



To: The Executive Councillor for Finance & Resources:
Report by: Head of Finance (The Council's Section 151 Officer)
Relevant scrutiny committee: Strategy & Resources 14/7/2014
Scrutiny Committee
Wards affected: All Wards

ANNUAL TREASURY MANAGEMENT REPORT 2013/14, INCLUDING CHANGES TO TREASURY MANAGEMENT STRATEGY 2014/15
Key Decision

1. Executive summary

- 1.1 The Council is required by regulations issued under the Local Government Act 2003, to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for each financial year.
- 1.2 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 2011) in respect of 2013/14.
- 1.3 This report also includes information on capital activity during the year together with associated prudential & treasury indicators.
- 1.4 It is a requirement of the Code of Practice on Treasury Management (2011 Edition) that the changes as referred to in Paragraph 4.2 & Appendix D require the approval of this Committee and Full Council.

2. Recommendations

- 2.1 The Executive Councillor is asked to recommend this report, which includes the Council's actual prudential and treasury indicators for 2013/14.
- 2.2 The Executive Councillor is also asked to recommend these amendments to the Treasury Management Strategy which are summarised below:-

- Recommendation 1 – Increase Counterparty limits
- Recommendation 2 – Increase the limits for longer term investments
- Recommendation 3 – Include other Building Societies on Counterparty list
- Recommendation 4 – Include suggested foreign banks on Counterparty list
- Recommendation 5 – Include Investment Commercial Properties on Counterparty list

2.3 The details of the above recommendations are shown in Paragraph 4.2 & Appendix D and are approved by this Committee and Full Council, scheduled for 24th July 2014.

3. Background

3.1 This report provides information on:

- Capital expenditure and financing activity during the year
- The impact of capital spending on the Council's 'need to borrow'
- The overall treasury position as at 31st March 2014
- An update on Icelandic Bank Deposits
- The Council's compliance with prudential & treasury indicators
- Treasury Management Position as at 31st March 2014 (Appendix A)
- The Council's Treasury Management advisors (Capita Asset Services) view on UK Interest & Investment rates (Appendix B)
- The actual prudential and treasury indicators (Appendix C)
- Changes to Treasury Management Strategy (Appendix D)
- A Glossary of Terms and Abbreviations (Appendix E)

3.2 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, developer contributions, revenue contributions, reserves 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 other resources, the funding of 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.

	2012/13 £'000 Actual	2013/14 £'000 Revised Estimate *	2013/14 £'000 Actual
Non-HRA capital expenditure	8,704	10,272	7,425
HRA capital expenditure	11,529	29,756	16,675
Total capital expenditure	20,233	40,028	24,100
Resourced by:			
• Capital receipts	-920	-3,266	-3,413
• Other contributions	-17,561	-36,762	-20,384
Total available resources for financing capital expenditure	-18,481	-40,028	-23,797
Un-financed capital expenditure	1,752	-	303

* Per Mid-Year Financial Review (MFR) agreed on 24th October 2013

3.3 The Council's overall borrowing need

During 2013/14, there was no requirement for external borrowing. Un-financed capital expenditure for the Clay Farm Collaboration Agreement of £303,000, as shown above, was met temporarily from internal cash borrowing, until the expected future capital receipt can be used.

3.4 Current Debt as at 31st March 2014

The table below shows the Council's current outstanding debt and headroom (the amount of additional borrowing that is possible without breaching the Authorised Borrowing Limit):-

	Principal (£)
Authorised Borrowing Limit (A)	250,000,000
HRA Debt Limit (B)	230,839,000
2011/12 Borrowing (for HRA Self-Financing, C)	213,572,000
General Fund Headroom (A minus B)	19,161,000
HRA Headroom (B minus C)	17,267,000
2012/13 Borrowing	NIL
2013/14 Borrowing	NIL
Total Current Headroom (A minus C)	36,428,000

At present the only debt held by the authority relates to the twenty loans from PWLB for self-financing the HRA.

3.5 Treasury Position as at 31 March 2014

The Council's debt and deposit position is managed in order to ensure adequate liquidity for revenue and capital activities, security for deposits and to manage risk in relation to all treasury management activities. Procedures and controls to achieve these objectives are well established both through the application of approved Treasury Management Practices and regular reporting to Members.

