

## Annual Treasury Management Report 2014/15

**1. Introduction**

- 1.1 The council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management. Before the start of every year the Code requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement detailing the policies and objectives of the council's treasury management activities for the forthcoming year. After the year end an outturn report is then produced detailing the actual results for the year.
- 1.2 The council has both borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the council's treasury management strategy.

**2. Economic Background**

- 2.1 **Growth:** The pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy.
- 2.2 **Inflation:** Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to a level not seen since March 2009), and a steep drop in wholesale energy prices, with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.
- 2.3 **Labour Market:** The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. In February 2015 the rate of unemployment fell to 5.6% from 6.9% a year earlier. Comparing the three months to February 2015 with a year earlier, employee pay (excluding bonuses) increased by 1.8%.
- 2.4 **UK Monetary Policy:** The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.
- 2.5 **Market reaction:** From July 2014 gilt yields were driven lower by a combination of factors: geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the slide in the price of oil. 5, 10 and 20 year gilt yields fell to their lowest levels in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively. Gilt yields determine the borrowing rates from the Public Works Loan Board with rates available to the council at approximately 0.80% above the equivalent gilt yield rate.

### 3. **Borrowing**

3.1 Because of the large differential between short and longer-term interest rates, the council continues to access lower cost short-term loans from other local authorities.

3.2 It is council strategy to maintain borrowing and investments below their underlying levels by using "internal borrowing". This means borrowing is reduced by utilising usable reserves and keeping investment balances relatively low.

3.2 Interest rates from the Public Works Loan Board (PWLB) fell to historically low levels during the year enabling the council to replace some short-term loans with longer-term finance. In 2014/15 the following longer term loans were taken out from the PWLB:

Amount Borrowed	From	To	Period	Type of loan*	Interest Rate
£5m	16/12/14	16/12/34	20 years	EIP	2.70%
£5m	26/03/15	26/09/64	49 years 6 months	Maturity	2.87%
£3m	31/03/15	31/03/50	35 years	EIP	2.73%
*EIP = Equal Instalments of Principal, where loan is repaid in equal instalments every six months over the period of the loan. Maturity = All principal repaid at the end of the loan period.					

3.3 The premium charged by the PWLB for the early repayment of PWLB debt remained too expensive for existing loans in the council's portfolio to be repaid and rescheduled. No rescheduling activity was undertaken in 2014/15 but this will continue to be constantly considered.

3.4 Borrowing activity during the year is summarised below:

<b>Borrowing Activity in 2014/15</b>	<b>01/04/14 Balance £m</b>	<b>New Borrowing £m</b>	<b>Debt Maturing £m</b>	<b>31/03/15 Balance £m</b>
Short-term borrowing	31.50	63.50	(76.00)	19.00
Long-term borrowing	136.53	13.00	(4.01)	145.52
<b>TOTAL BORROWING</b>	<b>168.03</b>	<b>76.50</b>	<b>(80.01)</b>	<b>164.52</b>
Other long-term liabilities	27.71	0.10	(1.20)	26.60
<b>TOTAL EXTERNAL DEBT</b>	<b>195.74</b>	<b>76.60</b>	<b>(81.21)</b>	<b>191.12</b>
<i>The above amounts show the principal outstanding. The figures in the council's annual accounts will be higher as they will include accrued interest and other required accounting adjustments.</i>				

3.5 The council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31/03/2015 was £244.29m. The difference of £53.17m between the CFR and total external borrowing represents internal borrowing from usable reserves and working capital.

3.6 The council's chief objective when borrowing has been to strike an appropriate balance between using low cost short term finance, securing fixed low interest rates with cost certainty over the period for which funds will be required and retaining flexibility to renegotiate loans should the council's long-term plans change.

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- 3.7 In 2014/15 the weighted average interest rate paid on council borrowing was 3.43% (3.48% in 2013/14). The weighted average cost of long term borrowing was 4.07% compared to 0.49% for short-term borrowing (being the gross cost including brokers' commission of between 0.03% and 0.10%).
- 3.8 The council's capital financing costs in 2014/15 were as follows.

