Agenda Item No: **12**

Report to: Cabinet

Date of Meeting: 6 July 2015

Report Title: Annual Treasury Management Report 2014-15

Report By: Peter Grace
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Purpose of Report

This report provides the opportunity for the Cabinet to scrutinise the Treasury Management activities and performance of the last financial year. This report was considered by the Audit Committee.

Recommendation(s)

1. To consider the report and its recommendations

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2014-15.

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 15th February 2010 and this Council fully complies with its requirements.

2. The primary requirements of the Code are as follows:

   a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

   c) Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

   d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

3. Treasury management in this context is defined as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

4. The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2014-15.

5. This annual Treasury report covers

   a) capital expenditure and financing 2014-15

   b) overall borrowing need (the Capital Financing Requirement)

   c) treasury position as at 31 March 2015;

   d) performance for 2014-15;

   e) the strategy for 2014-15;

   f) the economy and interest rates in 2014-15;

   g) borrowing rates in 2014-15;

   h) the borrowing outturn for 2014-15;

   i) debt rescheduling;

j) compliance with treasury limits and Prudential Indicators;

k) investment rates in 2014-15;

l) investment outturn for 2014-15;

The Council’s Capital Expenditure and Financing 2014/15

6. The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council’s borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

7. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Table 1: Capital Programme Financing 2014-15	**Outturn 2014/15**
	£ 000's
Expenditure	5,719
Financed by :	
Borrowing	2,697
Grants	1,045
Reserves	1,140
Capital Receipts	837
Total	5,719

The Council's Overall Borrowing Need

8. The Council’s underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council’s debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

9. Part of the Council’s treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council’s cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

10. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

11. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

12. The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 by Council on the 19/02/2014.

13. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against this scheme.

Table 2 CFR : General Fund	**2013/14**	**2014/15**	**2014/15**
	Actual	Estimate	Actual
	£000's	£000's	£000's
Opening balance	16,945	16,372	16,372
Add unfinanced capital expenditure	0	2,800	2,697
Less MRP	(503)	(488)	(488)
Less finance lease arrangements	(70)	(9)	(9)
Closing balance	£16,372	£18,675	£18,572

14. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

15. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2014/15 plus the expected changes to the CFR over 2014/15 and 2015/16 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15. The table below highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Table 3 Internal Borrowing Level	2013/14 Actual	2014/15 Estimate	2014/15 Actual
	£000's	£000's	£000's
Capital Financing Requirement	16,372	18,675	18,572
External Borrowing	11,500	14,197	14,197
Net Internal Borrowing	4,872	4,478	4,375

Treasury Position as at 31 March 2015

16. The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 4 **Debt**	31st March 2014 Principal	Annual Rate	Maturity	31st March 2015 Principal	Annual Rate
PWLB Loan1	£7.5m	4.80%	2033	£7.5m	4.80%
PWLB Loan 2	£1.0m	2.02%	2016	£1.0m	2.02%
PWLB Loan 3	£1.0m	1.63%	2018	£1.0m	1.63%
PWLB Loan 4			2044	£0.9m	3.78%
PWLB Loan 5			2044	£1.8m	3.78%
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Fixed Rate Debt	£9.5m			£12.2m	
PWLB Loan 6	£2.0m	0.55% (Variable Rate)	2019	£2.0m	0.56% (Variable Rate)
Total Debt	£11.5m	3.55%		£14.2m	3.59%

Table 5 **Investments**	31st March 2014 Principal	31st March 2015 Principal
-In-House *	£19.87m	£21.9m
Total Investments*	£19.87m	£21.9m

* excludes deposits held in respect of the Local Authority Mortgage Scheme

Performance Measurement (2014-15)

17. Table 6 below compares the Estimated Interest Payable and Received and associated fees for the year 2014-15.

Table 6	2013 -14 Actual Outturn £000's	2014 -15 Revised Budget £000's	2014 -15 Actual Outturn £000's
Gross Interest Payable	407	450	472
Gross Interest Received	(264)	(218)	(229)
Fees	12	13	13
Other (e.g. PWLB Discount)	(53)	(53)	(53)
Net Cost	102	192	203

18. There is a small variance from the revised budget due to variations between budgeted and actual rates achieved.

19. The net interest on the LAM scheme (as below) is being transferred into the mortgage reserve.

Table 7	2013 -14 Actual Outturn £000's	2014 -15 Revised Budget £000's	2014 -15 Actual Outturn £000's
Gross Interest Payable	36	36	36
Gross Interest Received	(64)	(64)	(64)
Net Surplus	(28)	(28)	(28)

20. The Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources are detailed below, and were in line with budget expectations.

