ITEM NO. 8.1

Report of:	**Head of Finance**
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Report Track:	**Audit & Governance 24/6/14 & Council 16/7/14**

AUDIT AND GOVERNANCE COMMITTEE

24 JUNE 2014

Annual Treasury Management Report 2013/14

1 Purpose of Report

1.1 To update members on treasury management activity and performance during the 2013/14 financial year.

2 Recommendation

2.1 To approve the actual 2013/14 prudential and treasury indicators in this report;

2.2 To note the annual treasury management report for 2013/14.

3 Key Issues and Reasons for Recommendations

3.1 Treasury management activity and performance during the 2013/14 financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and their spending plans.

5 Report Detail

Background

5.1 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).

5.2 During 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;
- a mid year treasury update report;
- an annual review following the end of the year describing the activity compared to the strategy (this report).

5.3 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 and highlights compliance with the Council's policies previously approved by members.

5.4 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council.

5.5 This report summarises:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

The Economy and Interest Rates

5.6 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.

5.7 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. 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.

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

5.9 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.

Overall Treasury Position as at 31 March 2014

5.10 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	Average Life yrs	31 March 2014 Principal	Rate/ Return	Average Life yrs
Total debt (PWLB)	£88.8m	3.95%		£88.8m	4.05%	
CFR	£96.0m		-	£95.7m	-	-
Over / (under) borrowing	(£7.2m)	-	-	(£6.9m)	-	-
Total investments	£10.8m	0.62%		£10.3m	0.49%	
Net debt	£78.0m	-	-	£78.5m	-	-

Strategy for 2013/14

5.11 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.

5.12 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.

5.13 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.

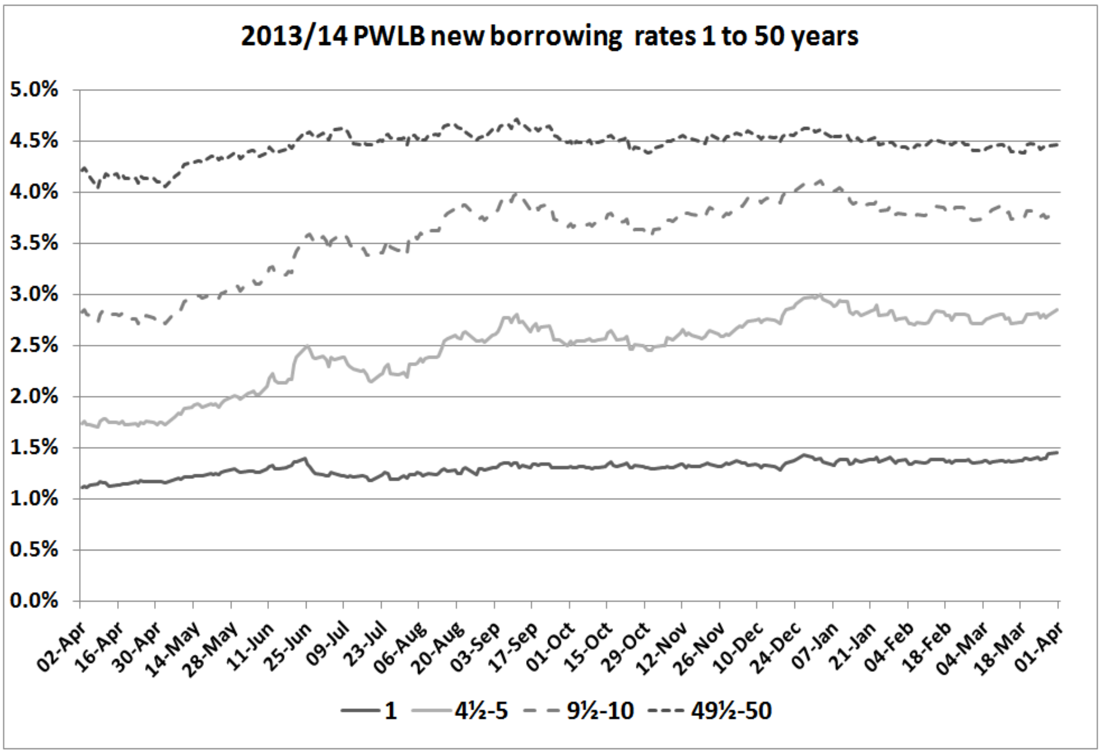
Borrowing Requirement

5.14 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
CFR (£m)	**95.994**	**98,274**	**95.743**

Borrowing Rates in 2013/14

5.15 **PWLB borrowing rates** - the graph below shows how PWLB certainty rates have risen from historically very low levels during the year.

