**Appendix 1**

# Annual Treasury Management Report 2013/14

## 1. Background

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.

## 2. Economic Background

2.1 At the beginning of 2013-14 lack of growth in the UK economy, the threat of a 'triple-dip' recession alongside falling real wages (i.e. after inflation) and low business investment were a concern for the Bank of England's Monetary Policy Committee.

2.2 In August 2013 the Bank of England gave forward guidance pledging to not consider raising the bank base rate until the unemployment rate fell below 7%. In the Bank's initial forecast, this level was only expected to be reached in 2016. Although the Bank stressed that this level was a threshold for considering an increase in rate rather than an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields (and hence borrowing rates from the Public Works Loan Board) rose aggressively.

2.3 As the year progressed the recovery in the UK surprised with strong economic activity and growth. The last quarter of 2013 showed year-on-year growth of 2.7%. Much of the improvement was down to the dominant service sector, and an increase in household consumption buoyed by the pick-up in housing transactions which were driven by higher consumer confidence, greater availability of credit and strengthening house prices which were partly boosted by government initiatives such as Help-to-Buy. However, business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth.

2.4 Inflation (as measured by the Consumer Price Index) fell from 2.8% in March 2013 to 1.7% in February 2014, the lowest rate since October 2009, helped largely by easing commodity prices and discounting by retailers, reducing the pressure on the Bank to raise rates. In February the Bank stepped back from forward guidance relying on a single indicator – the unemployment rate – to more complex measures which included spare capacity within the economy. The Bank also implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

2.5 Gilt yields ended the year higher than at the start. The peak in yields was during autumn 2013. The biggest increase was in 5-year gilt yields which increased by nearly 1.3% from 0.70% to 1.97%. 10-year gilt yields rose by nearly 1% ending the year at 2.73%. The increase was less pronounced for longer dated gilts; 20-year yields rose from 2.74% to 3.37% and 50-year yields rose from 3.23% to 3.44%. Gilt yields determine borrowing rates from the Public Works Loan Board (with the rates available to the council set at approximately 0.80% above the equivalent gilt yields) and so interest rates on new PWLB loans also increased.

## 3. Council Borrowing Requirement and Debt Management

3.1 In line with the treasury strategy for the year the council did not take out any new longer-term finance during 2013-14 and increased its use of short-term loans from other local authorities.

3.2 Borrowing during the year is summarised in the table below:

| Borrowing Activity in 2013/14 | 01/04/13 Balance £m | New Borrowing £m | Debt Maturing £m | 31/03/14 Balance £m |
|---|---|---|---|---|
| Short-term borrowing | 16.00 | 75.50 | (60.00) | 31.50 |
| Long-term borrowing | 140.53 | - | (4.00) | 136.53 |
| **TOTAL BORROWING** | **156.53** | **75.50** | **(64.00)** | **168.03** |
| Other long-term liabilities | 28.71 | 0.17 | (1.17) | 27.71 |
| **TOTAL EXTERNAL DEBT** | **185.24** | **75.67** | **(65.17)** | **195.74** |
| *The above amounts show the principal outstanding. The figures in the council's annual accounts will be higher as they include accrued interest and other accounting adjustments.* | | | | |

3.3 The council's underlying need to borrow at 31/03/14, as measured by the Capital Financing Requirement (CFR), was £216.65m. The difference of £20.91m between the CFR and total external borrowing represents internal borrowing from usable reserves and working capital.

3.4 With short-term interest rates being much lower than long-term rates, it is currently more cost effective to borrow short-term loans from other local authorities. By doing so the council is able to reduce borrowing costs and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as interest rates remain low, the policy will be kept under review and short-term loans will be replaced with longer term finance when it is deemed prudent to do so.

3.5 In 2013/14 the council's weighted average cost of total borrowing was 3.48%. The weighted average cost of long term borrowing was 4.05% compared to 0.40% for short-term borrowing (0.40% being the gross cost including broker's commission of between 0.03% and 0.10%).

3.6 The council's capital financing costs in 2013/14 have been as follows.

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| Capital financing costs for 2013-14 | Budget | Outturn | (Over) / Under spend |
|---|---|---|---|
| | £m | £m | £m |
| **Minimum Revenue Provision** (provision for repayment of loan principal) | **9.58** | **9.58** | - |
| **Interest on existing PWLB and bank loans** (actuals include accrued interest and other year end accounting adjustments not in budget) | **5.65** | **5.62** | **0.03** |
| **Variable rate borrowing for 2013/14** (Budget being £29m of short-term LA loans at an interest rate of 0.60%) | **0.17** | **0.11** | **0.06** |
| **Fixed rate borrowing for 2013/14** (Budget included provision for £17 million longer-term PWLB loans at 3.20% taken out mid-year) | **0.27** | **-** | **0.27** |
| **Other interest paid** (including finance lease interest) | **0.30** | **0.31** | **(0.01)** |
| **Reduction in budget contributions from service areas** | **(0.13)** | **-** | **(0.13)** |
| **Less capitalised interest** | **(0.30)** | **(0.33)** | **0.03** |
| **TOTAL** | **15.54** | **15.29** | **0.25** |

4. **Investments**

4.1 The council follows CLG's Investment Guidance which requires local authorities to focus on security and liquidity in priority to yield.

