POLICY & RESOURCES CABINET BOARD

REPORT OF THE HEAD OF FINANCIAL SERVICES – MR DAVID REES

3rd SEPTEMBER 2015

SECTION A – MATTERS FOR DECISION

WARDS AFFECTED: ALL

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2014/15

1. Purpose of Report

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2014/15 (this report).

1.2 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). Some information incorporated within this report has been provided by the Council's Treasury Advisors Capita Asset Services.

1.3 Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is 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.

1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to the annual strategy report, which was submitted to Cabinet in January 2014 before being reported to full Council.

2.0 Executive Summary

2.1 During 2014/15, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and Treasury Indicators	**2013/14 Actual £000**	**2014/15 Original Estimate £000**	**2014/15 Revised Estimate £000**	**2014/15 Actual £000**
Capital Expenditure	53,718	58,188	63,486	57,806
Capital Financing Requirement	219,942	246,862	235,749	241,875
External debt(gross)	172,085	170,426	189,861	194,224
Less Investments	(59,477)	(65,000)	(60,000)	(47,550)
Net Borrowing	112,608	105,426	129,861	146,674

2.2 The full list of prudential and treasury indicators are to be found in Appendix 1. During the financial year the Council operated within its treasury limits and Prudential Indicators.

2.3 The financial year 2014/15 was once again a challenging environment as in previous years with low investment returns and continuing counterparty risk.

3.0 Introduction and Background

3.1 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

4.0 The Council's Capital Expenditure and Financing 2014/15

4.1 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.

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

	2013/14 Actual £'000	**2014/15 Original Estimate £'000**	**2014/15 Revised Estimate £'000**	**2014/15 Actual £'000**
Total capital expenditure	53,718	58,188	63,486	57,806
Resourced by:				
• Capital receipts	(1,530)	(3,350)	(1,400)	(1,250)
• Capital grants & contributions	(26,820)	(17,586)	(29,346)	(22,708)
• Capital reserves + Direct Revenue Financing	(4,001)	(7,150)	(7,521)	(2,579)
Unfinanced capital expenditure (to be funded from Borrowing)	**(21,367)**	**(30,102)**	**(25,219)**	**(31,269)**

5.0 The Council's Overall Borrowing Need

5.1 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. It represents the 2014/15 unfinanced capital expenditure (see previous table), and prior years' net of unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

5.2 Part of the Council's treasury activities is to address the funding requirements for this 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.

5.3 Reducing the CFR – 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.

5.4 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).

5.5 The Council's 2014/15 MRP Policy (as required by WAG Guidance) was approved by Council as part of the Treasury Management Strategy Report for 2014/15 during January 2014.

5.6 The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR	**2013/14 Actual £'000**	**2014/15 Original Estimate £'000**	**2014/15 Revised Estimate £'000**	**2014/15 Actual £'000**
Opening balance	207,493	226,172	219,942	219,942
Add unfinanced capital expenditure (as above)	21,367	30,102	25,219	31,269
Less MRP/Set aside receipts	(8,918)	(9,412)	(9,412)	(9,336)
Closing balance	**219,942**	**246,862**	**235,749**	**241,875**

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

5.8 Net borrowing and the CFR – in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be used 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 2015/16 and 2016/17. 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 net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31/3/14 Actual £m	**31/3/15 Original Estimate £m**	**31/3/15 Revised Estimate £m**	**31/3/15 Actual £m**
Net borrowing position	112.608	105.426	129.861	146.674
CFR	219.942	246.862	235.749	241.875

5.9 The authorised limit – the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

5.10 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

	Actual 2014/15 £000
Authorised limit	249,861
Operational boundary	229,861
Maximum Gross Borrowing during 2014/15	
Comprising of:	
Maximum Long Term Borrowing at any point during year	193,224
Maximum Short Term Borrowing at any point during year	1,000

The Council has maintained gross borrowing below the Authorised limit.

