CITY COUNCIL – 14 JULY 2014

REPORT OF THE DEPUTY LEADER

TREASURY MANAGEMENT 2013-14 ANNUAL REPORT

1 SUMMARY

1.1 This report sets out the 2013/14 performance in respect of the management of the Council's external debt and investments (i.e. treasury management). The key issues are:

- the average rate of interest payable on external debt increased from 3.788% at 1 April 2013 to 3.795% at 31 March 2014 (see section 5.2 – Loan Debt);
- the average rate of interest earned on short-term investments in 2013/14 was 0.651%. This is benchmarked against the 7 day London Inter-bank (LIBID) rate provided by the Bank of England, which averaged 0.413% for the same period (see section 5.2 – Investment Performance);
- the 2013/14 out-turn showed General Fund Treasury Management expenditure of £59.694m (see section 6.1);
- updating the approved investment counterparty list.

2 RECOMMENDATIONS

2.1 To note the performance information in relation to Treasury Management for 2013/14.

2.2 To consider and approve the amendment of the 2014/15 Treasury Management Strategy to add Close Brothers Limited to the approved counterparty list.

3 REASONS FOR RECOMMENDATIONS

3.1 Council adopted the Chartered Institute of Public Finance and Accountancy (CIPFA)'s revised Code of Practice on Treasury Management in Local Authorities (the Code) on 05 March 2012. Part of the Code requires a formal annual report on the performance of the Treasury Management function.

3.2 Amendments to the Council's annual treasury management strategy are required to be approved at a meeting of Full Council in accordance with the adopted CIPFA Code of Practice for Treasury Management

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

4.1 Options for management of the Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

4.2 The approval of amendments to the Treasury Management Strategy is a requirement of the adopted Code, so no other options are available for consideration

5 BACKGROUND (INCLUDING OUTCOMES OF CONSULTATION)

5.1 Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks. To assist in this process the Council retains external financial advisors

5.2 TREASURY MANAGEMENT ACTIVITY IN 2013/14

External advisors

External advisors (Arlingclose) are retained to provide additional input on treasury management matters. The service comprises economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters, as required.

Prudential Indicators

Following the Local Government Act 2003, the Council is required to approve a series of treasury management prudential indicators. These were approved on 4 March 2013 by Council as part of the 2013/14 Treasury Management Strategy.

In compliance with the requirements of the CIPFA Code of Practice this report provides a summary 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. Appendix 1 shows actual performance against these indicators for 2013/14 together with comparative figures for 2012/13.

The prudence indicators reflect the management of the capital programme and associated debt, within existing resource limitations. The affordability and treasury management indicators, indicate whether the 2013/14 actual figures were within the set limits.
The 'PFI and leasing debt' figures within the indicators reflect the notional debt element of those schemes financed through Private Finance Initiative (PFI) funding or finance leases.

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

Loan debt portfolio

Total outstanding debt during 2013/14 decreased by £66.3m to £710.3m at 31 March 2014. The average rate of interest on that debt increased slightly, from 3.788% at 1 April 2013 to 3.795% at 31 March 2014. The majority of long-term borrowing is raised from the Government's Public Works Loan Board (PWLB). Table 1 analyses the debt portfolio:

TABLE 1: DEBT PORTFOLIO				
	1 APR 2013		31 MAR 2014	
DEBT	**£m**	**%**	**£m**	**%**
PWLB borrowing	684.8	3.950	648.8	3.814
Market loans	51.3	4.287	49.9	4.324
Local bonds	0.6	2.200	0.4	1.962
Temporary borrowing	39.9	0.393	11.2	0.393
TOTAL DEBT	**776.6**	**3.788**	**710.3**	**3.795**

Good treasury management practice requires a spread of maturing debt over future years, avoiding large amounts of debt falling to be repaid in any one year. Prudential indicators include a requirement for fixed debt maturity to be within set parameters. Table 2 shows that the actual debt percentages at 31 March 2014 fall within those parameters:

TABLE 2: DEBT MATURITY ANALYSIS

Period of loan	Parameters %	31/03/14 %
Under 12 months	0 – 25	3.56
1 to 2 years	0 – 25	2.13
2 to 5 years	0 – 25	12.46
5 to 10 years	0 – 50	19.23
10 to 25 years	0 – 50	33.10
25 to 40 years	0 – 25	20.50
> 40 years	0 – 75	9.02

The debt maturity profile is reviewed as part of the overall review of treasury management strategy.