The tables below provide a comparison of deposit activity and outturn for 2013/14 against 2012/13.

<u>Actual Returns</u>	2012/2013		2013/2014	
	Average Deposits	Average Rate of Return	Average Deposits	Average Rate of Return
1. Internally Managed Funds				
Fixed Short-Term (<365 days)	£58.47m	0.86%	49.21m	0.64%
Call/Overnight Accounts	£17.53m	0.65%	33.99m	0.64%
Fixed Long-Term (>365 days)	-	-	0.65m	1.09%
2. Overall Deposit Return				
	£76.00m	0.81%	£83.85m	0.64%

Benchmark Returns	2012/2013		2013/2014	
	Offer (LIBOR)	Bid (LIBID)	Offer (LIBOR)	Bid (LIBID)
Overnight	0.51%	0.38%	0.47%	0.35%
7 day	0.52%	0.39%	0.48%	0.35%
1 month	0.55%	0.43%	0.49%	0.36%
3 month	0.69%	0.56%	0.52%	0.39%
6 month	0.91%	0.78%	0.60%	0.47%
1 year	1.33%	1.21%	0.89%	0.76%
Average	0.75%	0.63%	0.57%	0.45%

Notes:

The 'Benchmark Return' figures are based upon Capita Asset Services average money market LIBOR & LIBID rates respectively. The benchmark returns shown above equate to the average annual rate for deposits as quoted on 31st March 2014. Similarly, the actual returns shown above equates to the Council's recorded average annual rate, also, on 31st March 2014.

Low market interest rates contributed to a lower yield in 2013/14 than in 2012/13. However, achievements compared favourably against the 'Benchmark Returns' for 2013/14.

- 3.6 Interest of £538,000 has been earned on the Council's deposits during 2013/14 at an average rate of 0.64%. This rate of return compares favourably with the average LIBOR & LIBID rate of 0.57% & 0.45%, respectively, as issued on 31st March 2014 by Capita. The budget for interest earned in 2013/14 was £576,000.
- 3.7 Interest yield has under-achieved the interest income budget by £38,000 for the year 2013/14. This was mainly due to further significant falls in market interest rates. The revised Treasury Management Strategy was agreed by Council on 24th October 2013 which will alleviate some of the effects of the downturn in market interest rates during 2014/15.
- 3.8 All of the Council's deposits had maturities of less than two years. A summary of deposits is shown at Appendix A.

3.9 Icelandic Bank Deposits Update

This authority had the following deposit (s) in Icelandic banks and their UK subsidiaries at the time of the collapse of the Icelandic banking system in October 2008, as detailed below:-

Counterparty	Principal	% Rate	Deposit Date
Heritable Bank Limited	1,000,000	5.65000%	09-Jan-08
Heritable Bank Limited	1,000,000	6.21000%	13-Jun-08
LBI hf	2,000,000	6.22000%	30-Jun-08
Heritable Bank Limited	2,000,000	6.00000%	05-Sep-08
LBI hf	1,000,000	6.35000%	01-Jul-08
LBI hf	2,000,000	6.42000%	01-Jul-08
Total:-	9,000,000		

Heritable Bank Limited

The total of distributions now received from the administrators of Heritable Bank Plc represents 94.02 pence in the pound of the total claim.

LBI hf

The total of distributions now received from LBI (formerly Landsbanki Islands Hf) represents approximately 55% of the claim.

3.10 Interest Rate Update

Capita Asset Services is the Council's independent treasury advisor. In support of effective forecasting the Council needs to be aware of the potential influence of market interest & investment rates for the Council. Capita's opinion is presented at Appendix B, and provides an overview as at 31st March 2014.

- 3.11 The Bank of England's May 2014 Inflation Report gives additional information on growth, inflation and interest rates. The Bank of England Monetary Policy Committee (MPC) noted that the economy appeared on course to absorb remaining spare capacity over the next few years, thereby keeping inflation close to the 2% target, reducing the need for an increase in interest rates.

The margin of spare capacity had probably narrowed slightly over recent months, but the central view of most MPC members was that it remained in the region of 1% to 1.5% of GDP. The Committee judged that there was scope to make further inroads into slack before an increase in Bank Rate was necessary.

3.12 Compliance with Treasury Limits

During the financial year the Council operated within the 'authorised' and 'operational' borrowing limits contained within the Prudential Indicators set out in the Council's Treasury Management Strategy Statement. The outturn for these Prudential Indicators is shown in Appendix C.