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

| Investments | 01/04/2013 Balance £m | Investments Made £m | Maturities/ Withdrawals £m | 31/03/2014 Balance £m |
|---|---|---|---|---|
| Instant Access Accounts | 0.97 | 321.80 | (316.94) | 5.83 |
| Notice Accounts | - | 22.00 | (17.00) | 5.00 |
| Term Deposits | 8.50 | 41.69 | (37.69) | 12.50 |
| **Total** | **9.47** | **385.49** | **(371.63)** | **23.33** |
| **Increase in investments** | | | | **13.86** |

4.3 Security remains the council's main objective. This was maintained by following the council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14 which defines "high credit quality" organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

4.4 In March Moody's downgraded the long-term credit ratings of both the Royal Bank of Scotland and NatWest Bank to Baa1. As this rating is below the council's minimum credit criterion of A-, the Royal Bank of Scotland was withdrawn from the counterparty list for further investment and NatWest, which is the council's bank, is now only being used for operational and liquidity purposes.

4.5 Interest received during the year was as follows:

| Month | Amount invested | | Average rate of interest earned | | Amount of interest £'000 | Budget £'000 | Surplus £'000 |
|---|---|---|---|---|---|---|---|
| | Actual £m | Budget £m | Actual % | Budget % | | | |
| Apr-13 | 30.41 | 30 | 0.85% | 0.70% | 21 | **18** | 3 |
| May-13 | 50.50 | 40 | 0.87% | 0.70% | 37 | **23** | 14 |
| Jun-13 | 52.57 | 40 | 0.84% | 0.70% | 36 | **23** | 13 |
| Jul-13 | 51.18 | 40 | 0.84% | 0.70% | 37 | **23** | 14 |
| Aug-13 | 49.75 | 35 | 0.84% | 0.70% | 35 | **20** | 15 |
| Sep-13 | 50.52 | 35 | 0.81% | 0.70% | 34 | **20** | 14 |
| Oct-13 | 46.22 | 30 | 0.78% | 0.70% | 31 | **17** | 13 |
| Nov-13 | 40.17 | 25 | 0.66% | 0.70% | 22 | **15** | 7 |
| Dec-13 | 34.18 | 20 | 0.62% | 0.70% | 18 | **11** | 7 |
| Jan-14 | 40.39 | 20 | 0.59% | 0.70% | 20 | **12** | 9 |
| Feb-14 | 41.06 | 15 | 0.62% | 0.70% | 19 | **9** | 10 |
| Mar-14 | 32.58 | 15 | 0.66% | 0.70% | 18 | **8** | 10 |
| **Sub-Total** | | | | | **328** | **199** | **129** |
| **Savings already declared and budget increased** | | | | | **-** | **60** | **(60)** |
| **Treasury Management outturn for year** | | | | | **328** | **259** | **69** |
| **Add other interest receivable on loans etc** | | | | | **4** | **-** | **4** |
| **Total** | | | | | **332** | **259** | **73** |

4.6 The interest received in the year exceeded budget due to the amounts invested being higher than the budgeted amounts and the average interest rates achieved being higher than budget for the first seven months of the year to October 2013. Interest rates on the council's bank accounts fell sharply during the year with the result that the average interest rate achieved fell short of budget in the final five months.

4.7 The average interest rate achieved during the year was 0.75% which compares favourably with the generally accepted benchmark of the average 7-day London Inter-Bank Bid (LIBID) rate of 0.41%.

## 5. Compliance with Prudential Indicators

5.1 The Authority confirms that it has complied with its Prudential Indicators for 2013/14, approved on 18 February 2013 as part of the council's Treasury Management

Strategy Statement. Details can be found in Appendix 1.

5.2 In accordance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2013/14. None of the 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.

5.3 The council also confirms that during 2013/14 it complied with its Treasury Management Policy Statement and Treasury Management Practices.

