BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 6**

Resources Committee **24 June 2015**

Report of Head of Finance

TREASURY MANAGEMENT OUTTURN - ANNUAL REPORT 2014-15

1 Purpose of Report

The purpose of this report is to present the annual report of treasury management activity for 2014-15. The treasury management function contributes towards the Council's overall objective of the efficient use of resources.

2 Executive Summary

To inform Members of the outturn position in respect of the application of the treasury management strategy for 2014-15.

3 Appendices

1. Prudential indicators
2. Economy Updates

4 The Committee Is invited to RECOMMEND to:

4.1 NOTE the Treasury Management outturn position, as detailed in the report.

5 Background

5.1 This 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 2014-15. 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 2014-15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 15 April 2014)
- a mid-year treasury update report (Council 9 December 2014)
- 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 This Council also 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 Resources Committee before they were reported to the full Council.

5.5 The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 15 April 2014. The Credit Worthiness policy was amended and approved by the Council on 22 July 2014. 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).

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

5.7 **Investments held by the Council** - the Council maintained an average balance of £24.5m of internally managed funds, which is a combination of short and long term investments. These investments earned an average rate of return of 0.83% which compares with a budget assumption of £24.5m investment balances earning an average rate of 1.27%.

6 Discussion

Investments

6.1 At 31 March 2015 the Council held the following investments.

Money Market transactions:

Short term investments for periods of less than 1 year:

Investments	**Range of Interest Rates Receivable %**	**Total Investment at 31 March 2014 £000**	**Total Investment at 31 March 2015 £000**
Building Societies	0.5% - 1.05%	17,079	21,059
Banks		2,014	-
Other Local Authorities	-	-	-
Total		**19,093**	**21,059**

Long term investments for periods greater than 1 year:

Long Term Investments	**Period**	**Range of Interest Rates Receivable %**	**Total Investment at 31 March 2014 £000**	**Total Investment at 31 March 2015 £000**
Building Societies	1–3 years			
Banks	1–5 years	0.25-0.40	5,549	3,546
Other Local Authorities		-	-	-
Total			**5,549**	**3,546**

Total investments for the year were therefore

	31st March 2014	**31st March 2015**
Short Term Investments	19,093	21,059
Long Term investments	5,549	3,546
Total investments	**24,642**	**24,605**
Bank Balance	2,360	2,958
Total cash available for Investment	**27,002**	**27,563**

6.2 The year on year variance for money market transactions is therefore an increase of £561k, which is due to following:

- The majority is as a result of a net cash inflow on revenue activities of £658k.
- The remaining deficit of £97k represents a net cash outflow on capital activities.

6.3 The average rate of interest earned on investments during the year was 0.83% (2013-14 1.12%).

6.4 **Investment Trusts:**

At the 31 March 2015 the Council held long term investments of share capital in the BlackRock Income Strategies Trust (previously known as British Assets Trust) investment with the following comparative values:

	31st March 2014 £000	**31st March 2015 £000**
Purchase Price	157	157
Market Value	340	328

6.5 The Authority's statutory accounts are required to disclose the fair value of investments. The difference in the value of the BlackRock income Strategies Trust Investment when compared to the historical cost, amounted to a decrease in value of £12k (in 2013-14 there was an increase of £8k), due to a fall in the share price to £1.31. The decrease in value (£12k) has been credited to the Available for Sale

Financial Instruments Reserve.

Borrowing

6.6 The Authority became debt free in December 2002; consequently the Authority has no outstanding borrowings (other than those inherent in Finance Leases).

Interest Received

6.7 Details of interest received during 2014-15 compared with the estimate are as follows:

	2014-15 Original Estimate £	**2014-15 Actual £**	**Variance Original Est. to Actual £**
Amount received:			
Investment income	321,000	203,371	-117,629
Dividends	3,600	16,100	12,500
Other (incl. bank interest)	-	17,145	17,145
Total	**324,600**	**236,616**	**-87,984**

Future Prospects

6.8 Clearly, future prospects for generating investment income to support the annual revenue budget continue to be dependent on the level of balances and future movement in the level of interest rates. However, with balances reducing and interest rates continuing to be at historically low levels this again highlights the continuing need for increased treasury management skills internally and also external professional advice and support to assist in maximising future investment returns.

6.9 Interest rates reduced quite dramatically towards the end of 2013/14 (see appendix 2) and continued into 2014/15. Recent investment activity by the Council has highlighted the fact that the current market for investments with both banks and building societies is limited with the knock on effect that interest rates being offered are being reduced even further. This has lead to additional budget pressure in the current year of approximately £88k.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As shown in the report.

