Gedling
Borough Council

Report to Cabinet

Subject: Annual Treasury Activity Report 2013/14

Date: 19 June 2014

Author: Corporate Director (Chief Financial Officer)

Wards Affected

All

Purpose

To inform members of the outturn in respect of the 2013/14 Prudential Code Indicators, and to advise members of the outturn on treasury activity, both as required by the Treasury Management Strategy.

Key Decision

This is not a key decision.

Background

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury review of its 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).

1.2 For 2013/14 the minimum reporting requirements were that the Full Council should receive the following reports:

- An annual treasury strategy in advance of the year (the TMSS).
- A mid-year treasury update report (members will note that, as in previous years and in accordance with best practice, quarterly monitoring reports for treasury activity have been provided, and that this exceeds the minimum requirements).
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities during the year, and highlights compliance with the Council's policies, previously approved by members.

1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by submitting them to Cabinet before they are reported to Full Council.

1.5 Member training on treasury management issues is undertaken by the Chief Financial Officer as it is needed in order to support members' scrutiny role.

Proposal

2.1 <u>The economy and interest rates in 2013/14</u>

2.1.1 The financial year 2013/14 continued the challenging investment environment of previous years with rates remaining low, although levels of counterparty risk did subside somewhat. The original expectation was that base rate would not rise during 2013/14, and rise only gently from Q1 of 2015. This forecast has now been pushed back to a rise starting only in Q3 of 2015. Economic growth was strong during 2013/14 and there was no additional quantitative easing (QE). Base rate ended the year unchanged at 0.5% for the fifth successive year. CPI inflation fell to 1.7% by February and is expected to remain slightly below the target rate of 2% for most of the two years ahead.

2.1.2 The Government's Funding for Lending scheme resulted in a flood of cheap credit being made available to banks, which has resulted in further dramatic falls in money market investment rates during 2013/14. The part of the scheme which supported credit for mortgages was withdrawn in the first quarter of 2014 as concerns rose over rising house prices.

2.1.3 The UK coalition Government maintained its tight fiscal policy stance but strong economic growth has led to a reduction in the forecast for total borrowing of £97bn over the next five years, culminating in a surplus of £5bn in 2018/19.

2.2 <u>The borrowing requirement</u>

The Council's underlying need to borrow to finance its capital expenditure is termed the capital financing requirement (CFR).

	1 April 2013 (Actual) £000s	31 March 2014 (Orig. Est) £000s	31 March 2014 (Actual) £000s
Capital Financing Requirement	11,436	14,440	12,384

The variance is mainly due to amendments to the capital programme during 2013/14, including slippage of schemes to 2014/15.

2.3 The overall treasury position 31 March 2014

The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security of investment, and to manage risks within all treasury management activities. At the beginning and end of 2013/14, the treasury position was as follows:

	31 March 2013 £000s	31 March 2014 £000s
Total external debt	11,412	10,812
Capital Financing Requirement (CFR)	11,436	12,384
Over/(Under) borrowing to CFR	**(24)**	**(1,572)**
Total external debt	11,412	10,812
Total investments	(8,260)	(8,950)
Net debt	**3,152**	**(1,862)**

2.4 The treasury strategy for 2013/14

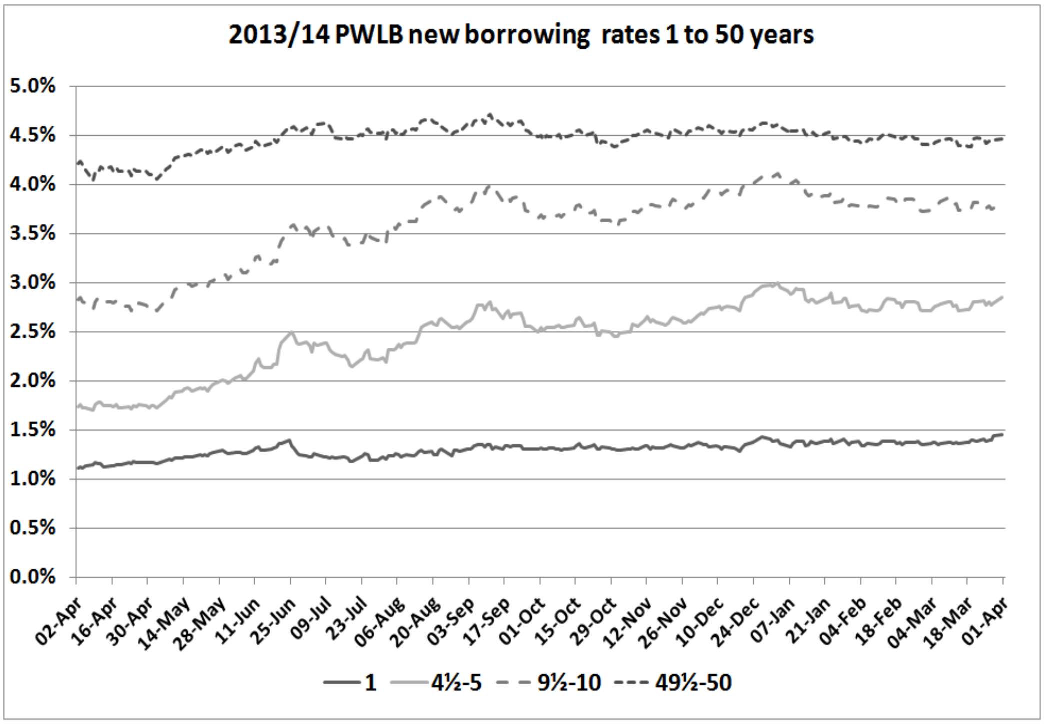
2.4.1 The expectations for interest rates within the strategy for 2013/14 were for Bank Rate to be low but rising from Q1 2015, medium and long term fixed borrowing rates to rise gradually, and variable rates to be the cheaper form of borrowing. Continued uncertainty in the aftermath of the 2008 financial crisis prompted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates. Given this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