6.0 Treasury Position as at 31st March 2015

6.1 The Council’s debt and investment position is managed by Finance Treasury Staff in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the executive summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the beginning and the end of 2014/15 the Council’s treasury position was as follows:

	31 March 2014 Principal	**Rate / Return**	**31 March 2015 Principal**	**Rate / Return**
Fixed rate funding:	**£m**	**%**	**£m**	**%**
-PWLB	109.4	5.35	127.9	5.03
-Market (Rifw & LOBO)	62.7	3.93	65.3	3.93
-Other			1.0	0.50
Variable rate funding:				
-PWLB	-	-		
-Market	-	-		
Total debt	**172.1**	**4.80**	**194.2**	**4.67**
Investments:				
- in house	59.4	0.92	47.6	1.20
- with managers				
Total investments	**59.4**	**0.92**	**47.6**	**1.20**

PWLB = Public Works Loans Board which is a body the Government has established to lend money to Local Government.

Market LOBO’s = Lender Option Borrower Option – this is borrowing from the market when the lender has offered a long term loan but with options to continue or foreclose on the loan at various specific intervals.

7.0 The Strategy for 2014/15

7.1 The strategy for 2014/15 was approved by Cabinet Board and Council in January 2014.

7.2 Interest Rate and New Borrowing Forecasts:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing up the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.

- Temporary borrowing from the money markets or other local authorities.

- PWLB variable rate loans for up to 10 years.

- Short dated borrowing from non PWLB sources.

- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

- PWLB fixed rate loans for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.

7.3 The main sensitivities to the forecasts were:

- If a sharp fall in long and short term rates (due to risks around relapse into recession, deflation etc) was likely then long term borrowings would be postponed and potential rescheduling from fixed rate funding into short term borrowing would be considered.

- If a sharp rise in long and short term rates was likely (due to an increase in world economic activity or inflation risks) then fixed rate funding would be considered before any increases took effect

7.4 Investments

The Council continued with its main investment priorities:

(a) security of capital
(b) liquidity of capital

with the aim of achieving the optimum return commensurate with proper levels of security and liquidity. With investments being dominated by low counterparty risk considerations, relatively low returns were expected when compared to borrowing rates.

7.5 For balances generated through normal cashflow the strategy looked to utilise the business reserve (call account) and short dated deposits.

7.6 External v Internal Borrowing

Investment rates were expected to be below long term borrowing rates for the foreseeable future. In recent years new capital expenditure has been financed using internal cash balances instead of new external borrowing.

7.7 Debt Rescheduling

The strategy did allow for the use of investment balances to repay debt prematurely providing it was economically worthwhile and it enhanced the maturity profile of the debt portfolio.

No debt rescheduling was anticipated (or took place) in 2014/15 particularly as the PWLB rate structures have made it more expensive in recent years to do so.

8. Borrowing Outturn for 2014/15

8.1 The following long term loans were entered into during 2014/15 due to the fact that PWLB loan rates were at historic low rates. These loans are used to finance capital expenditure on projects such as the Strategic School Improvement Programme, Neath Town Centre Redevelopment, Street Lighting Replacement Programme and the new Aberafan Seafront Leisure Investment.

Lender	Date	Amount	Rate	Period	Details
PWLB	10tOct14	£10.0m	3.69%	25 years	Fixed maturity loan repayable 1st July 2039
PWLB	10Oct14	£5.0m	3.70%	39 years	Fixed maturity loan repayable 1st July 2053
PWLB	22Jan15	£5.0m	2.98%	48 years	Fixed maturity loan repayable 1st January 2063
RiFW	22Dec14	£2.6m	2.50%	3 years	Fixed rate to 31st December 2017