4. Proposed Changes to Treasury Management Strategy 2014/15 (to include an assessment of any associated risks)

4.1 Due to reduced market interest rates, with no anticipated increases in the near future, a number of recommendations are being proposed that maintain interest returns, while minimising any associated risks.

4.2 These proposals are highlighted in the table shown below:-

Proposed Treasury Strategy Change	Reason for Change	Risk
1. Increase counterparty limits by £5m (banking group by £7.5m)	Provides the opportunity for not using the lower yield alternatives with deposit balances increasing	A major proportion of the deposit portfolio is placed in one area
2. Increase the limit for investments greater than 1 year to £30m	To give greater diversity to this Council, for options that avoids depositing funds in the Debt Management Office (DMO) at a low interest rate currently at 0.25%. Also, to achieve better yields at the longer end of the market	Interest rates increase sooner than expected making current deposits 'tied up' for longer at the previous interest rate
3. Include other building societies on counterparty list with an asset value greater than £5 billion	Improve diversity in accessing counterparties	No guarantee of security
4. Include other highly rated foreign banks to our counterparty list of £5m each (Deutsche Bank, Santander UK, Svenska Handelsbanken)	Rates on our current call accounts are reducing substantially. This sector will increase our access to better interest rates with quality foreign institutions	Not backed by the Bank of England (except Santander UK), which may compromise security and liquidity
5. Include the Council's UK Investment Property Portfolio on counterparty list and 'pooled' property vehicles (e.g. CCLA Local Authorities' Property Fund) – up to £10m	Improve yields from capital investment & 'pooled' property funds in order to gain increased revenue returns from commercial property	Any downturns in the property market could compromise the preservation of capital and liquidity (thus area continually monitored)

5. Implications

(a) Financial Implications

The recommendations will improve interest receipts with the current level of interest rates being continually reduced.

(b) Staffing Implications

None.

(c) Equality & Poverty Implications

No negative impacts identified.

(d) Environmental Implications

None.

(e) Procurement

None.

(f) Consultation and communication

None required.

(g) Community Safety

No community safety implications.

6. Background papers

6.1 None.

7. Appendices

- 7.1 Appendix A – The Council's deposits as at 31st March 2014
- Appendix B – Capita's opinion on UK interest rates
- Appendix C – Prudential Indicators – outturn for 2013/14
- Appendix D – Summarised amendments to the current Treasury Management Strategy
- Appendix E – Glossary of Terms and Abbreviations

8. Inspection of papers

8.1 To inspect the background papers or if you have a query on the report please contact:

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TREASURY MANAGEMENT POSITION AS AT 31st March 2014

CURRENT DEPOSITS

The Council's current deposits are summarised (by counterparty) in the table below, this does not include deposits with Icelandic banks.

Counterparty	% Rate	Duration	Principal (£)
Fixed Term Deposits			
Bank of Scotland Plc	0.98	1 year	3,000,000
Bank of Scotland Plc	0.98	1 year	3,000,000
Bank of Scotland Plc	0.98	1 year	2,000,000
Bank of Scotland Plc	0.95	1 year	2,000,000
Bank of Scotland Plc	0.95	1 year	3,000,000
Bank of Scotland Plc	0.95	1 year	1,000,000
Lloyds TSB Bank Plc	0.95	1 year	2,500,000
Lloyds TSB Bank Plc	0.85	9 months	3,000,000
Lloyds TSB Bank Plc	0.83	9 months	3,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	1,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	1,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	2,000,000
Nationwide BS	0.47	3 months	1,000,000
Cheshire West & Cheshire Council	1.15	2 years	2,000,000
Leeds City Council	0.45	1 day	4,000,000
Thurrock Borough Council	0.47	4 months	2,000,000
Wolverhampton City Council	1.00	18 months	3,000,000
West Yorkshire PCC	0.40	10 days	500,000
Total Fixed Term Deposits			49,000,000
Variable Rate Notice Accounts			
Barclays Bank Plc	0.62188	100 Day Notice	15,000,000
The Royal Bank of Scotland	0.60	Same Day Notice	4,960,023
National Westminster Bank Plc	0.60	95 Day notice	10,000,000
HSBC Bank Plc	0.30	Same Day Notice	1,210,000
Total Variable Rate Notice Accounts			31,170,023
TOTAL			80,170,023

The above deposits include any forward-deals or forward-renewals that have been agreed (i.e. where the deposit/renewal will take place at a future date).

