AGENDA ITEM 8

Policy Committee – 22nd July 2014

Treasury Management Annual Report 2013/14

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 Treasury Management Annual Report for 2013/14;
- Note the actual Treasury Management Indicators for 2013/14.

3. Introduction

3.1 The CIPFA (the Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report therefore ensures this council is implementing best practice in accordance with the Code.

4. The Economy and Interest Rates

4.1 The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. 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.

4.2 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.

4.3 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.

4.4 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.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2013/14, which includes the Annual Investment Strategy, was approved by the Council on 25th February 2013. It sets out the Council’s investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

5.2 The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover short term cash flow needs but also to seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions, using Sector’s suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Sector.

5.3 There was one breach of counterparty limit in the year when a counterparty with a value limit of £1m when the duration is three months or less held £1m for a period of four months. This was due to there being an overlap of two separate investments of £500k each and was the result of there being no alternative counterparties available which would not have caused a similar breach. (The counterparty limits are scheduled to be reviewed in 2013/14).

5.4 Investment rates available in the market have continued at low levels with little improvement throughout the year which restricts the level of income achieved from investments.

5.5 The availability of funds fluctuates within each month – there being in the region of £2.5m to invest in the first two weeks, with the most significant outgoings occurring largely in the latter two weeks. Surplus funds are therefore kept as liquid as cashflows demand, with recurring surpluses being invested in secure fixed term vehicles to maximise return.

5.6 The following table summarises the treasury management transactions undertaken during the 2013/14 financial year: A detailed analysis of investments and borrowing at 31 March is shown at Appendix A.

			Principal Amount £000	Average Interest Rate %
Investments	- as at 31st March 2013	(a)	4,443	
	- matured in year		19,000	0.58
	- arranged in year		19,500	0.53
	- Instant access accounts *		2,402	0.47
	- Long-term investments		3	0.01
	- as at 31st March 2014	(b) **	**7,348**	**0.47**
Debt	- as at 31st March 2013	(c)	6,238	4.81
	- matured/repaid in year		1,250	6.01
	- arranged in year		1,000	3.09
	- as at 31st March 2013	(d) **	**5,988**	**4.27**
Net Investment at 31st March 2013		(d-b)	**1,360**	
Net Debt at 31st March 2013		(c-a)	**1,795**	

* *Movement in balances held in call accounts and Money Market Funds*
*** See Analysis at Appendix A*

6. Performance Report

6.1 Fixed term investments were capped at £1m as a consequence of maintaining the need to observe security over liquidity over yield.

6.2 Surplus short-term cash remains invested in AAA-rated Money Market Funds and call accounts with A-rated 'high-street' banks giving instant access to meet cash outflow requirements.

6.3 Debt fell as a result of new borrowing being less than redeemed debt with no requirement for short-term borrowing.

6.4 Interest on Treasury Activities:

	Actual £000	Budget £000	Variance £000
Investment Income	46	54	8
Interest Paid	274	284	(10)

7. Risk Management

7.1 As noted in the Treasury Management Policy Statement, the Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The key treasury risks being managed are:

- credit risk,
- liquidity risk,
- interest rate risk,
- refinancing risk, and
- operational risk.

7.2 The techniques employed to manage these risks are covered in detail in the Council's Treasury Management Practices, and include:

- robust counterparty monitoring and selection criteria,
- prudent cash flow forecasting,
- a range of exposure limits and indicators, and
- procedures designed to prevent fraud and error.

7.3 The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. All of its surplus cash is therefore held as short-term investments with the UK Government, local authorities, and highly credit-rated banks, building societies and pooled funds.

7.4 The Council's primary objective for the management of its debt is to ensure its long-term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board at long-term fixed rates of interest.

7.5 However, the combination of short-term investments and long-term debt exposes the Council to the risk of falling investment income during periods of low interest rates.

8. Treasury Management Indicators

The Council is asked to note the following indicators as at 31st March 2014:

8.1 Security: Average credit rating

Fixed-term investments were held across a range of counterparties and the average rating achieved, compared to a median target, was:

	Median	Actual
Portfolio average credit rating	BB+	A-

For the purpose of this indicator, unrated building societies are assigned an indicative rating of BBB+.

8.2 Liquidity: cash available within three months

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period. The use of instant access accounts ensures cash is available on demand.

The average holding for the year was:

	Target £000	Actual £000
NatWest	100	40
Lloyds	100	16
Santander	100	0
Bank of Scotland	200	116
Money Market Funds	3,000	3,079
	3,500	3,251

Interest Rate Exposures

8.3 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

8.4 All of the Council's investments are deemed to be variable rate while the whole of its borrowing is at fixed rate. The Council is, therefore, at the mercy of falling or low rate investment returns while remaining tied-in to the cost of fixed term borrowing.

8.5 The upper limits on fixed rate exposures therefore match the Council's fixed rate borrowings, and the value of 'Zero' for variable rate exposures enables variable rate borrowing only up to the value of variable rate investments.

	Limit £000	Actual £000
Upper limit on fixed rate exposures	6,238	5,988
Upper limit on variable rate exposures	0	0

Maturity Structure of Borrowing

8.6 This indicator is set to control the Council's exposure to refinancing risk. The maturity structure of fixed rate borrowing at the 31st March 2013 is:

Maturity Date of Borrowing	Target Spread	Actual Spread
Under 12 months	0%	0%
12 months and within 24 months	10%	0%
24 months and within five years	10%	0%
Five years and within 10 years	10%	16.7%
10 years and within 25 years	20%	11.7%
Over 25 years	50%	71.6%

8.7 The target spread is designed to ensure that not all the Council's borrowings become repayable at the same time. An actual percentage greater than target is not necessarily detrimental, but would need to be taken into consideration should further borrowing be contemplated.

9. Implications

9.1 Financial Implications

There are no financial implications associated with this report.

9.2 Legal Implications

There are no legal implications attached to this report..

10. 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.

11. 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.

12. 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.

13. Consultations with Others

None

14. Access to Information : Background Documents

Working papers held in Financial Services**.**

15. 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.

16. Appendices

Appendix A – Analysis of Investments and Loans

APPENDIX A

Investments and Holdings as at 31.03.2014

	From	To		
Fixed term:				
Furness BS	01/10/2013	01/04/2014	500,000	0.55%
Cumberland BS	01/10/2013	01/04/2014	500,000	0.50%
National Counties BS	02/10/2013	02/04/2014	500,000	0.65%
Money Market:				
Goldman Sachs			1,000,000	0.36%
SWIP			1,000,000	0.29%
Blackrock			500,000	0.32%
RBS Global Treasury Fund			1,000,000	0.34%
Ignis Sterling Liquidity Fund			1,000,000	0.35%
Call Accounts:				
Bank of Scotland			1,000,000	0.40%
NatWest SIBA			345,191	0.40%
Long term:				
HM Treasury $2^1/_2$% Annuities			17.63	0.63%
HM Treasury $3^1/_2$% Annuities			2,700.00	1.75%
TOTAL			**7,347,908**	

Loans Outstanding as at 31.03.2014

Fixed term repayable on maturity:	From	To		
PWLB	01/12/2005	01/02/2031	700,000	4.25%
	17/09/2007	01/08/2057	2,000,000	4.55%
	17/09/2007	01/08/2057	2,288,110	4.55%
	04/11/2013	04/05/2021	500,000	2.89%
	04/11/2013	04/05/2023	500,000	3.28%
TOTAL			**5,988,110**	