Table 8 Balance Sheet	31-Mar-14	31 March 2015 (Est)
	£000's	£000's
General Fund Balance	500	500
Earmarked Reserves	10,249	9,675
General Reserves	8,733	8,001
Total	£19,482	£18,176

The Strategy for 2014-15

21. The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter one of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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 has promoted a cautious approach, whereby investments decisions are dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

22. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk except where contractual arrangements with Amicus Horizon are involved.

The Economy and Interest Rates

23. 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 European central Bank (ECB) was going to do too little too late to ward off the threat of deflation and recession in the Eurozone (EZ). 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 1 of 2016.

24. 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.

25. 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.

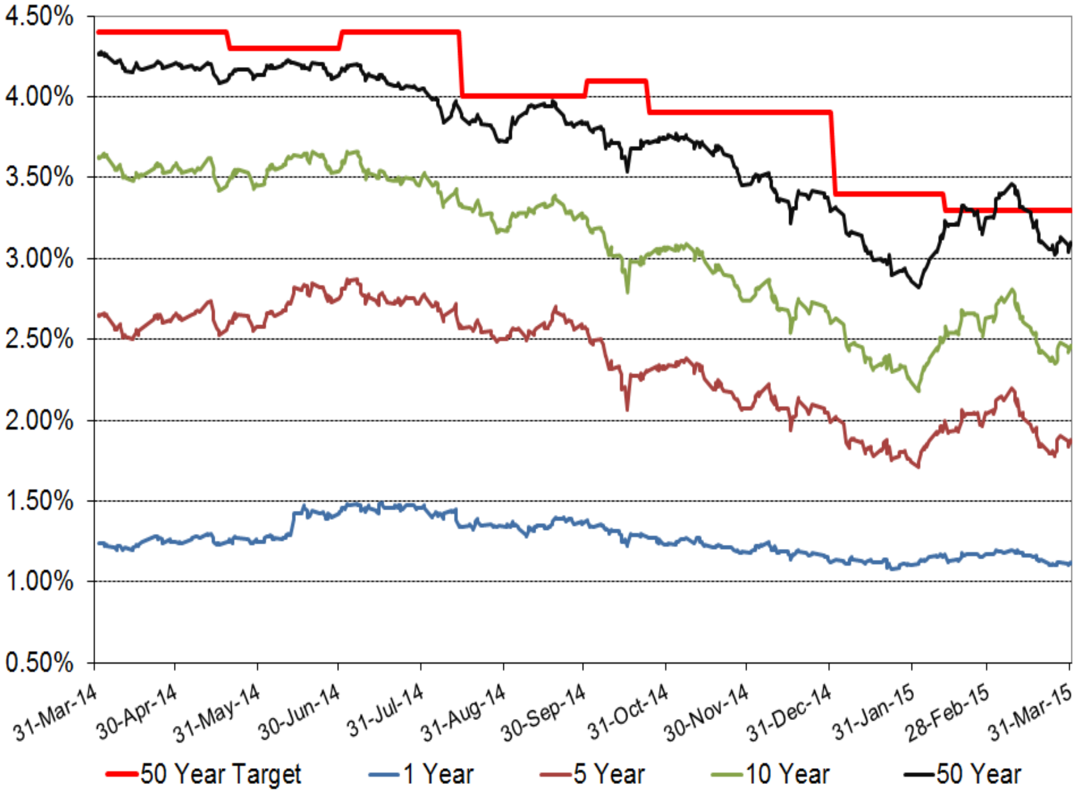
26. The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

27. 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.