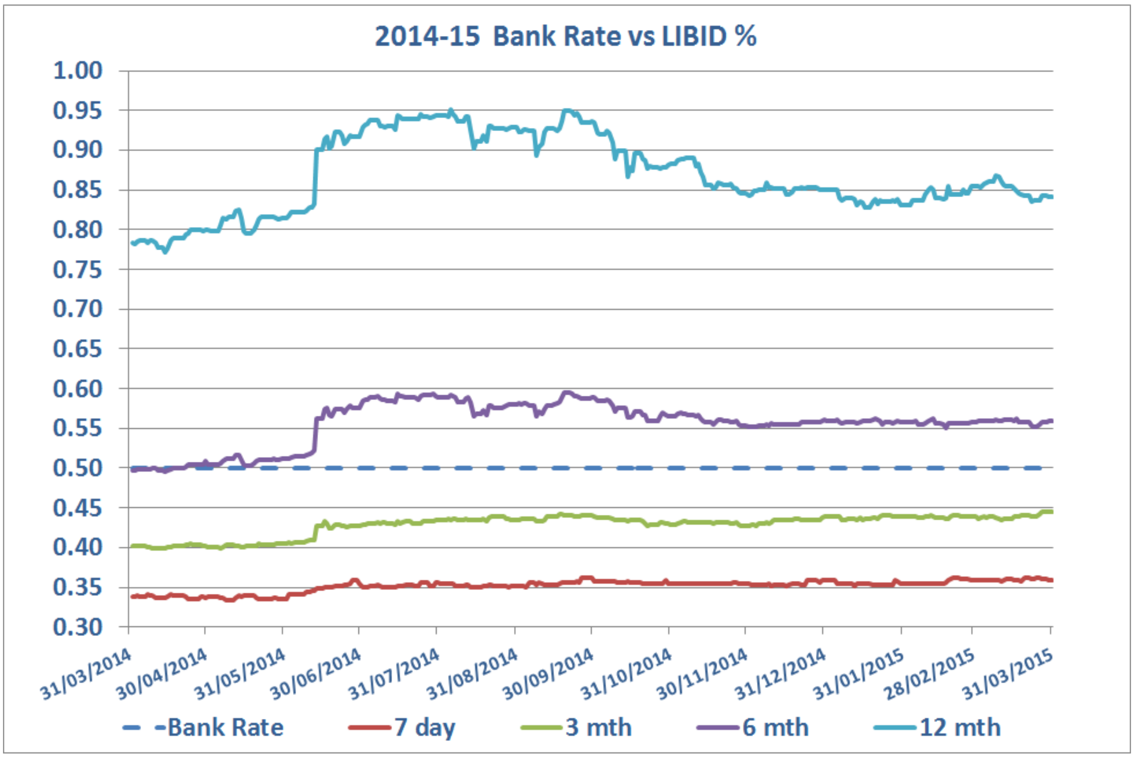
8.2 Treasury Borrowing – The following short term temporary loans were undertaken during the year:-

Start Date	End Date	Lender	Value £'000	Rate %
31/3/15	1/4/15	Rhondda Cynon Taff Superannuation Fund	1,000	0.50

8.3 Rescheduling – No loans were rescheduled during 2014/15

9. Investment Rates in 2014/15

9.1 Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year.



10. Investment Outturn for 2014/15

10.1 Investment Policy – the Council's investment policy is governed by Welsh Government guidance, which has been implemented in the annual investment strategy approved by the Council in January 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).

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

10.3 Resources – 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 comprised the following:

Balance Sheet Resources	**31 March 2014 £'000**	**31 March 2015 £'000**
Balances and Earmarked Reserves	50,000	42,739
Provisions	3,332	2,130
Usable capital receipts	7,631	6,826
Total	60,963	51,695

10.4 Investments held by the Council – The Council received the following return on its investments:

Average Investment £'000	**External Interest Earned £'000**	**Rate of Return**	**Benchmark Return**
67,337	806	1.20%	0.43%

The benchmark for funds managed in house is the 3 month LIBID uncompounded. The rate reflects a more realistic neutral position for core investments with a medium term horizon and a rate which is more stable with fewer fluctuations caused by market liquidity.