<b>Capital financing costs for 2014/15:</b>	<b>Budget</b>	<b>Outturn</b>	<b>Over / (under) spend</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Minimum Revenue Provision</b> (provision for repayment of loan principal)	<b>10.19</b>	<b>9.93</b>	<b>(0.26)</b>
<b>Interest on existing longer-term PWLB and bank loans</b> (Actuals include accrued interest and other year end accounting adjustments not in budget)	<b>5.52</b>	<b>5.50</b>	<b>(0.02)</b>
<b>Interest on new PWLB loans</b>	<b>0.10</b>	<b>0.04</b>	<b>(0.06)</b>
<b>Interest on short-term variable rate loans</b>	<b>0.55</b>	<b>0.15</b>	<b>(0.40)</b>
<b>Other interest paid (including finance lease interest)</b>	<b>-</b>	<b>0.04</b>	<b>0.04</b>
<b>Less capitalised interest</b>	<b>(0.30)</b>	<b>(0.58)</b>	<b>(0.28)</b>
<b>TOTAL</b>	<b>16.06</b>	<b>15.08</b>	<b>(0.98)</b>

- 3.9 Substantial savings during the year have arisen from:
- Anticipated capital expenditure in 2014/15 being deferred into 2015/16;
  - Short-term variable interest rates being lower than expected;
  - Long-term fixed rates from the PWLB being lower than forecast and loans secured later in the year than budgeted; plus
  - Additional loan interest being capitalised due to accelerated spend on leisure centre improvements.

#### **4. Investments**

- 4.1 The council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves. During 2014/15 the council's investment balances have averaged at £32m and ranged from £54m in May 2014 to £3m as at the year end.
- 4.2 Security of capital remained the council's chief objective. Investment income remained low due to the continued low interest rate environment and the reduction in investment maturity

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limits.

4.3 The reduction in maturity limits (which at the year end were 100 days for most UK banks) followed advice from the council's treasury adviser, Arlingclose and were due to:

- New legislation outlawing government bail-outs and increasing the likelihood of the council losing funds should a bank get into financial difficulty; and
- Deteriorating global growth prospects, especially in the Eurozone.

4.4 Investments held at the start and end of the year were as follows:

Investments	01/04/14 Balance £m	Investments Made £m	Maturities/ Withdrawals £m	31/03/15 Balance £m
Instant Access Accounts	5.83	318.41	(321.68)	2.56
Notice Accounts	5.00	-	(4.80)	0.20
Term Deposits	12.50	10.00	(22.50)	-
<b>Total</b>	<b>23.33</b>	<b>328.41</b>	<b>(348.98)</b>	<b>2.76</b>
<b>Decrease in investments</b>				<b>(20.57)</b>

4.5 Interest received during the year was as follows:

Month	Average amount invested		Average rate of interest earned		Amount of interest earned £000	Budget £000	(Surplus) /deficit £000
	Actual £m	Budget £m	Actual %	Budget %			
Apr-14	35.09	20	0.68	0.60	19	10	(9)
May-14	40.21	40	0.63	0.60	22	20	(2)
Jun-14	33.96	40	0.68	0.60	19	20	1
Jul-14	37.30	40	0.66	0.60	21	20	(1)
Aug-14	38.29	40	0.63	0.60	21	20	(1)
Sep-14	32.90	40	0.66	0.60	18	20	2
Oct-14	29.72	30	0.70	0.60	18	15	(3)
Nov-14	31.06	30	0.67	0.60	17	15	(2)
Dec-14	31.09	30	0.63	0.60	17	15	(2)
Jan-15	34.03	20	0.64	0.60	18	10	(8)
Feb-15	26.88	20	0.69	0.60	14	10	(4)
Mar-15	18.31	10	0.75	0.60	12	5	(7)
<b>Treasury Management outturn for year</b>					<b>216</b>	<b>180</b>	<b>(36)</b>
<b>Add other net interest receivable on loans including the energy from waste plant loan</b>					<b>209</b>	<b>304</b>	<b>95</b>
<b>TOTAL</b>					<b>425</b>	<b>484</b>	<b>59</b>

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- 4.6 The interest received in the year exceeded budget due to average interest rates achieved being higher than the budgeted rates and also the amounts invested were greater for much of the year.
- 4.7 The average interest rate achieved during 2014/15 was 0.66% which compares favourably with the generally accepted benchmark of the average 7-day London Inter-Bank Bid (LIBID) rate of 0.44%.
- 4.8 During the year the waste disposal PFI was varied to include the provision of loan finance to the provider, this generated loan interest payable to us of £0.2m which will be recharged through the PFI.

**5. Compliance with Prudential Indicators**

- 5.1 The Authority confirms that it has complied with its Prudential Indicators for 2014/15, approved 7 February 2014 as part of the council's Treasury Management Strategy Statement. No Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Details can be found in Annex 1.
- 5.2 The council also confirms that during 2014/15 it complied with its Treasury Management Policy Statement and Treasury Management Practices.

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## Annex 1

Performance Indicators**1. Treasury Management Indicators**

The council measures and manages its exposures to treasury management risks using the following indicators.

**1.1 Interest Rate Exposures**

This indicator is set to control the council's exposure to interest rate risk. The indicator sets upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed.