**Appendix 1**
**Performance Indicators**

**(a) Capital Financing Requirement (CFR)**

Estimates of the council's cumulative maximum external borrowing requirement for 2013/14 to 2015/16 are shown in the table below:

| **Capital Financing Requirement** | 31/03/2014 Approved £m | **31/03/2014 Actual £m** | 31/03/2015 Estimate £m | 31/03/16 Estimate £m |
|---|---|---|---|---|
| **Total CFR** | **230,952** | **216,645** | **264,038** | **289,809** |

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

**(b) 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 Officer – Finance and Commercial confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year.

| | **Approved Operational Boundary for 2013/14 £m** | **Approved Authorised Limit for 2013/14 £m** | **Actual External Debt as at 31/03/2014 £m** |
|---|---|---|---|
| Borrowing | 195.00 | 200.00 | 168.03 |
| Other Long-term Liabilities | 35.00 | 40.00 | 27.71 |
| **Total** | **230.00** | **240.00** | **195.74** |

**(c) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

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.

| | **Approved Limits for 2013/14 %** | **Maximum during 2013/14 %** |
|---|---|---|
| **Upper Limit for Fixed Rate Exposure** | 100% | 100% |
| **Upper Limit for Variable Rate Exposure** | 25% | 7.34% |

Note that the above indicator relates to net debt. Therefore 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 340 days in the year the council's investments exceeded its variable rate short-term borrowing and so the effect of an increase in interest rates on revenue may well have been positive.

**(d) 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.

| Maturity Structure of Fixed Rate Borrowing | Lower Limit % | Upper Limit % | Actual Fixed Rate Borrowing 31/03/2014 £m | % Fixed Rate Borrowing 31/03/2014 |
|---|---|---|---|---|
| Under 12 months (including £12m of LOBO loans) | 0% | 30% | **16.01** | **11.7%** |
| 12 months and within 24 months | 0% | 30% | **8.24** | **6.0%** |
| 24 months and within 5 years | 0% | 30% | **15.17** | **11.1%** |
| 5 years and within 10 years | 0% | 30% | **15.32** | **11.2%** |
| 10 years and within 20 years | 0% | 40% | **35.79** | **26.2%** |
| 20 years and within 30 years | 0% | 40% | **14.00** | **10.3%** |
| 30 years and within 40 years | 0% | 40% | **9.00** | **6.6%** |
| 40 years and within 50 years | 0% | 40% | **23.00** | **16.9%** |
| **Total** | | | **136.53** | **100.0%** |

**(e) 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 | 2013/14 Approved Budget £'000 | 2013/14 October Forecast £'000 | 2013/14 Actual £'000 | 31/03/2015 Estimate £'000 | 31/03/16 Estimate £'000 |
|---|---|---|---|---|---|
| **Total** | **58,076** | **51,176** | **43,403** | **85,351** | **39,909** |

Capital expenditure has been and will be financed or funded as follows:

| Capital Financing | 2013/14 Approved Budget £m | 2013/14 October Forecast £m | 2013/14 Actual £m | 31/03/2015 Estimate £m | 31/03/16 Estimate £m |
|---|---|---|---|---|---|
| Capital grants | 26,487 | 31,182 | 26,213 | 24,905 | 634 |
| Capital receipts | 1,569 | 3,271 | 1,979 | 3,209 | 1,904 |
| Revenue funding | 0 | 61 | 198 | 0 | 0 |

| | | | | | |
|---|---|---|---|---|---|
| Prudential borrowing | 30,020 | 16,662 | 15,013 | 57,237 | 37,371 |
| **Total** | **58,076** | **51,176** | **43,403** | **85,351** | **39,909** |

Prudential borrowing in future years will be less than that shown above if the level of usable reserves increases through fixed asset sales (the current years Treasury Management Strategy Statement includes projected fixed asset sales of £20 million in both 2015/16 and 2016/17).

### (f) 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.

| **Ratio of Financing Costs to Net Revenue Stream** | **2013/14 Approved %** | **2013/14 Revised %** | **2013/14 Actual %** | **2014/15 Estimate %** | **2015/16 Estimate %** |
|---|---|---|---|---|---|
| Net Revenue Stream | 150,296 | 150,296 | 150,296 | **146,135** | **141,318** |
| Financing Costs | 17,725 | 17,343 | 16,787 | **18,288** | **19,230** |
| **Percentage** | **11.79%** | **11.54%** | **11.17%** | **12.51%** | **13.61%** |

### (g) 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.

### (h) Upper Limit for Total Principal Sums Invested Over 364 Days

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

| **Upper Limit for Total Principal Sums Invested Over 364 Days** | **2013/14 Approved £m** | **2013/14 Revised £m** | **2013/14 Actual £m** | **2014/15 Estimate £m** | **2015/16 Estimate £m** |
|---|---|---|---|---|---|
| | **15** | **N/A** | **0** | **10** | **10** |