2.4.2 The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013/14 as markets anticipated the start of the tapering of asset purchases by the Federal Reserve (The Fed) in the USA. This started in December and a course of monthly reductions means that asset purchases by the Fed are likely to stop by the end of 2014.

2.4.3 Volatility set in during the first quarter of 2014 as fears around the emerging markets, vulnerability in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in Ukraine, caused rates to dip down.

2.5 Borrowing rates in 2013/14

The graph below provided by the Council's treasury advisors illustrates that PWLB rates have risen during the year from historically low levels.



2.6 The borrowing outturn for 2013/14

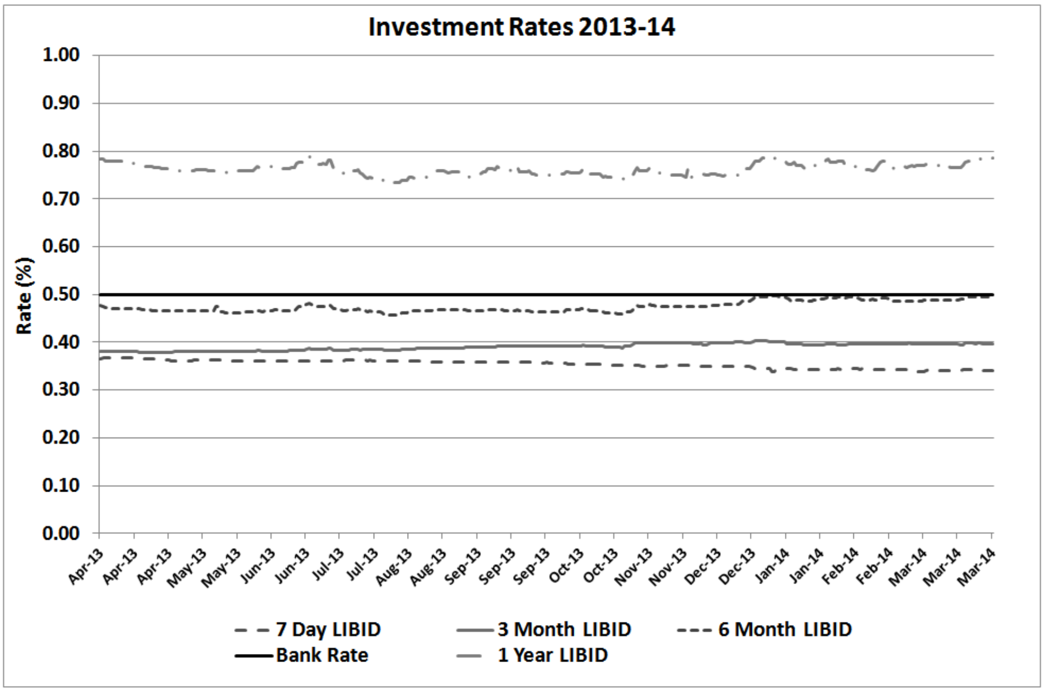
2.6.1 There was no new long term debt taken during 2013/14. One temporary loan was arranged during the year for cashflow purposes, but the duration of this was only seven days, and the rate paid 0.27%.