	<b>2014/15 Approved Limit</b>	<b>2014/15 maximum exposure</b>
<b>Upper Limit for Fixed Rate Exposure</b>	100%	100%
<b>Upper Limit for Variable Rate Exposure</b>	45%	13%

The above indicator relates to net debt, if the council has variable rate investments at the same level as its variable rate debt it is deemed to have no variable rate exposure (all council investments are regarded as being at variable rate because no investments are for more than one year). For 184 days in the year the council's investments exceeded its variable rate short-term borrowing.

**1.2 Maturity Structure of Fixed Rate Borrowing**

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

<b>Maturity Structure of Fixed Rate Borrowing</b>	<b>Lower Limit %</b>	<b>Upper Limit %</b>	<b>Actual Fixed Rate Borrowing 31/03/15 £m</b>	<b>% Fixed Rate Borrowing 31/03/15</b>
Under 12 months (including £12m of LOBO loans)	0%	30%	<b>20.57</b>	<b>14%</b>
12 months and within 24 months	0%	30%	<b>7.38</b>	<b>5%</b>
24 months and within 5 years	0%	30%	<b>14.96</b>	<b>11%</b>
5 years and within 10 years	0%	30%	<b>16.36</b>	<b>11%</b>
10 years and within 20 years	0%	40%	<b>36.96</b>	<b>26%</b>
20 years and within 30 years	0%	40%	<b>11.86</b>	<b>8%</b>
30 years and within 40 years	0%	40%	<b>9.43</b>	<b>6%</b>
40 years and within 50 years	0%	40%	<b>28.00</b>	<b>19%</b>
<b>Total</b>			<b>145.52</b>	<b>100%</b>

Two LOBO ("Lenders Option then Borrowers Option") bank loans of £6m each are shown as possibly being repayable within the next twelve months however it is very unlikely that the lenders will seek to increase the interest rate being charged (from 4.50%) and thereby give the council the opportunity to repay the loans. If the lenders do not seek to increase interest rates the loans are repayable in 2054.

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## 1.3 Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of financial loss that may arise as a result of the council having to seek early repayment of the sums invested.

Upper Limit for Total Principal Sums Invested Over 364 Days	2014/15 Approved £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
<b>Total</b>	<b>10</b>	<b>0</b>	<b>5</b>	<b>5</b>

During 2014/15 no long-term investments were made for a period exceeding 364 days.

## 2. Prudential Indicators

## 2.1 Estimates of Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on council tax.

Capital Expenditure	2014/15		31/03/16 Estimate £000	31/03/17 Estimate £000
	Estimate £000	Actual £000		
<b>Total</b>	<b>85,351</b>	<b>77,719</b>	<b>67,929</b>	<b>47,354</b>

Capital expenditure has been and is expected to be financed or funded as follows:

Capital Financing	2014/15		31/03/16 Estimate £000	31/03/17 Estimate £000
	Estimate £000	Actual £000		
Capital grants	24,905	34,064	23,948	13,419
Capital receipts	3,209	3,640	0	0
Revenue funding	0	1,336	0	0
Prudential borrowing	57,237	38,679	43,981	33,935
<b>Total</b>	<b>85,351</b>	<b>77,719</b>	<b>67,929</b>	<b>47,354</b>

Generally prudential borrowing finance is provided where the return on the investment exceeds the debt financing cost.

## 3. Capital Financing Requirement (CFR)

Estimates of the council's cumulative maximum external borrowing requirement for 2014/15 to 2016/17 are shown in the table below:

Capital Financing Requirement	31/03/15 Approved £000	31/03/15 Actual £000	31/03/16 Estimate £000	31/03/17 Estimate £000
<b>Total CFR</b>	<b>264,038</b>	<b>244,292</b>	<b>289,809</b>	<b>298,547</b>

Total debt is expected to remain at or below the CFR during the forecast period.

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**4. Authorised Limit and Operational Boundary for External Debt**

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit or Authorised Limit. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; borrowing at its peak was £180.37m.

	<b>2014/15 Approved Operational Boundary £m</b>	<b>2014/15 Approved Authorised Limit £m</b>	<b>Actual External Debt as at 31/03/15 £m</b>
Borrowing	240.00	250.00	164.52
Other Long-term Liabilities	30.00	40.00	26.60
<b>Total</b>	<b>270.00</b>	<b>290.00</b>	<b>191.12</b>

**5. Ratio of Financing Costs to Net Revenue Stream**

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2014/15 Approved %</b>	<b>2014/15 Actual %</b>	<b>2015/16 Estimate %</b>	<b>2016/17 Estimate %</b>
Net Revenue Stream	146,456	146,148	<b>141,138</b>	<b>140,474</b>
Financing Costs	18,288	17,296	<b>18,781</b>	<b>19,230</b>
<b>Percentage</b>	<b>12.49%</b>	<b>11.83%</b>	<b>13.29%</b>	<b>13.69%</b>

**6. Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the council has adopted the principles of best practice.

The council has incorporated the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* into its treasury policies, procedures and practices.