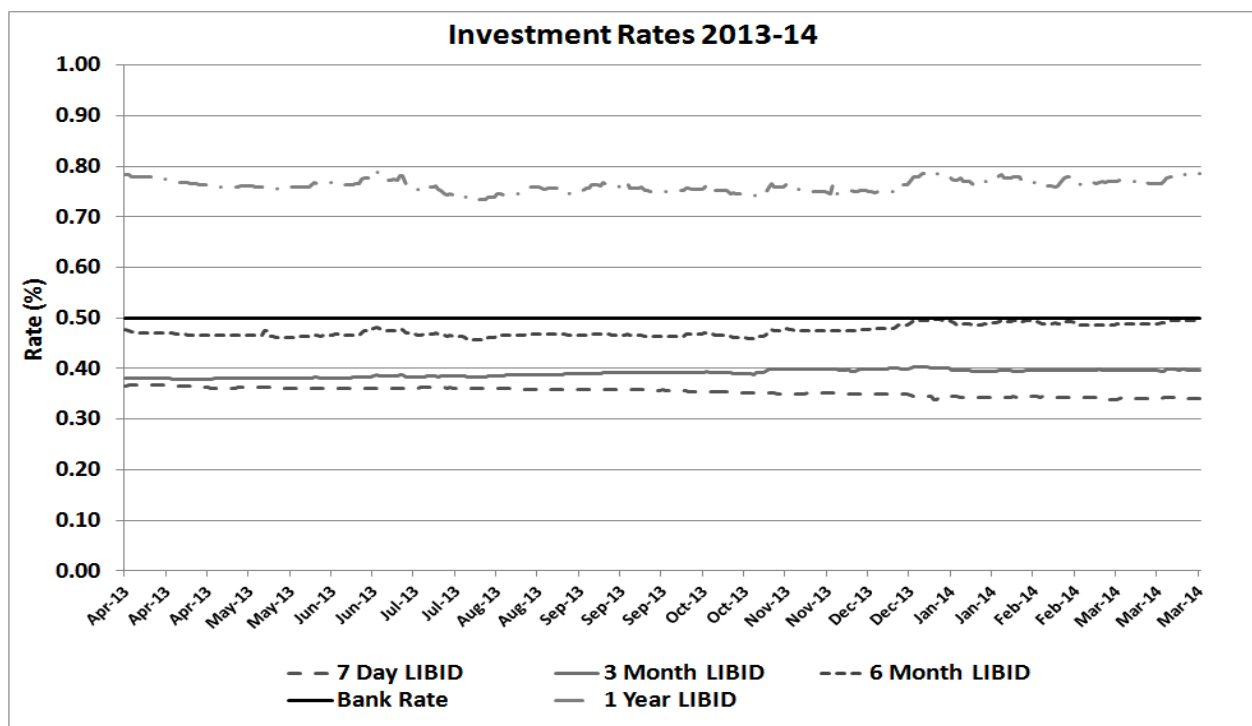
Capita's Opinion on UK Interest & Investment Rates as at 31st March 2014.

UK 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.

UK INVESTMENT RATES

Market expectations as to the timing of the start of monetary tightening ended up unchanged at early 2014. 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. The table below represents graphically the comparison between market investment rates with the Bank of England Base Rate.



PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2012/13 £'000	Original 2013/14 £'000	Revised 2013/14 £'000	Actual 2013/14 £'000
<u>PRUDENTIAL INDICATORS</u>				
Capital expenditure				
- General Fund	8,704	6,761	10,272	7,425
- HRA	11,529	21,581	29,756	16,675
Total	20,233	28,342	40,028	24,100
Incremental impact of capital deposit decisions on:				
Band D Council Tax (City element)	0	0	0	0
Average weekly housing rent	0	0	0	0
Capital Financing Requirement (CFR) as at 31 March				
- General Fund	858	858	858	1,161
- HRA	214,748	214,748	214,748	214,748
Total	215,606	215,606	215,606	215,909
Deposits at 31 March (Note 2)	65,543	59,027	76,206	82,796
Net borrowing Requirement	150,063	156,579	139,400	133,113
Change in the CFR	1,752	0	0	303
External Gross Debt	213,572	213,572	213,572	213,572
Ratio of financing costs to net revenue stream				
-General Fund	-2.85%	-2.64%	-2.65%	-2.77%
-HRA	20.04%	19.50%	19.50%	19.50%
Total	17.19%	16.86%	16.85%	16.73%

Note1: 'Original' refers to the Council's Budget Setting Report 2013/14 as agreed by Council on 21st February 2013.