2.6.2 There was no rescheduling of PWLB debt undertaken during the year, since the average 1% differential between PWLB new borrowing rates and premature repayment rates made such action unviable.

2.7 Investment rates in 2013/14

Bank rate remained at its historic low of 0.5% throughout the year and has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening remains at early 2015. The

Funding for Lending scheme resulted in deposit rates remaining depressed throughout the year, although the part of the scheme supporting the provision of credit for mortgages ended during the first quarter of 2014.



2.8 <u>Investment outturn for 2013/14</u>

2.8.1 The Council's investment policy is governed by CLG guidance implemented by the annual investment strategy, which formed part of the TMSS approved on 4 March 2013. This policy sets out the approach for selecting investment counterparties, and is based on credit ratings provided by the three main credit agencies, supplemented by additional market data such as rating outlooks, credit default swaps, and bank share prices. Whilst credit ratings advice is taken from the Council's treasury advisors, the ultimate decision on what is prudent and manageable for the Council is taken by the Chief Financial Officer under the approved scheme of delegation.

2.8.2 The Council's investment priorities in 2013/14 remained the security of capital and good liquidity. Whilst the Council always seeks to obtain the optimum return (yield) on its investments, this is at all times commensurate with proper levels of security and liquidity. In the current economic climate it has remained appropriate either to keep investments short–term to cover cashflow needs, or to take advantage of fixed period up to one year with selected government-backed counterparties.

2.8.3 During 2013/14, significant use was made of call account facilities paying around 0.6%, and of a money market fund achieving around 0.38%. This fund is an AAA rated investment vehicle which allows the pooling of many billions of pounds worth of assets into a highly diversified fund, thus reducing risk.

2.8.4 An equated rate of 1.1% was achieved for the year, which outperforms both the 7 day and 3 month LIBID rates of 0.35% and 0.39% by 0.75% and 0.71% respectively.

2.8.5 Investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

2.8.6 The Treasury Activity Report for the year ended 31 March 2014 is attached at Appendix 1 in accordance with the TMSS. For reference, definitions of LIBOR and LIBID are given at Appendix 2.

2.9 Compliance with Prudential and treasury indicators

2.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Council on 4 March 2013.

2.9.2 During the financial year 2013/14 the Council has at all times operated within the treasury limits and Prudential Indicators set out in the council's TMSS, and in compliance with the Council's Treasury Management Practices. A summary of the outturn in respect of the 2013/14 Prudential and Treasury Indicators is shown at Appendix 3.

a) Prudential Indicators:

i) Capital Expenditure

Capital expenditure for 2013/14 totalled £3,147,157.

ii) Capital Financing Requirement (CFR)

The CFR represents the Council's underlying need to borrow and totalled £12,384,464 at 31 March 2014.

iii) Ratio of Financing Costs to Net Revenue Stream

The outturn of 8.65% represents an increase from the approved indicator of 6.37%, largely due to reduced investment income and an increased revenue contribution to capital, partially offset by a reduction in MRP as a result of slippage on the capital programme in 2012/13.

iv) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2013/14 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Gross debt at 31 March 2014 was £10.812m which was well within the approved indicator.

Treasury Management Indicators:

These indicators are based on limits, beyond which activities should not pass without management action, and the Council has operated within these limits at all times during 2013/14. They include two key indicators of affordability and four key indicators of prudence.

Affordability

i) Operational boundary for external debt.
ii) Authorised limit for external debt.

Prudence

iii) Upper limit for fixed interest exposure – represented by the maximum permitted net outstanding principal sum borrowed at fixed rates. Please note that a negative indicator represents a position of net investment.

iv) Upper limit for variable interest rate exposure – represented by the maximum permitted net outstanding principal sum borrowed at variable rates. Please note that a negative indicator represents a position of net investment.

v) Maximum new principal sums to be invested during 2013/14 for periods in excess of 364 days - such investments are classified as a “non-specified”. This indicator is subject to the overall limit for non-specified investments set in the TMSS.

vi) Upper limits for the maturity structure of borrowing - set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing.

2.10 Other Issues

No other significant treasury matters arose during the year 2013/14.

Alternative Options

There are no alternative options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

Financial Implications

No specific financial implications are attributable to this report.

Appendices

1. Annual Treasury Activity Report 2013/14.
2. Definitions of LIBOR and LIBID
3. Outturn Prudential and Treasury Indicators for 2013/14.

Background Papers

None identified.

Recommendation

That:

Members note the Annual Treasury Activity Report 2013/14, together with the appendices, and refer it to Council for approval.

Reasons for Recommendations

To comply with the requirements of the Council's Treasury Management Strategy Statement.

For more information, please contact:

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