, asset size, Government support and information from the Council's Treasury Advisors, Capita Treasury Services Ltd.

9 INVESTMENT PORTFOLIO 2015/16

9.1 The Council held £32.7m of investments as at the 31 August 2015; the table below illustrates the maturity of investments over the forthcoming months and the average interest rate achieved on the investment.

	01/04/2015 £m	Average Interest Rate %	31/08/2015 £m	Average Interest Rate %
Call Accounts (Liquidity Funds)	12.6	0.38	15.7	0.38
Term Investments: 12 months	11.0	0.97	17.0	0.98

9.2 The Council can confirm that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16.

10 BASE RATE FORECAST

10.1 The Treasury Management Strategy and Investment Strategy 2015/16 included the following forecast on base rate, with the anticipation that the rate would increase in Q4 of 2014/15 with a further increase of 0.25% in September 2015 and March 2016.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Dec-16
Upside Risk	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%	0.75%
Base Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Downside Risk	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

10.2 Although there has been speculation from the Bank of England Governor, Mark Carney, that there could be a rise in base rate by the end of 2015, the markets seem to suggest that the rate increase will be within the first quarter of 2016.

11 BORROWING

11.1 The Council debt portfolio (see 3.4) contains £5m of short term local authority borrowing which matured in June 2015. The Council has secured replacement local authority borrowing for a further nine months with a reduction in interest rate of 0.09% saving approximately £3.3k in interest payments.

12 TREASURY MANAGEMENT PRACTICES (TMPS)

12.1 As a backdrop to the Council's approved Treasury Management policies, the Council also maintains a number of Treasury Management Practices (TMPS) which set out the manner in which the Council seeks to achieve the policies and objectives of the treasury function and how it will manage and control those activities. These were approved at Council on 30 September 2013.

12.2 There have been no major changes, although as mentioned below in section 15, the Council's banking arrangements have changed and will be reflected in the TMPS.

12.3 The TMPS can be viewed within the Finance Service area on the Council's intranet page "FRED" or by contacting the Financial Services Compliance Team.

13 INVESTMENT POLICY UPDATE

13.1 The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") Investment Regulations and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

14 CREDITWORTHINESS POLICY UPDATE

14.1 The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary.

14.2 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution.

Banks 1 - good credit quality – the Council will only use banks which:

i. are UK banks; and/or
ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA+

and have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

i. Short term – F1
ii. Long term – A-

14.3 Viability, Financial Strength and Support ratings have been removed and will not be considered in choosing counterparties. All other criteria remains as previously approved.

15 BANKING ARRANGEMENTS

15.1 The Council completed its move from the Co-operative Bank to Lloyds Bank Plc during April 2015 and is already benefiting from an interest rate of 0.40% on balances held within the Council's current accounts. This is in addition to reducing the Council's banking charges by 50%.

16 CONCLUSION

16.1 The Council has operated its Treasury Management function within the prescribed Treasury Management Policy and Prudential Indicators for 2014/15 and for the first half of 2015/16. The Council has maintained a healthy cash balance during 2015/16 to date and ensured that an improved interest rate return has been achieved.

17 REASON FOR RECOMMENDATIONS

17.1 The CIPFA Treasury Management Code requires a report to be produced covering the Council's Treasury Management activities during 2014/15 and a Mid Year Review of the Treasury Management activities that have taken place during the first half of 2015/16. These reports must be approved by 30 September 2015.

RECOMMENDATIONS

1. That the Annual Report on the Council's Treasury Management activity for 2014/15 incorporating the Mid Year review for 2015/16 be approved.
2. That the Prudential Indicators Outturn position for 2014/15 in Appendix A be noted.

APPENDICES	
Appendix A	Prudential Indicators Outturn for 2014/15

BACKGROUND PAPERS		
Date	**Type**	**Available From**
August 2015	Capita templates and economic information	Financial Services

Compliance with Prudential Indicators 2014/15

1 ESTIMATED AND ACTUAL CAPITAL EXPENDITURE

1.1 This indicator is set to ensure that the level of proposed investment in capital assets remains within sustainable limits and in particular, to consider the impact on the Council Tax and in the case of the HRA, housing rent levels.

	2014/15	**2014/15**
	Estimated £m	**Outturn £m**
Capital Expenditure		
Non-HRA	8.12	**8.71**
HRA	5.12	**4.68**
Total Capital Expenditure	**13.24**	**13.39**

1.2 The £0.59m variance on Non-HRA relates to completion of Capital projects earlier than anticipated and the £0.44m variance on HRA relates to programme delivery being deferred until 2015/16.

2 ESTIMATED AND ACTUAL RATIO OF FINANCING COSTS TO NET REVENUE STREAM

2.1 This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments. Any increase in the percentages requires an increased contribution from the revenue account to meet the borrowing cost.

	2014/15	2014/15
	Estimated %	Outturn %
Ratio of Financing Costs to Net Revenue Stream		
Non-HRA	22.25%	23.17%
HRA	34.48%	31.80%

3 CAPITAL FINANCING REQUIREMENT

3.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

3.2 The Council met this requirement in 2014/15.

	2014/15	2014/15
	Estimated £m	Outturn £m
Capital Financing Requirement		
Non-HRA	24.49	26.66
HRA	77.75	77.75
Total	**102.24**	**105.89**

3.3 The difference on the estimated CFR and the Outturn CFR for Non-HRA is due to grant funded capital expenditure being deferred until 2015/16 and non grant funded expenditure being completed in advance of 2015/16.

4 AFFORDABLE BORROWING LIMIT, AUTHORISED LIMIT AND OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

4.1 **Authorised Limit**: This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements. This limit was set at £122m for 2014/15, with the actual total borrowing being £93.22m.

4.2 **Operational Boundary**: This limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and was set at £119m for 2014/15 with the actual borrowing amount being £93.22m.

4.3 The levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The Council maintained its total external borrowing and other long-term liabilities within both limits.

5 UPPER LIMITS FOR FIXED INTEREST RATE EXPOSURE AND VARIABLE INTEREST RATE EXPOSURE

5.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a net basis, i.e. fixed rate debt net of fixed rate investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	2014/15	2014/15
	Estimated %	Outturn %
Upper Limit for Fixed Rate Exposure	100	85
Upper Limit for Variable Rate Exposure	50	38

6 MATURITY STRUCTURE OF FIXED RATE BORROWING

6.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

6.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

Maturity structure of fixed rate borrowing	Upper limit %	Lower limit %	Actual Borrowing as at 31/03/2015 £m	Percentage of total as at 31/03/2015 %
under 12 months	50	0	5.0	7
12 months and within 24 months	50	0	0	0
24 months and within 5 years	75	0	0	0
5 years and within 10 years	75	0	3.0	4
10 years and within 20 years	75	0	20.0	27
20 years and above	100	0	45.0	62

6.3 All borrowing has been taken in conjunction with advice from the Council's Treasury Management Advisors.

7 TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS

7.1 There were no proposals for the Council to invest sums for periods longer than 364 days.