9 Risk Analysis

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Losses on invested funds	Potentially significant to the Council	Unlikely	Treasury management strategy
Fluctuations in interest rates	Beneficial if interest rates rise, adverse when interest rates fall	Investment income rates continue to be at historically low levels	Use of external advisors to determine best strategy

10 Implications for Resources

As shown in the report.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

H Essom, Technical Accountant

14 Consultees

L Elliott, Head of Finance.
S Knowles, Principal Accountancy Manager

15 Background Papers

The Prudential indicators and Treasury Management Report 2014-15 Resources committee 19 March 2014.
2014-15 Final Accounts working papers
Information received from Sector Treasury Services Ltd., the Council's Treasury Management advisers.

Appendix 1

Prudential indicators for the year 2014-15

The Capital Prudential Indicators 2015/16 – 2017/18

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

Capital Expenditure. This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure £m	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	1.966	2.250	10.345	1.574	0.441

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no finance leases which effectively include borrowing instruments:

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £m	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	1.966	2.250	10.345	1.574	0.441
Financed by:					
Capital generated in year receipts	1.457	1.499	8.362	1.009	1.770
Capital grants	0.269	0.454	1.983	0.565	0.264
Capital receipts reserves	0.40	0.297	-	-	-
Revenue					
Net financing need for the year	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

£m	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement					
CFR – non housing	-8.683	-8.686	-8.686	-8.686	-8.686
CFR – housing	0.000	0.000	0.000	0.000	0.000
Total CFR	**-8.683**	**-8.686**	**-8.686**	**-8.686**	**-8.686**
Movement in CFR	-0.143	-0.003	0.000	0.000	0.000

Movement in CFR represented by					
Net financing need for the year (above)	0.0	0.0	0.0	0.0	0.0
Less MRP/VRP and other financing movements	-0.143	-0.003	0.000	0.000	0.000
Movement in CFR	**-0.143**	**-0.003**	**0.000**	**0.000**	**0.000**

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of Finance Leases.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2013/14 Actual £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Fund balances / reserves	7.75	7.9	7.2	6.1	4.84
Capital receipts	12.901	12.604	15.967	16.208	17.281
Provisions	0.065	0.065	0	0	0
Other					
Total core funds	**20.716**	**20.569**	**23.167**	**22.308**	**22.121**
Working capital*	-2.397	-1.692	-2.0	-2.0	-2.0
Under/over borrowing	8.683	8.686	8.686	8.686	8.686
Expected investments	**27.002**	**27.563**	**31.853**	**30.994**	**30.807**

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

The Prudential Code for Capital Expenditure in Local Authorities requires each Council to set and report against indicators showing:

- the cost of servicing long-term borrowing, including both interest costs and provision for loan repayment, as a percentage of total net service costs, and
- the impact on Council Tax levels of funding additional capital expenditure from borrowing.

The previous sections cover the capital prudential indicators, but the prudential indicators required to assess the affordability of the capital investment plans, are not reported because the Council is debt-free and is projected to remain so for the foreseeable future.

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	**2013/14 Actual**	**2014/15 Actual**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
External Debt					
Debt at 1 April	-	-	-	-	-
Expected change in Debt	-	-	-	-	-
Other long-term liabilities (OLTL)	-0.148	0.003	0.000	0.000	0.000
Expected change in OLTL	0.145	0.003	0.00	0.000	0.000
Actual debt 31 March	**0.003**	**0.000**	**0.000**	**0.000**	**0.000**
The Capital Financing Requirement					
Under/(over) borrowing	**-8.683**	**-8.686**	**-8.686**	**-8.686**	**-8.686**
Total investments at 31 March					
Investments	**27,002**	**27,563**	**27,850**	**26,950**	
Investment change	-	0.561	3,245	-0.900	
Net Debt	**-**	**-**	**-**	**-**	**-**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate
Debt	0.050	0.050	0.050	0.050
Other long term liabilities	0.148	0.000	0.000	0.000
Total	0.198	0.050	0.050	0.050

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate
Debt	5.050	5.050	5.050	5.050
Other long term liabilities	0.148	0.000	0.000	0.000
Total	5.198	5.050	5.050	5.050

The Economy and Interest Rates

The original market expectation at the beginning of 2014-15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

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 throughout 2014-15.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK and its banking system has little direct exposure to Greece, it is much more difficult to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the EZ and cause major damage to their banks.