Note 2: As per the Council's Balance Sheet.

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2012/13 £'000	Original 2013/14 £'000	Revised 2013/14 £'000	Actual 2013/14 £'000
<u>TREASURY INDICATORS</u>				
Authorised limit				
for borrowing	250,000	250,000	250,000	250,000
for other long term liabilities	0	0	0	0
Total	250,000	250,000	250,000	250,000
HRA Debt Limit	230,839	230,839	230,839	230,839
Operational boundary				
for borrowing	215,606	215,606	215,606	215,909
for other long term liabilities	0	0	0	0
Total	215,606	215,606	215,606	215,909
Upper limit for total principal sums deposited for over 364 days & up to 3 years	5,000	5,000	5,000	5,000
Upper limit for fixed & variable interest rate exposure				
Net interest on fixed rate borrowing/deposits	6,840	6,942	6,942	6,916
Net interest on variable rate borrowing/deposits	-23	-23	-23	-23
Maturity structure of new fixed rate borrowing during 2012/13		Upper Limit	Lower Limit	
10 years and above (PWLB borrowing for HRA Reform)		100%	100%	

Note1: 'Original' refers to the Council's Budget Setting Report 2013/14 as agreed by Council on 21st February 2013.

**Recommended Changes to the Treasury Management
Strategy to take effect from 25th July 2014**

Counterparty	Duration	Current Limit (£)	Revised Limit (£)
Increase Single Counterparty limit i.e. UK Nationalised & Non-Nationalised UK Domiciled Banks and Local Authorities	Up to 1 year	15m	20m
Increase counterparty Group Bank limit i.e. UK Nationalised & Non-Nationalised UK Domiciled Banks	Up to 1 year	22.5m (1.5 times Single Counterparty limit)	30m (1.5 times Single Counterparty limit)
Increasing the financial limit for non-specified investments (local authorities only)	Over 1 year and up to 5 years	5m	Up to 30m
Increase the limit for UK Investment Commercial Properties (Including CCLA Local Authorities' Property Fund)	Over 1 year and up to 5 years	NIL	Up to 10m
Increase the HSBC Deposit A/C limit	Up to 1 year	20m	25m
Increase the Certificate of Deposit (single counterparty) limit	Liquid Rolling Balance	10m	15m
Increase the Money Market Fund (single counterparty) limit	Liquid Rolling Balance	10m	15m
Include other UK Building Societies (that fall just outside our criteria)	1 month or in line with Capita's Credit Worthiness Methodologies, if longer	NIL	2m per Building Society
Making use of highly rated foreign banking institutions (e.g. Deutsche Bank, Santander UK & Svenska Handelsbanken)	Up to 1 year	NIL	5m per foreign bank

Note:- An updated Counterparty list incorporating the above changes are shown, also under Appendix D, for additional information.

Proposed Revised Counterparty List (Recommendations shown in bold)

The full listing of approved counterparties is shown below, showing the category under which the counterparty has been approved, the appropriate deposit limit and current duration limits. The changes recommended are shown in bold.