Economic background

At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a 'triple-dip' alongside falling real wages (i.e. after inflation) and the paucity of business investment were a concern for the Bank of England's Monetary Policy Committee.

With new Governor Mark Carney at the helm, the Bank of England unveiled forward guidance in August pledging to not consider raising interest rates until the unemployment rate fell below the 7% threshold. 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 consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.

The UK economy registered overall growth of 1.7% in Gross Domestic Product (GDP) for the calendar year 2013. 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. Worries of a housing bubble were tempered by evidence that net mortgage lending was up by around 1% annually.

The UK Bank Rate was maintained at 0.5% through the year and the Government's Funding for Lending scheme introduced in 2012, continued to provide cheap funding for banks. These factors led to the short-term money market rates remaining at very low levels which continued to have a significant impact on investment income. The average 3-month LIBID rate during 2013/14 was 0.45%, the 6-month LIBID rate averaged 0.53% and the 1-year LIBID rate averaged 0.78%.

The low rates of return on the Authority's short-dated money market investments reflect these prevailing market conditions and the Authority's objective of optimising returns commensurate with the principles of security and liquidity.

Strategy during year

The overall Treasury Management strategy for 2013/14 was approved at a meeting of the Council on 4 March 2013 and included:

- *new borrowing*

A borrowing requirement of £72.4m was estimated for 2013/14, to replace maturing debt and finance capital expenditure. The type, period, and timing of new borrowing would be dependant on the expected movement in interest rates and the existing debt maturity profile, as well as approved prudential indicators and limits. The continued use of existing surplus cash to fund the borrowing requirement ('internal borrowing') would remain an option, given projected interest rates.

- *rescheduling*

Rescheduling of debt (the early repayment of existing loans and the replacement of that debt with new borrowing for different periods) is undertaken to improve the maturity profile of outstanding debt and reduce the interest charge on the revenue account. It was intended to take advantage of such opportunities if and when they arose during the year.

- *investments*

Cash surpluses during the year would be invested with security and liquidity being the primary driver. Within those stated guidelines, the interest earned would be maximised. Investment activity would follow the specific approach included within the Treasury Management strategy report. The use of such surpluses to fund the borrowing requirement, on a temporary basis, would continue where appropriate.

Performance

Performance on the various elements within the adopted treasury management strategy during 2013/14 is set out below:

- *Overall borrowing strategy*
  In 2013/14, surplus cash continued to be used to suppress the need for new borrowing due to the margins between long-term borrowing costs and short-term investment returns. Despite foregone investment income this strategy continues to generate significant revenue savings and reduced overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term.

- *New borrowing*
  There was no new long-term borrowing raised in 2013/14.

- *Other repayments / rescheduling*
  Opportunities to reschedule existing debt remained very limited during the year, as a result of continuing low rates of interest across all periods.

- *Investments*
  Investments of surplus cash were made with approved counterparties throughout the year, in line with the strategy approved by Council in March 2013.

Investments are cash generated from a combination of core cash, the cash being carried from the NET loan taken in advance of need, short-term surpluses and various reserves and provisions.

The counterparty list is based on the approved financial institution achieving a minimum specified credit rating, with the lowest rating from the three rating agencies being applied. Other factors, such as share prices, Credit Default Swap rates, sovereign credit ratings and support mechanisms and market sentiment are also considered. Monitoring of all these elements is carried out by the Council and by its advisors each day.

- *Investment performance*
  The average sum formally invested during the year was £223m, earning total interest of £1.436m at an average rate of 0.651%. The investment portfolio was inflated by the £100m advance borrowing raised for NET Phase 2 project taking advantage of the very low long-term interest rates available at the time (November/December 2012). The effect of this additional investment sum, and the lower short-term interest rates following the Government's Funding for Lending scheme, meant that the average return for 2013/14 fell below the original estimate of 0.82%.

  The Council benchmarks its average return against the 7-day London Inter-bank (LIBID) rate provided by the Bank of England. For 2013/14, the average 7-day LIBID rate was 0.413%.

- *Icelandic bank deposits*
  In October 2008, the Icelandic banking system failed, resulting in the collapse of its four major banks. At that time, the Council had a total of £41.6m deposited with three of those banks - Glitnir, Landsbanki and Heritable. The administration process to enable repayments to be made to the banks' various creditors has continued throughout 2013/14, with further instalments being received at regular intervals.