Borrowing Rates in 2014-15

28. PWLB borrowing rates - the graphs and table for PWLB maturity rates below show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.

Table 9: PWLB rates



PWLB certainty rates quarter ended 31.3.2015

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/14	1.24%	2.65%	3.63%	4.29%	4.27%
31/3/15	1.11%	1.86%	2.45%	3.11%	3.08%
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.27%	2.36%	3.08%	3.74%	3.72%

29. The table above highlights the fluctuation in borrowing rates throughout the year for different borrowing periods (in years). Members would be able to scrutinise the timing of any borrowing decisions with this information.

Borrowing Outturn for 2014/15

30. The additional long term borrowing that was undertaken in 2014/15 was in respect of the Coastal Communities project but was at a reduced amount of £2,697m for 38 properties where £3.6m as originally budgeted for 51 properties.

Debt Rescheduling

31. The Council examined the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Compliance with Treasury Limits

32. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

Investment Rates in 2014-15

33. Investment rates available in the market have continued at historically low levels and have fallen further during the last year. The funds invested during the year were often available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Council holds approximately £15m core cash balances for investment purposes (i.e. funds available for more than one year).

34. The table below shows the bank base rate and the PWLB rates forecasts.

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%
5yr PWLB rate	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in February 2014. This forecast now includes a first increase in Bank Rate in quarter four of 2015 (previously quarter two of 2016), and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate.

Investment Strategy

35. The strategy has not changed during the year, other than Investment returns being lower and for a longer period than previously anticipated, although a base rate rise looks more likely in late 2015 or early 2016.

Investment Outturn for 2014-15

36. Investments held by the Council - the Council maintained an average balance in the year of £23m. The average rate of return for the year was 0.66% (0.86% including LAMS scheme deposits). The comparable performance indicator is the average 7-day LIBID rate (un-compounded), which was 0.354%.

37. The table below provides a snapshot of the investments held at 31 March 2015.

Table 12: Counter Party	Rate / Return	Start Date	End Date	Principal	Term
Barclays	0.65%			£1.91m	Call account
Nordea Bank	0.60%	01/10/2014	01/04/2015	£5m	Certificate of Deposit
Standard chartered	0.65%	01/10/2014	01/04/2015	£5m	Certificate of Deposit
Lloyds	0.95%	11/04/2014	11/04/2016	£5m	Fixed Term Deposit
RBS - NatWest	0.60%	21/08/2013		£5m	Call account
RBS - NatWest	0.25%	21/08/2013		£0.03m	Call account
				£21.94M	

The above table excludes two £1million deposits that are held with Lloyds bank as part of the Local Authority Mortgage scheme; the deposits are held for periods of 5 years.

38. No institutions in which investments were made during 2014/15 had any difficulty in repaying investments and interest in full during the year.

Financial Implications

39. The security of the Council's monies remains the top priority within the strategy. The past year has seen the continuing historically low level of interest rates available to investors. There has been some new borrowing, of which £1,788,235 represents a loan made to Amicus Horizon.

The net position once borrowing costs and investment interest are considered is a net increase in costs from £102,000 in 2013/14 to £203,000 in 2014/15. This is partly the result of the reprofiling of the lending to and grant payment to Amicus Horizon as part of the Coastal Space initiative, but also a reduction in the investment interest being received. The figures are in line with budget expectations.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	No
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No

Background Information

Treasury Management and Annual Investment Strategy 2014/15, Cabinet, 17 February 2014
CIPFA - Treasury Management Code of Practice (revised 2009)
CIPFA - The Prudential Code (revised 2009)

Officer to Contact

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Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2013/14	2014/15	2015/16	2016/17	2017/18
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£20,000	£20,000	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000	£30,000	£30,000
Operational Boundary for external debt -					
borrowing	£20,000	£20,000	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000	£30,000	£30,000
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for total principal sums invested for over 364 days – LAMS Scheme and Coastal Space	£5,620	£5,620	£6,000	£6,000	£6,000

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%