Name	Council's Current Deposit Period	Category	Limit (£)
All UK Local Authorities	N/A	Local Authority	20m
All UK Local Authorities – longer term limit	Over 1 year and up to 5 years	Local Authority	Up to 30m
UK Investment Commercial Properties (Including CCLA Local Authorities' Property Fund)	N/A	UK Commercial Property Portfolio	Up to 10m
All UK Passenger Transport Authorities	N/A	Passenger Transport Authority	20m
All UK Police Authorities	N/A	Police Authority	20m
All UK Fire Authorities	N/A	Fire Authority	20m
All UK Nationalised Industries	N/A	Nationalised Industry	20m
Debt Management Account Deposit Facility	N/A	DMADF	None
Barclays Bank Plc	100 days	UK Bank	20m
HSBC Bank Plc	1 year	UK Bank	25m
Standard Chartered Bank	1 year	UK Bank	20m
Bank of Scotland Plc	1 Year	UK Nationalised Bank	20m
Lloyds TSB Bank Plc	1 Year	UK Nationalised Bank	20m
National Westminster Bank Plc	1 Year	UK Nationalised Bank	20m
The Royal Bank of Scotland Plc	1 Year	UK Nationalised Bank	20m
Members of a Bank Group	1 Year	UK Nationalised Bank	30m
Deutsche Bank	In line with Capita's Credit Worthiness Methodologies	Foreign Banking Institution	5m
Santander Bank UK Plc	In line with Capita's Credit Worthiness Methodologies	Foreign Banking Institution (domiciled in UK)	5m

Name	Council's Current Deposit Period	Category	Limit (£)
Svenska Handelsbanken	In line with Capita's Credit Worthiness Methodologies	Foreign Banking Institution	5m
Nationwide Building Society	In line with Capita's Credit Worthiness Methodologies	UK Building Society	20m
Other UK Building Societies with an asset value greater than £5 billion	1 month or in line with Capita's Credit Worthiness Methodologies, if longer	UK Building Society	2m per Building Society
Money Market Funds – AAA mmf	Liquid Rolling Balance	Financial Instrument	15m (in total, per fund)
Certificate of Deposits (CDs with UK Banking Institutions) – AAA	Liquid Rolling Balance	Financial Instrument	15m (per single counterparty)
Certificate of Deposits (CDs with UK Building Societies) – AAA	Liquid Rolling Balance	Financial Instrument	2m (per single counterparty)
Certificate of Deposits (CDs with Foreign Banking Institutions) – AAA	Liquid Rolling Balance	Financial Instrument	2m (per single counterparty)
Custodian of Funds - AAA	Requirement for Undertaking Financial Instruments	Fund Managers	Up to 15m (per single counterparty)
UK Government Gilts (longer term Government debt) – AAA	Over 1 year & up to 30 Years	Financial Instrument	None (through DMADF, via secondary market)
UK Government Treasury Bills (shorter term Government debts) - AAA	Up to 6 months	Financial Instrument	None (via DMADF)
Supranational Bonds - AAA	Over 1 year & up to 50 Years	Multi-lateral Development Bank Bond	In line with Capita's Lending Methodologies

Treasury Management – Glossary of Terms and Abbreviations

Term	Definition
Authorised Limit for External Borrowing	Represents a control on the maximum level of borrowing
Capital Expenditure	Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day to day items including employees' pay, premises costs and supplies and services)
Capital Financing Requirement	A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources
CIPFA	Chartered Institute of Public Finance and Accountancy
Consumer Price Index (CPI)	Measures changes in the price level of a market of consumer goods and services purchased by households
Counter-parties	Financial Institutions with which funds may be placed
Credit Risk	Risk of borrower defaulting on any type of debt by failing to make payments which it is obligated to do
DCLG	Department for Communities & Local Government
Eurocurrency	Any deposits residing in banks located outside borders of the country that issues the deposit that it is denominated in
Gross Domestic Product (GDP)	GDP per capita is considered an indicator of a country's 'standard of living'
HRA	Housing Revenue Account - a 'ring-fenced' account for local authority housing account where a council acts as landlord
HRA Self-Financing	A new funding regime for the HRA introduced in place of the previous annual subsidy system
LBI hf	Formerly Landsbanki Islands hf
London Inter-bank Bid Rate (LIBID)	The average estimated interest rate leading banks in London are willing to pay for eurocurrency deposits
London Inter-bank Offered Rate (LIBOR)	The average interest rate estimated by leading banks in London would be charged if borrowing from other banks
Liquidity	A measure of how readily available an investment is
MPC	Monetary Policy Committee - The Bank of England Committee responsible for setting the UK's bank base rate
Net Borrowing Requirement	External borrowing less deposits
Operational Boundary	Limit which external borrowing is not normally expected to exceed
PWLB	Public Works Loans Board - an Executive Government Agency of HM Treasury from which local authorities & other prescribed bodies may borrow at favourable interest rates
Security	A measure of the creditworthiness of a counter-party
Yield	Interest, or rate of return, on an investment