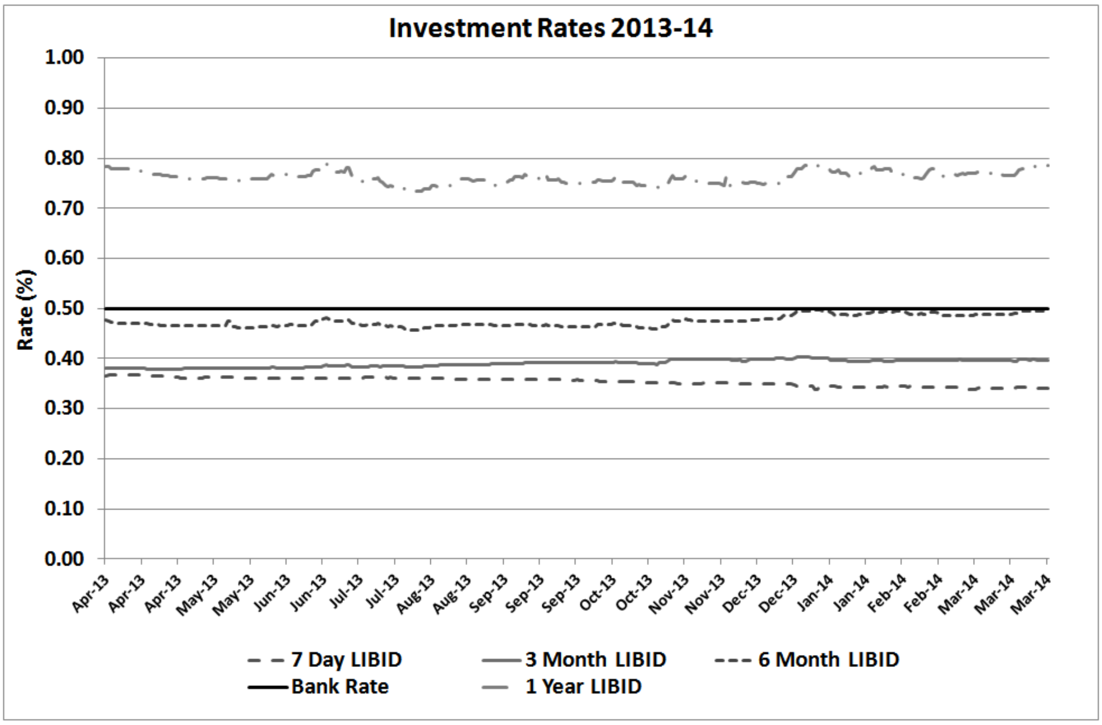


Borrowing Outturn for 2013/14

5.16 **Borrowing** – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Investment Rates in 2013/14

5.17 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. The following graph shows the continued low deposit rates achievable:



