AGENDA ITEM 5

Policy Committee – 15th September 2015

Treasury Management Outturn Report 2014/15

Report of the Corporate Head of Financial Management

Ward(s) affected: All

1. Purpose of Report
To inform Members of the treasury activity undertaken in the year in the context of current and forecast economic climates.

2. Recommendations
Members are recommended to:

- Note the actual Treasury Management Indicators for 2014/15
- Note the Treasury Management Annual Report for 2014/15;

3. Introduction

3.1 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 2014/15. 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).

3.2 During 2014/15 the reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 11/02/2014);
- a mid-year treasury update report (Council 18/11/2014);
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.3 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.

3.4 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 Policy Committee before they were reported to the full Council.

4. The Council's Capital Expenditure and Financing

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.

Table 1

	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
Capital expenditure	634	1,608	1,731
Financed in year	634	1,469	1,431
Unfinanced capital expenditure	0	139	300

5. Borrowing and the Capital Financing Requirement

5.1 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 2014/15 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.

5.2 Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. 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).

5.3 The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 11/02/2014.

5.4 The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2

CFR	31 March 2014 Actual £000	31 March 2015 Budget £000	31 March 2015 Actual £000
Opening balance	5,910	5,833	5,548
Add unfinanced capital expenditure (as above)	0	139	300
Less MRP	(362)	(311)	(318)
Closing balance	5,548	5,661	5,530

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

5.5 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. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 3

	31 March 2015 Actual £000	31 March 2016 Forecast £000	31 March 2017 Forecast £000
Gross borrowing position	5,988	5,988	5,988
CFR	5,530	6,208	6,435

(The gross borrowing position for 2014/15 is slightly above CFR but only in the short term.)

5.6 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 2014/15 the Council has maintained gross borrowing within its authorised limit.

5.7 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.

5.8 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.

Table 4

	2014/15 £000
Authorised limit	8,250
Maximum gross borrowing position	5,988
Operational boundary	6,000
Average gross borrowing position	5,988
Financing costs as a proportion of net revenue stream*	3.48%

(Net revenue stream is the total of taxation and non-specific grant income)

6. Treasury Position as at 31 March 2015

6.1 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 as detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2014/15 the Council's treasury position was as follows:

Table 5

	31 March 2014 Principal £000	Average Rate	Average Life	31 March 2015 Principal £000	Average Rate	Average Life
Total debt	5,988	4.27%	28.4yrs	5,988	4.27%	28.4yrs
CFR	5,548			5,530		
Over/(under) borrowing	0.440			0.458		
Investments	7,348	0.47%	111days	8,956	0.49%	130days

6.2 The maturity structure of the debt portfolio was as follows:

Table 6

	31 March 2014 Actual £000	2014/15 original limits £000	31 March 2015 Actual £000
Under 12 months	0	825	0
12 months and within 24 months	0	1,240	0
24 months and within 5 years	0	1,240	0
5 years and within 10 years	1,000	1,650	1,000
10 years and within 25 years	700	2,060	700
25 years and over	4,288	6,600	4,288

All investments were for less than one year.

7. The Strategy for 2014/15

7.1 The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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.

7.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

7.3 The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

8. The Economy & Interest Rates

8.1 The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England’s initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

8.2 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 a major programme of 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 over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

8.3 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 throughout 2014/15.

8.4 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

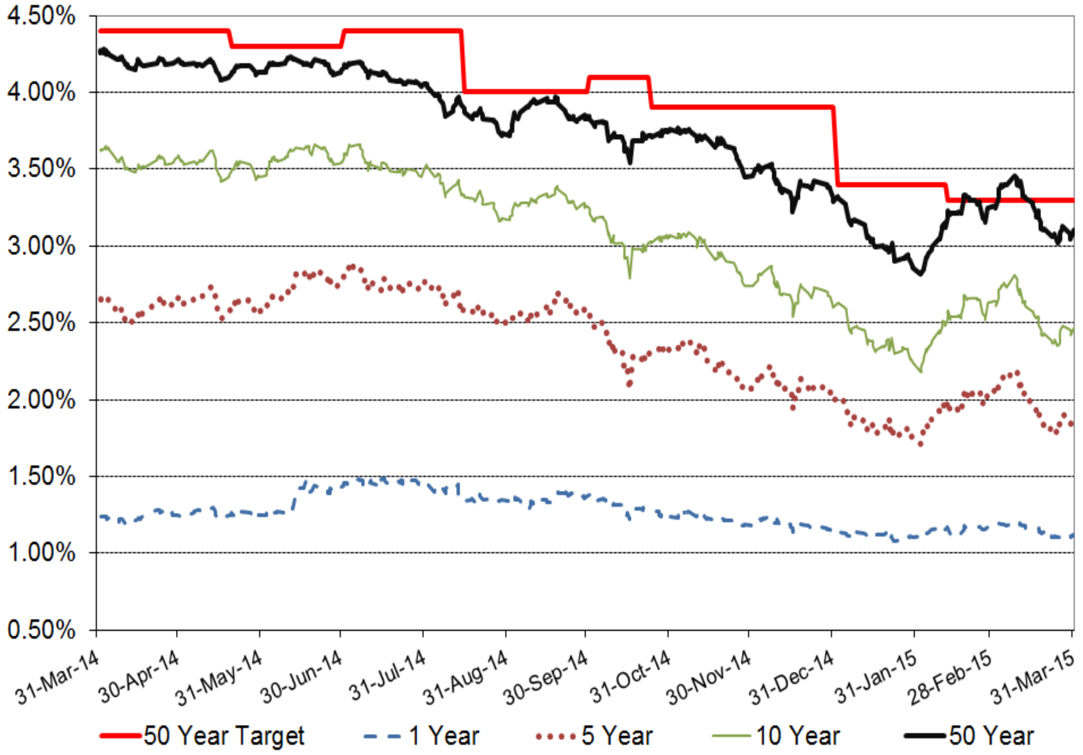
8.5 The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK and its banking system has little direct exposure to Greece, it is much more difficult to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the EZ and cause major damage to their banks.

