# Annual Treasury Management Review 2014/15

## Purpose

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).

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 13/02/2014)
- a mid-year (minimum) treasury update report (Council 15/12/2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This Council 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 Treasury Management Panel before they were reported to the full Council.

# Executive Summary

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 £000 | 2014/15 Actual £000 |
|---|---|---|---|
| Capital expenditure | | | |
| • General Fund | 5,044 | 9,558 | 4,333 |
| • HRA | 6,363 | 7,948 | 6,974 |
| • **TOTAL** | **11,407** | **17,506** | **11,307** |
| Capital Financing Requirement: | | | |
| • General Fund | 27,844 | 28,300 | 29,120 |
| • HRA | 44,750 | 44,750 | 44,750 |
| • **TOTAL** | **72,594** | **73,050** | **73,870** |
| Gross borrowing | **68,454** | **67,527** | **69,614** |
| External debt | **58,680** | **60,781** | **58,926** |

| Prudential and treasury indicators | 2013/14 Actual £000 | 2014/15 Original £000 | 2014/15 Actual £000 |
|---|---|---|---|
| Investments | | | |
| • Longer than 1 year | 210 | 140 | 140 |
| • Under 1 year | 16,860 | 17,520 | 20,660 |
| • Total | **17,070** | **17,660** | **20,800** |
| Net Borrowing | **51,384** | **49,867** | **48,814** |

Other prudential and treasury indicators are to be found in Appendix 1 of this report. The Director of Resources also confirms that new long term borrowing of £1.4m was undertaken for a capital purpose during 2014/15 and the statutory borrowing limit (the authorised limit) was not breached at any time.

The financial year 2014/15 continued the challenging investment environment of previous years, namely low investment returns.

# Recommendations

The Council is recommended to:

1. Approve the actual 2014/15 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2014/15

# Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual 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 investment activity.

# 1. The Council's Capital Expenditure and Financing 2014/15

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

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

| £m General Fund/HRA | 2013/14 Actual £000 | 2014/15 Estimate £000 | 2014/15 Actual £000 |
|---|---|---|---|
| **Capital expenditure** | | | |
| Financed in year | 11,407 | 17,506 | 11,307 |
| **Unfinanced capital expenditure** | **0** | **0** | **0** |

# 2. The Council's Overall Borrowing Need

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 indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2014/15 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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 that sufficient cash is available to meet the capital plans and cash flow requirements. Borrowing of £1.4m from the Public Works Loan Board was taken to finance the 2014/15 capital expenditure.

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

**Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2014/15) plus the estimates of any additional capital financing requirement for the current (2014/15) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to either borrow in advance of its immediate capital needs in 2014/15 or reduce its investments. The table below highlights the Council's gross borrowing position against the CFR.

| | 31 March 2014 Actual | 31 March 2015 Budget | 31 March 2015 Actual |
|---|---|---|---|
| Gross borrowing position | £66.424m | £69.044m | £69.614m |
| CFR | £72.594m | £73.050m | £73.870m |

**The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2013/14 the Council has maintained gross borrowing within its authorised limit.

**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 financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| | 2014/15 |
|---|---|
| Authorised limit | £109m |
| Operational boundary | £101m |
| Average gross borrowing position | £59.5m |
| Financing costs as a proportion of net revenue stream | 5.88% |

# 3. Treasury Position as at 31 March 2015

The Council's debt and investment position is organised by the treasury management service 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 through member reporting detailed in the summary. At the beginning and the end of 2014/15 the Council's treasury position was as follows:

| TABLE 1 | 31 March 2014 Principal | Rate/Return | 31 March 2015 Principal | Rate/Return |
|---|---|---|---|---|
| Fixed rate funding: | | | | |
| -PWLB | £41.81m | 3.75% | £43.03m | 3.78% |
| -Market | £15.90m | 4.00% | £15.90m | 4.00% |
| -Temporary | - | - | - | - |
| Total debt | £57.71m | 3.83% | £58.93m | 3.84% |
| CFR | £72.594m | | £73.87m | |
| Over / (under) borrowing | (£14.80m) | | (£14.94m) | |
| Investments: | | | | |
| - in house | £17.07m | 0.57% | £20.80m | 0.62% |
| Total investments | £17.07m | 0.57% | £20.80m | 0.62% |

# 4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 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 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.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

# 5. 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 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.

# 6. Borrowing Outturn for 2014/15

For 2014/15 the Council's actual debt management costs (borrowing) were £2,072,848 compared to a revised budget of £2,054,300, an over spend of £18,548. The weighted average rate on all loans for 2014/15 was 3.80% (2013/14 3.83%) on an average loan balance of £ 59,547m for the financial year.

