AGENDA ITEM NO 9

TREASURY OPERATIONS ANNUAL PERFORMANCE REVIEW

Committee: Corporate Governance and Finance Committee

Date: 25th September 2014

Author: Linda Grinnell, Financial Services Manager and S151 Officer

[P80]

1.0 ISSUE

1.1 To report on the Council's treasury operations during 2013/14.

2.0 RECOMMENDATIONS

2.1 That Members recommend to Full Council to note the report on the Council's treasury operations during 2013/14, including the prudential and treasury indicators, as set out at Appendix 1.

3.0 BACKGROUND

3.1 The 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).

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

- an annual treasury strategy in advance of the year (Council 21/2/13)
- an in - year treasury update report (Finance & Governance Committee 19/12/13)
- 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 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 The 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 Finance & Governance Committee before they were reported to Full Council.

4.0 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.

5.0 OVERALL TREASURY POSITION AS AT 31 MARCH 2014

5.1 The Council's debt and investment position is organised by Financial Services 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 committee reporting and through officer activity detailed in the Council's Treasury Management Practices.

5.2 At the beginning and the end of 2013/14 the Council's treasury position was as follows:

TABLE 1	31 March 2013 Principal	Rate/ Return	31 March 2014 Principal	Rate/ Return
Total external debt	**£0.00m**	**N/A**	**£0.00m**	**N/A**
Total lease liability	**£0.193m**		**£0.96m**	
CFR	**£0.145m**		**£0.62m**	
Over / (under) borrowing	**£0.048m**		**£0.034m**	
Total investments	**£12.156m**	**0.82%**	**£12.717m**	**0.69%**

6.0 THE STRATEGY FOR 2013/14

6.1 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 postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

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.

6.2 The Council had not anticipated in its 2013/14 treasury strategy the need to undertake any long-term borrowing during the year. The Council did not take out any long-term loans and neither did it need to borrow on a short-term basis for cash flow purposes. With the exception of the lease liability on the waste vehicles, the Council remained debt free as at 31 March 2014.

6.3 The strategy adopted in the original Treasury Management Strategy report for 2013/14, which was approved by Full Council on 27 February 2013, was subject to revision during the year. This was due to the Council having deposited the maximum £3m with every institution it was able to transact with as a result of the Council receiving £4.2m from the DCLG to fund some changes to the refuse and recycling services. An urgent action was undertaken to increase the counterparty limit from £3m to £4m to give officers greater flexibility when making decisions and maximising the interest receivable on the Council's investments.

7.0 THE BORROWING REQUIREMENT AND DEBT

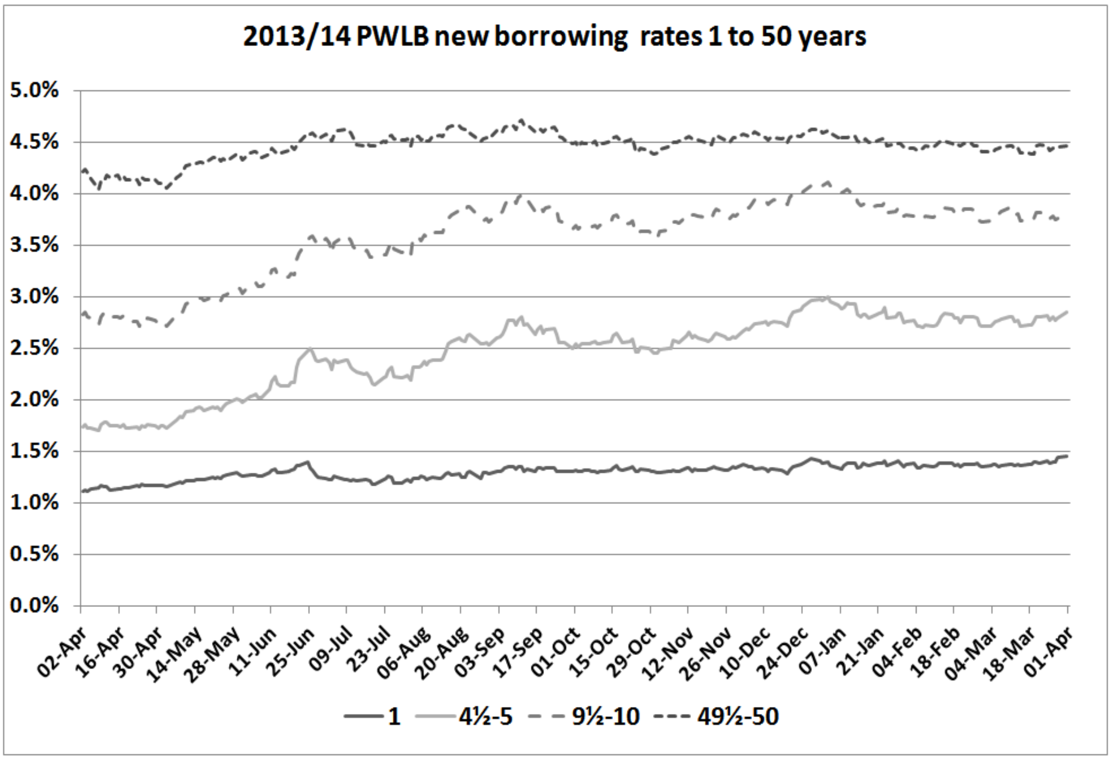
7.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2013 Actual	**31 March 2014 Budget**	**31 March 2014 Actual**
Total CFR	**£0.145m**	**£0.106m**	**£0.62m**