9. Borrowing Rates in 2014/15

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

Table 7

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/14	1.24%	2.65%	3.63%	4.29%	4.27%
31/3/15	1.11%	1.86%	2.45%	3.11%	3.08%
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.27%	2.36%	3.08%	3.74%	3.72%



10. Borrowing Outturn for 2014/15

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

The following table shows the Councils current borrowing:

Table 8

Lender	Date of Borrowing	Date of Maturity	Value	Interest Rate	Interest Paid
PWLB	04/11/2013	04/05/2021	500,000	2.89%	7,225
PWLB	04/11/2013	04/05/2023	500,000	3.28%	8,200
PWLB	01/12/2005	01/02/2031	700,000	4.25%	14,875
PWLB	17/09/2007	01/08/2057	2,000,000	4.55%	45,500
PWLB	17/09/2007	01/08/2057	2,288,110	4.55%	52,055

11. Investment Rates in 2014/15.

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but by the end of the year had moved back to around quarter 3 2016. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.

12. Investment Outturn for 2014/15

12.1 Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 11th February 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 investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

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

Table 9

Balance Sheet Resources (£000)	31 March 2014 £000	31 March 2015 £000
Balances	668	772
Earmarked reserves	4,056	5,615
Provisions	362	318
Usable capital receipts	2,143	2,593
Total	**7,229**	**9,238**

12.3 Investments held by the Council - the Council maintained an average balance of £10.414m of internally managed funds. The internally managed funds earned an average rate of return of 0.49%. This compares with a budget assumption of £5.82m investment balances earning an average rate of 0.54%. A full list of investments is at Appendix A.

12.4 Additionally, the Council's investment income was boosted by a discount of £13,000 on the annual pensions contribution as a result of making a payment in advance. The total of investment income received from all sources is therefore £74,744.

13. Prudential and treasury indicators

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 10

Prudential Indicators	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Capital expenditure	634	1,608	1,731
Capital Financing Requirement	(166)	139	(18)
Gross borrowing in year	(250)	0	0
Total external debt	5,988	5,988	5,988
Total investments	7,003	7,003	8,956
Net investments	1,015	1,015	2,968

Table 11

Treasury Management Indicators	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Authorised Limit for external debt - borrowing	8,238	8,250	8,250
Operational Boundary for external debt	6,238	6,000	6,000
Actual external debt	5,988	5,988	5,988
Upper limit for fixed interest rate exposure expressed as net principal re fixed rate borrowing/investments	6,238	6,000	6,000
Upper limit for variable rate exposure expressed as net principal re variable rate borrowing/investments	0	0	0
Upper limit for total principal sums invested for over 364 days	0	0	0

14. Implications

14.1 Financial Implications - There are no financial implications associated with this report.

14.2 Legal Implications - There are no legal implications attached to this report.

15. Contribution to Corporate Priorities

The Treasury Management function does not contribute directly to the Council's Corporate Priorities albeit the delivery of the Treasury Management Strategy supports the Council's budget strategy which in turn is a fundamental element of the Council's service and financial planning approach to achievement of the Council Plan.

16. Risk Management

There are no direct risk management implications arising from this report. Regular review provides assurance that treasury management activities are being managed in line with the Treasury Management Strategy.

17. Equalities Impact Assessment

Since this report is not seeking to set or amend policy, the Council's Equality Impact Assessment procedure has not been followed.

18. Consultations with Others

None

19. Access to Information : Background Documents

Working papers held in Financial Services.

20. Author of the Report

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Note: Members are invited to contact the author in advance of the meeting with any detailed queries or questions.

Appendix A

Counterparty	Date of Investment	Date of Maturity	Value	Interest Rate	Interest Due or Forecast
Fixed term:					
Furness BS	01/10/2014	01/04/2015	500,000	0.60%	1,500
National Counties BS	02/01/2015	02/04/2015	1,000,000	0.52%	1,280
Newcastle BS	02/01/2015	02/04/2015	500,000	0.50%	620
Cumberland BS	15/01/2015	15/01/2015	500,000	0.48%	590
Newcastle BS	13/11/2014	13/05/2015	500,000	0.68%	1,690
Progressive BS	13/11/2014	13/05/2015	500,000	0.65%	1,610
Bank of Scotland	07/01/2015	07/07/2015	1,000,000	0.70%	3,470
Money Market Funds:					
Goldman Sachs	n/a	n/a	1,000,000	0.43%	n/a
Aberdeen Sterling Liquidity	n/a	n/a	50,000	0.40%	n/a
Blackrock	n/a	n/a	400,000	0.35%	n/a
Insight	n/a	n/a	1,000,000	0.43%	n/a
Ignis Sterling Liquidity Fund	n/a	n/a	1,000,000	0.37%	n/a
Santander	n/a	n/a	1,000,000	0.40%	n/a
Lloyds Bank Current Account	n/a	n/a	549,535	0.40%	n/a