  In January 2014 the council sold the remaining Landsbanki bank (LBI) claims by auction. The final recovery of the LBI claims is 91%.

  The overall repayment position at 31 March 2014, and the final expected recovery levels, based on the latest reports from the various bank administrators are shown in Table 3:

TABLE 3: ICELANDIC BANK DEPOSITS

Bank	**Deposit**	**Recovery To 31/3/14**	**Final Est. Recovery**
	£m	**%**	**%**
Glitnir	11.0	79	97
Landsbanki	15.0	91	91
Heritable	15.6	94	94
TOTAL	**41.6**	**89**	**94**

In cash terms, the Council has recovered a total of £37.0m of its original deposits, plus a further £1.5m in interest at 31 March 2014. Based on the final estimated percentage returns in Table 3 above, the total final principal sum recovered will be

£39.0m plus £1.6m interest, although the timing of final repayment is uncertain due to the currency controls in place in Iceland. Full provision for the financial loss (impairment) associated with these deposits was made in 2010/11 and was met from the Treasury Management Reserve. As at 31 March 2014 the financial accounts reflect the final estimated position shown above.

Accounting regulations require notional accrued interest in respect of the outstanding principal sums to be credited to the revenue account each year, together with any changes in the impairment calculation, until the recovery process is complete. These sums are then transferred to the Treasury Management Reserve to offset the original gross impairment provision (see Table 4 below).

- *Daily cash management*
  To avoid bank overdraft charges and maximise interest earned, the Council seeks to maintain an overnight cash balance between - £300k and + £150k. The target for 2013/14 was 99%, with an actual rate of 99.24% being achieved.

- *Authorities Banker*
  The Co-operative Bank was the Authority's banker throughout 2013/14. In November 2013 the bank advised the Council that it would not be bidding for the upcoming banking contract. The Council has since awarded the banking services contract to Lloyds Bank.

  In 2013 the Co-op's long-term credit ratings were downgraded by Moody's and Fitch to Caa1 and B respectively, both sub-investment grade ratings. During this time Co-op bank was used for operational and liquidity purposes only. The Council makes every effort to keep the net overnight balance as close to zero as possible.

Update to Treasury Management Strategy for 2014/15
The Council approved the Treasury Management Strategy on 3 March 2014. Included in the investment strategy was 'Table of Eligible Counterparties for Investment in 2014/15' on page 11 of Appendix A. It is proposed to add one further UK bank to the list – Close Brothers Limited. This bank meets all of the Council's specified criteria and would have the same investment limits as the other UK banks in that table.

6 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

6.1 General Fund Revenue Implications
Revenue costs associated with borrowing and lending can be volatile, being affected by a number of factors including movements in interest rates, the timing of capital spending, the extent of reserves held and actual cash flows during the year.

Total treasury management-related costs in 2013/14, comprising interest charges less receipts, plus provisions for repayment of debt, were £67.761m. A proportion of the Council's debt relates to capital expenditure on council housing and £11.511m of these costs was charged to the Housing Revenue Account (HRA). The remaining costs, £56.250m ware included within the treasury management section of the General Fund corporate budget.

Accrued notional interest and changes in the impairment charge in respect of Icelandic deposits produced a credit to the revenue account of £1.586m in 2013/14.

The transfer of this sum to the Treasury Management Reserve, along with a further transfer to reserves of £3.443m in respect of revenue savings in the year leaves a net General Fund charge in 2013/14 of £59.694m.

The final General Fund position for 2013/14 is summarised in Table 4:

TABLE 4: GENERAL FUND TREASURY MANAGEMENT COSTS 2013/14			
DESCRIPTION	**ORIGINAL BUDGET 2013/14 £m**	**REVISED BUDGET 2013/14 £m**	**OUTTURN 2013/14 £m**
External interest	30.929	30.848	28.847
Debt repayment provision	32.853	43.143	40.752
Prudential borrowing recharge	(0.516)	(0.516)	(0.522)
Investment interest	(1.050)	(1.050)	(0.786)
Other interest	(0.132)	(0.132)	(0.530)
Gross Treasury Management costs	**61.814**	**72.293**	**67.761**
Less: HRA interest element	(11.605)	(11.605)	(11.511)
Net Treasury Management costs	**50.209**	**60.688**	**56.250**
Icelandic bank impairment – change in year	-	-	(1.587)
General Fund expenditure	**50.209**	**60.688**	**54.663**
Treasury Management Reserve transfer – Icelandic banks impairment change in year	-	-	1.587
Reserve transfers – Treasury Management revenue savings	-	-	3.443
NET GENERAL FUND POSITION	**50.209**	**60.688**	**59.694**