The HRA repaid the General Fund £1.685m interest for the use of debt balances it holds.

Loans were drawn down in 2014/15 from the PWLB for £1.4m to fund capital expenditure for the Garage Sites project on behalf of Cheltenham Borough Homes. This loan was taken on an annuity basis in which Cheltenham Borough Homes are repaying back in full to the Council based on the loan term taken (40 years) with the PWLB, ensuring the GF is cost neutral.

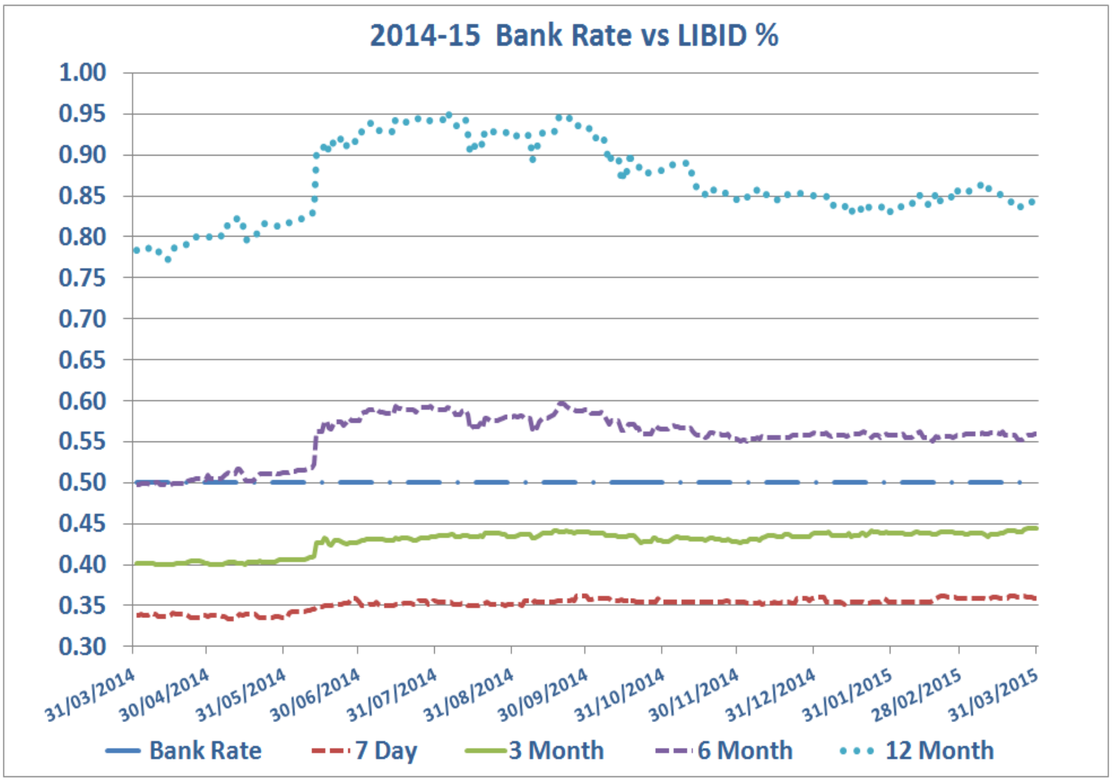
The loans drawn were:

| Lender | Principal | Type | Interest Rate | Maturity |
|---|---|---|---|---|
| PWLB | £1.4m | Fixed interest rate | 4.22% | 40 years |

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

# 7. Investment Rates in 2014/15

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. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.




# 8. Investment Outturn for 2014/15

**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 13th February 2014 and again on the 15th December 2014 for changes made. 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.).

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

| Type of Investments | Balance on 01/04/2014 | Average Weighed | Interest Earned in | % Rate Achieved in | Balance on 31/03/2015 |
|---|---|---|---|---|---|

| | £ | Balance Held in 2014/15 £ | 2014/15 £ | 2014/15 % | £ |
|---|---|---|---|---|---|
| **Fixed Term Deposits** | 5,000,000 | 14,517,260 | 99,816 | 0.69 | 12,000,000 |
| **Call Accounts & MMF's** | 11,790,000 | 5,642,013 | 22,978 | 0.41 | 8,590,000 |
| **Policy Investments** | 280,000 | 253,000 | 3,633 | 1.50 | 210,000 |

The Council maintained an average balance of £20.413m of internally managed funds during 2014/15. The internally managed funds earned an average rate of return of 0.62%. The comparable performance indicator is the average 3 month LIBID rate which was 0.43%. The Council budgeted for £111,400 investment interest for 2014/15 but made an actual return of £159,936, a surplus of £48,536. Included in this figure was interest accrued on the Glitnir Escrow account which accounted for £31,697 towards the surplus.