7.2 The Capital Financing Requirement (CFR) has changed from a historic negative to a positive position under the International Financial Reporting Standards (IFRS). This is due to the embedded leases for the refuse and recycling vehicles, which are now included on the Council's Balance Sheet.

8.0 PWLB BORROWING RATES IN 2013/14

8.1 The graph below shows how PWLB certainty rates have risen from historically very low levels during the year.



9.0 BORROWING OUTTURN FOR 2013/14

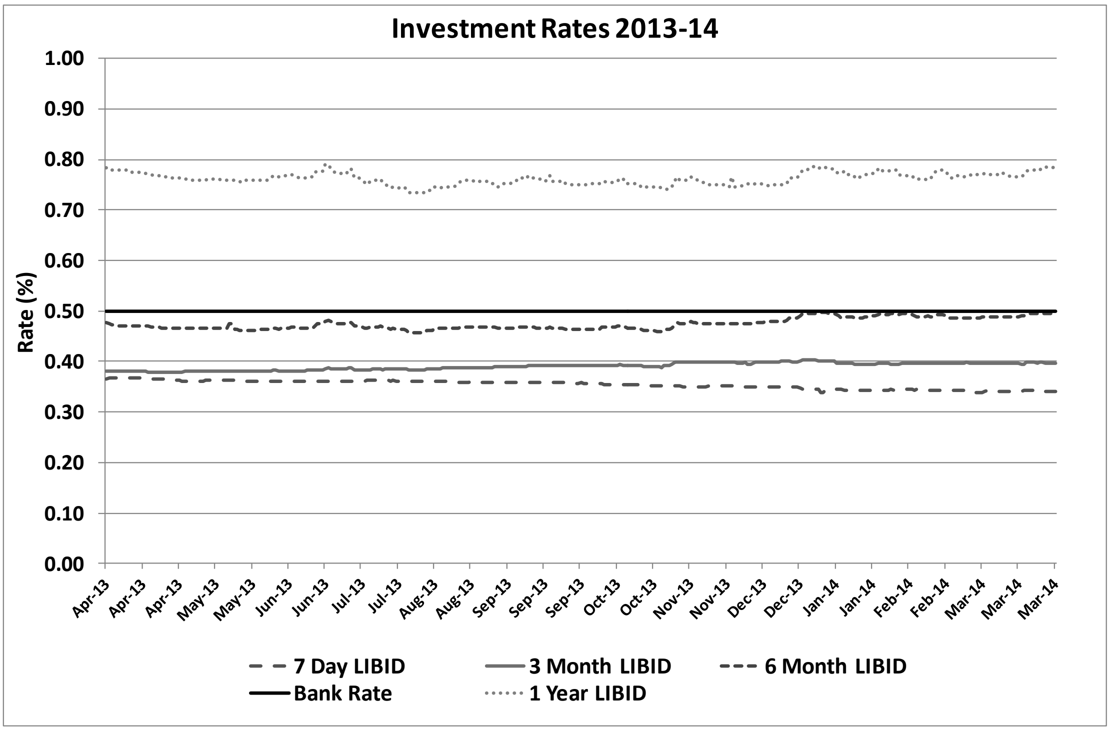
9.1 No borrowing was undertaken during the year.