Treasury Management Reserve

The Treasury Management Reserve is maintained to smooth the impact of any volatility in treasury management revenue charges in any one year. The balance on the Reserve at 31 March 2014 is £11.236m.

Value for Money

Management of borrowing and investments is undertaken in conjunction with our appointed advisors, with the aim of minimising net revenue costs, maintaining an even debt maturity profile and ensuring the security and liquidity of investments.

7 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS, CRIME AND DISORDER ACT IMPLICATIONS)

7.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

7.2 The key Strategic Risk relating to treasury management is SR17 ‘Failure to protect the Council’s investments’. The rating for this risk at 31 March 2014 was Likelihood = unlikely, Impact = moderate which represents the same risk assessment as at 1 April 2013.

8 EQUALITY IMPACT ASSESSMENT (EIA)

8.1 Not needed (report does not contain proposals or financial decisions)

9 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

9.1 None.

10 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

10.1 Full Council report – 3 March 2013

10.2 Executive Board report - 17 June 2014

10.3 Audit Committee report – 27 June 2014

COUNCILLOR GRAHAM CHAPMAN
DEPUTY LEADER

PRUDENTIAL INDICATORS **Appendix 1**

INDICATORS	2012/13 Actual	2013/14 Estimate	2013/14 Actual	Within Limits?
1) Prudence indicators **i) Capital Expenditure**				
General Fund	£ 78.9m	£ 114.9m	£69.8m	YES
HRA	£ 44.2m	£ 68.3m	£52.4m	YES
	£123.1m	**£ 183.1m**	**£122.2**	
ii) CFR at 31 March General Fund	£ 553.0m	£ 599.3m	£542.9m	YES
HRA	£ 283.3m	£ 282.3m	£282.3m	YES
PFI notional 'debt'	£ 65.8m	£ 93.0m	£91.8m	N/A
	£ 902.1m	**£ 974.6m**	**£917.0m**	
iii) External Debt at 31 March Borrowing	£ 776.7m	£ 801.8m	£710.2m	YES
PFI & leasing notional 'debt'	£ 65.8m	£ 93.1m	£91.8m	N/A
Gross debt	**£ 842.5m**	**£ 894.9m**	**£802.0m**	
Less investments	£ (217.0)m	£ (220.0)m	£ (227.2)m	N/A
Net Debt	**£ 625.5m**	**£ 674.9m**	**£ 574.8m**	
2) Affordability indicators **i) Financing costs ratio**				
General Fund	14.61%	13.68%	16.15%	YES
HRA	13.35%	14.63%	12.23%	YES
Council Tax Band D (per annum)	+ £1.10	-	-	YES
HRA rent (per week)	+ £0.56	-	-	YES
	Max in year		**Max in year**	
iii) Authorised limit for external debt	£882.0m	£954.9m	£842.7m	YES
iv) Operational limit for ext. debt	£882.0m	£914.9m	£842.7m	YES
3) Treasury Management indicators	**@ 31/3/13**	%	**@ 31/3/13**	
ii) Limit on variable interest rates	6.99%	0-50%	7.64%	YES
iii) Limit on fixed interest rates	93.01%	50-100%	92.36%	YES
iv) Fixed Debt maturity structure				
- Under 12 months	9.82%	0-25%	3.56%	YES
- 12 months to 2 years	1.80%	0-25%	2.13%	YES
- 2 to 5 years	5.99%	0-25%	12.46%	YES
- 5 to 10 years	19.67%	0-25%	19.23%	YES
- 10 to 25 years	35.54%	0-50%	33.10%	YES
- 25 to 40 years	16.41%	0-25%	20.50%	YES
- 40 years and above	10.77%	0-75%	9.02%	YES
	Max in year		**Max in year**	
v) Max sum invested for >364 days	£17.0m	£60.0m	£15.0m	YES