Investment Outturn for 2013/14

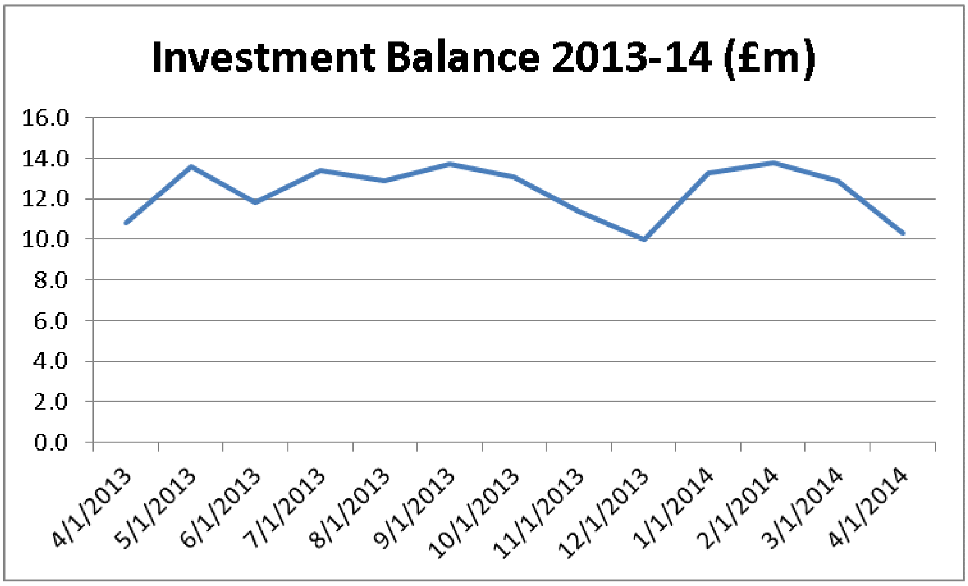
5.18 **Investment Policy** - the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 19 February 2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

5.19 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

5.20 **Investments as at 31 March 2014** -The Council's investments as at 31 March 2014 are set out in the table below:

Counterparty	Start Date	Maturity	Value (£)	Rate
Natwest Bank plc		Call	2,880,000	0.50%
Ignis (MMF)		Call	3,701,000	0.38%
Bank of Scotland plc	17/01/14	17/07/14	1,000,000	0.75%
Bank of Scotland plc	06/03/14	05/03/15	2,724,000	0.95%
TOTAL			**10,305,000**	**0.60%**

5.21 The chart below illustrates the movement in the level of investments held by the Council at each month end during the year. The peak in year was **£17.1 million** and the average balance for the year was **£13.5 million**.



5.22 The funds earned an average rate of return for the year of **0.49%**. The comparable performance indicator is the average 3 month LIBID rate, which was **0.39%**. The Council's performance exceeds the benchmark by a good margin.

5.22 Overall investment earnings for the year totalled **£102,000**, which is **£20,000** more than was predicted when the budget was set in February 2013 **(£82,000)**.

6 Implications

6.1 Financial

The financial implications have been referred to throughout the report.

6.2 Legal

The legal implications have been referred to throughout the report.

6.3 **Human Resources**

There are no human resource implications arising from this report.

6.4 **Section 17 (Crime Prevention)**

There are no implications arising from this report.

6.5 **Human Rights Act**

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 **Data Protection**

There are no implications arising from this report.

6.7 **Risk Management**

Treasury Management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces all risks to a minimum.

6.8 **Equality & Diversity**

There are no identified implications arising form this report.

6.9 **Best Value**

The strategy ensures that best value is provided to the Council.

Previous Consideration - Nil

Background Papers – Available in Financial Services

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APPENDIX

AUDIT AND GOVERNANCE COMMITEE

24 JUNE 2014

Annual Treasury Management Report 2013/14

1. PRUDENTIAL INDICATORS	2012/13	2013/14	2013/14
	actual	estimate	actual
	£'000	£'000	£'000
Capital Expenditure	10,447	17,272	15,915
Ratio of financing costs to net revenue stream (GF)	3.8%	4.9%	4.4%
Gross debt	88,839	91,574	88,836
Capital Financing Requirement as at 31 March	95,994	98,274	95,743
2. TREASURY MANAGEMENT INDICATORS			
Authorised Limit for external debt -	101,773	103,270	103,270
Operational Boundary for external debt	94,930	98,274	98,274
Actual external debt	88,839	92,378	88,836
Upper limit for fixed interest rate exposure	100%	100%	100%
Upper limit for variable rate exposure	75%	75%	75%
Upper limit for total principal sums invested for over 364 days	£10 million	£10 million	£10 million

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 above	100%	0%