# 9. Icelandic Bank Defaults

The Council had £11m deposited with three Icelandic Banks when the banking system in Iceland collapsed in October 2008.

At the current time, the process of recovering assets is still ongoing with the administrators. In the case of Kaupthing, Singer and Friedlander Ltd, the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2015/16. To date 82.5p in the pound has been recovered. It is estimated that total dividends will be between 85p to 86.5p in the pound.

In regard to Glitnir the outstanding amount currently resides in an escrow account held in Iceland where it is earning interest at over 3%. Until government controls are relaxed the Council cannot access these funds. It is reported that these controls could be relaxed sometime later on this year.

The table below shows the detailed repayments in respect of the specific Icelandic investments held in administration:

| **Icelandic Deposits Held** | **Original Deposits** | **Amount Received to date** | **Amount Owed** |
|---|---|---|---|
| | **£** | **£** | **£** |
| Kaupthing Singer & Friedlander | 2,000,000 | 1,650,000 | 350,000 |
| Kaupthing Singer & Friedlander | 1,000,000 | 825,000 | 175,000 |
| Glitnir | 3,000,000 | 2,427,600 | 572,400 |
| Landsbanki | 2,000,000 | 1,888,835 | 0 |
| Landsbanki | 2,000,000 | 1,889,110 | 0 |
| Landsbanki | 1,000,000 | 974,730 | 0 |
| **TOTAL** | **11,000,000** | **9,655,275** | **1,097,400** |

## Appendix 1: Prudential and treasury indicators

| **1. PRUDENTIAL INDICATORS** | 2013/14 | 2014/15 | 2014/15 |
|---|---|---|---|
| Extract from budget and rent setting report | actual | original | actual |
| | £'000 | £'000 | £'000 |
| Capital Expenditure | | | |
| Non - HRA | 5,044 | 9,449 | 4,333 |
| HRA | 6,363 | 7,948 | 6,974 |
| TOTAL | **11,407** | **17,397** | **11,307** |
| Ratio of financing costs to net revenue stream | | | |
| Non - HRA | 3.24% | 3.27% | 2.90% |
| HRA | 8.47% | 8.05% | 8.01% |
| Gross borrowing requirement | | | |
| brought forward 1 April | £66,424 | £68,454 | £68,454 |
| carried forward 31 March | £68,454 | £69,641 | £69,614 |
| in year borrowing requirement | £2,030 | £1,187 | £1,160 |
| CFR | | | |
| Non – HRA | £27,844 | £28,300 | £29,120 |
| HRA | £44,750 | £44,750 | £44,750 |
| TOTAL | £72,594 | £73,050 | £73,870 |
| Incremental impact of capital investment decisions | £ | £ | £ |
| Increase in council tax (band D) per annum * | £nil | £nil | £nil |
| Increase in average housing rent per week ** | £nil | £nil | £nil |
| * Council Tax Freeze for 2014/15 | | | |
| ** Decisions on annual rent increases are subject to rent restructuring guidelines set by Central Government. As a consequence rent levels will only rise by RPI Index plus 0.5% and this should cover all additional capital expenditure. | | | |

| 2. TREASURY MANAGEMENT INDICATORS | 2013/14 | 2014/15 | 2014/15 |
|---|---|---|---|
| | actual | original | actual |
| | £'000 | £'000 | £'000 |
| Authorised Limit for external debt - | | | |
| borrowing | £109,000 | £109,000 | £109,000 |
| other long term liabilities | £0 | £0 | £0 |
| TOTAL | £109,000 | £109,000 | £109,000 |
| Operational Boundary for external debt - | | | |
| borrowing | £96,000 | £101,000 | £101,000 |
| other long term liabilities | £0 | £0 | £0 |
| TOTAL | £96,000 | £101,000 | £101,000 |
| Actual external debt | £57,709 | £59,074 | £58,926 |
| Upper limit for fixed interest rate exposure | | | |
| Net principal re fixed rate borrowing / investments :- | 0-100 % | 0-100 % | 0-100 % |
| Upper limit for variable rate exposure | | | |
| Net principal re variable rate borrowing / investments :- | 0-100 % | 0-100 % | 0-100 % |

| Maturity structure of fixed rate borrowing during 2014/15 | upper limit | lower limit |
|---|---|---|
| under 12 months | 50% | 0% |
| 12 months and within 24 months | 50% | 0% |
| 24 months and within 5 years | 100% | 0% |
| 5 years and within 10 years | 100% | 0% |
| 10 years and above | 100% | 0% |