11. Performance Measurement

11.1 One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 6). The Council's original performance indicators for 2014/15 were set out in the Annual Treasury Strategy approved by Council in January 2014.

12. Icelandic Bank Defaults

12.1 As at the 31st March 2015 the Authority had the following investments outstanding from Iceland related banks:

Bank Name	**Balance Remaining £'000**
Heritable Bank	403
KSF	454
Total	**857**

12.2 Some of the investments matured by the old Glitnir, totalling £387k, have resulted in cash being held in the form of Icelandic Kroner. In line with Icelandic law, the Kroner is not tradable and can only be spent within Iceland. The Local Government Association is pursuing ways of transferring these investments to realise repayments into Sterling. These new investments with the new bank are held in an Escrow Account in the name of the local authority and generating interest in at c4%.

13. Appendices

Appendix 1 – Prudential Indicators

14. Recommendation

14.1 It is recommended that Members note the 2014/15 treasury management function performance as set out in this report including the actual 2014/15 prudential and treasury indicators.

15. Reason for Proposed Decision

15.1 For Members to note the Treasury Management Performance for last financial year.

List of Background Papers

Treasury Management Closing Files 2014/15

Capita Asset Services - Treasury Management Templates

Officer Contact

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COMPLIANCE STATEMENT

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2014/15

Implementation of Decision

The decision is proposed for implementation after the three-day call in period.

Sustainability Appraisal

Community Plan Impacts		
Economic Prosperity	-	Neutral
Education & Lifelong Learning	-	Neutral
Better Health & Well Being	-	Neutral
Environment & Transport	-	Neutral
Crime & Disorder	-	Neutral
Other Impacts		
Welsh Language	-	Neutral
Sustainable Development	-	Neutral
Equalities	-	Neutral
Social Inclusion	-	Neutral

Consultation

There is no requirement under the Constitution for external consultation on this item.

Appendix 1

PRUDENTIAL INDICATORS

PRUDENTIAL INDICATORS	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2014/15 Actual
	£'000	**£'000**	**£'000**	**£'000**
Capital Expenditure	53,718	58,188	63,486	57,806
	%	%	**%**	**%**
Ratio of financing costs to net revenue stream	5.87	6.44	6.80	6.70
	£'000	**£'000**	**£'000**	**£'000**
In year borrowing requirement	12,449	20,690	15,807	21,933
	£'000	**£'000**	**£'000**	**£'000**
Capital Financing Requirement as at 31st March	219,942	246,862	235,749	241,875
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (Band D) per annum	3.83	14.61	20.58	14.69

Appendix 1

PRUDENTIAL INDICATORS

TREASURY MANAGEMENT INDICATORS	2013/14 Actual	2014/15 Original Estimate	2014/15 Revised Estimate	2014/15 Actual
	£'000	**£'000**	**£'000**	**£'000**
Authorised Limit for External Debt:				
Borrowing and other long term liabilities	244,024	268,694	249,861	249,861
Operational Boundary for External Debt:				
Borrowing and other long term liabilities	224,024	248,694	229,861	229,861
External Debt (Gross)	**172,085**	**170,426**	**189,861**	**194,224**
Less Investments	(59,477)	(65,000)	(60,000)	(47,550)
Net Borrowing Position	**112,608**	**105,426**	**129,861**	**146,674**

Appendix 1

PRUDENTIAL INDICATORS

Maturity Structure of Fixed Rate Borrowing During 2014/15	2013/14 Actual	2014/15 Original Estimate		2014/15 Actual
		Upper Limit	Lower Limit	
	%	%	%	%
Under 12 months	1	15	0	1
12 months to 2 years	1	15	0	2
2 to 5 years	5	40	0	6
5 to 10 years	13	60	0	12
10 years and above	80	100	15	79