10.0 INVESTMENT RATES DURING 2013/14

10.1 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 unchanged at early 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.

11.0 INVESTMENT OUTTURN 2013/14

11.1 The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by Full Council on 23 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 credit rating outlooks, credit default swaps and sovereign ratings.



During 2013/14 the Council operated within its approved treasury limits and Prudential Indicators, although adjustments were made to the counterparty limits per the Annual Treasury Management Strategy, by an Urgent Action Notice.

11.2 During 2013/14, business accounts and call accounts have been used more than money market investments, as their short-term rates have been higher. The down grading of various financial institutions' credit ratings during the past couple of years has meant that there are fewer counterparties on the Council's lending list with which monies could be deposited. The Council, has therefore, lent monies to other local authorities during the year when the opportunity has arisen.

11.3 The Council maintained an average balance of £19m of internally managed funds during 2013/14.

11.4 The interest earned on investments during 2013/14, totalled £141,034 against an original budget of £140,000 and produced an average return on investments of 0.69%. This was above the benchmark three month LIBID (London Inter-bank Bid Rate) of 0.47%.

12.0 CONCLUSIONS

12.1 The size of the Council's investment portfolio is relatively small meaning that investment decisions have to be made primarily to accommodate cash flow requirements as opposed to optimising investment returns. Despite these pressures, opportunities for some proactive investment decisions were taken when available.

12.2 During the financial year the Council operated within its approved treasury limits and Prudential Indicators, other than the increase in the counterparty limit.

13.0 FINANCIAL IMPLICATIONS/EQUALITY IMPACT ASSESSMENT

13.1 The investment interest receipts of £141,034 in 2013/14 were in line with the original budget of £140,000.

13.2 An Equality Impact Assessment (INRA) is not required.

14.0 APPENDICES

14.1 Appendix 1: Prudential indicators

Background Documents	Location	Contact Officer
Sector Annual Treasury Management Review Template 2013/14 Finance & Governance Committee TM Strategy January 2013 Statement of Accounts 2013/14 Treasury Register	Room 204 The Grange Ely	Linda Grinnell Financial Services Manager & S151 Officer (01353) 616470 E-mail: linda.grinnell@eastcambs.gov.uk

Appendix 1: Prudential and Treasury Indicators

1. PRUDENTIAL INDICATORS	2012/13	2013/14	2013/14
Extract from budget and rent setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	£835	£4,238	£4,273
HRA (applies only to housing authorities)	£0	£0	£0
TOTAL	£835	£4,238	£4,273
Ratio of financing costs to net revenue stream			
Non - HRA	(0.40%)	(2.95%)	(1.62%)
HRA (applies only to housing authorities)	0%	0%	0%
Gross borrowing requirement General Fund			
brought forward 1 April	£0	£0	£0
carried forward 31 March	£0	£0	£0
in year borrowing requirement	£0	£0	£0
Gross debt	£164	£106	£96
CFR			
Non – HRA	£145	£106	£62
HRA (applies only to housing authorities)	£0	£0	£0
TOTAL	£145	£106	£62
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	£3.96	£5.23	£0.99

2. TREASURY MANAGEMENT INDICATORS	2012/13	2013/14	2013/14
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£4,741	£4,741	£4,741
other long term liabilities	£259	£259	£259
TOTAL	£5,000	£5,000	£5,000
Operational Boundary for external debt -			
borrowing	£0	£0	£0
other long term liabilities	£259	£259	£259
TOTAL	£259	£259	£259
Actual external debt	£164	£106	£96
Upper limit for fixed interest rate exposure			
Net interest re fixed rate borrowing / investments	£25,000	£ 25,000	£ 25,000
Upper limit for variable rate exposure			
Net interest re variable rate borrowing / investments	£ 25,000	£ 25,000	£ 25,000
Upper limit for total principal sums invested for over 364 days	£2,000	£2,000	£2,000
(per maturity date)			

Maturity structure of fixed rate borrowing during 2013/14	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%

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. In 2013/14, the gross debt exceeded the capital financing requirement and this was due entirely to the refuse vehicles embedded lease which was brought onto the Balance Sheet in 2010/11 under the changes to accounting under International Financial Reporting Standards (IFRS). Once the lease liability is cleared the Council's external debt will be zero.

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 above demonstrates that during 2013/14 the Council has kept 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.