Stevenage BOROUGH COUNCIL

Part I – Release to Press

Meeting: **COUNCIL** **Agenda Item:** **13**

Portfolio Area: Resources

Date: **7 OCTOBER 2015**

ANNUAL TREASURY MANAGEMENT REVIEW OF 2014/15

NON-KEY DECISION

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1. PURPOSE

1.1 To review the operation of the 2014/15 Treasury Management and Investment Strategy.

2. RECOMMENDATIONS

2.1 That of the 2014/15 Annual Treasury Management Review be approved.

3. BACKGROUND

3.1 The Council is required under the Local Government Act 2003 to produce an Annual Treasury Report reviewing treasury management activities including the 2014/15 prudential and treasury indicators. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (revised 2013 (the Code)) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.2. This report covers one of three reporting requirements under the code of practice, the other reports being;

- Annual Treasury Strategy in advance of the year (last reported to Council 25 February 2015)
- Mid-year (minimum) treasury update report (to be reported to Council 9 December 2015)

3.3 This report summarises:

- Capital expenditure for 2014/15;
- Impact of the expenditure 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.

3.4 This report was considered by the Audit Committee at its meeting on 1 September 2015 and the Executive on 21 September. Both bodies agreed that the Review be recommended to Council for approval.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

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

4.1.1 Council expenditure can be classified as capital when it is used to purchase assets with a life of more than one year and meets the guidelines laid out in CIPFA accounting practises.

4.1.2 These costs can be financed either by capital resources the Council has on its Balance Sheet for example capital receipts, capital grants or by making a revenue contribution to capital. If sufficient capital resources are not available to fund the expenditure incurred it would give rise to a need to borrow.

4.1.3 The Treasury Management review of 2014/15 Prudential Indicators have changed from the Treasury Strategy approved by Council 26 February 2014. The original indicators were based on the capital programme approved by Executive 21 January 2014. Since then budget changes have been approved and the Prudential Indicators were updated in the 2014/15 Mid Year Review and approved by Council on the 8 October 2014. The 2014/15 final out-turn figures have been confirmed and reported to Executive 14 July 2015. For 2014/15 capital expenditure requiring borrowing (£1.309Million) remained unchanged from that reported at the Quarter 3 and was £997,577 less than approved in the original 2014/15 budget. However, there were no loans taken to fund this in year.

4.1.4 The actual capital expenditure for the year has been used to calculate the prudential indicators included in this report. Table One (shown overleaf) summarises the actual capital expenditure and how this was financed.

Table One: 2014/15 Capital Expenditure and Financing				
	2014/15 Original Estimate £'000	2014/15 Quarter 3 Revised Working Budget £'000	2014/15 Actual £'000	2014/15 Variance Actual to Quarter 3 Revised Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	5,754	5,280	5,008	(272)
HRA Capital Expenditure	27,348	14,686	16,234	1,548
Total Capital Expenditure	**33,102**	**19,966**	**21,242**	**1,276**
Resources Available for Capital Expenditure:				
• Capital Receipts	(3,198)	(2,585)	(2,604)	(19)
• Capital Grants /Contributions	(8,721)	(9,378)	(9,135)	243
• Capital Reserves		(88)	(88)	0
• Revenue contributions	(18,878)	(6,606)	(8,106)	(1,500)
Total Resources Available	**(30,796)**	**(18,657)**	**(19,933)**	**(1,276)**
Capital Expenditure Requiring Borrowing	**2,306**	**1,309**	**1,309**	**0**

4.2 The Council's Overall Need to Borrow

4.2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt the Council needs to/has taken to fund the capital programme after repayments and Minimum Revenue Provision (MRP) are taken into account.

4.2.2 Based on the Capital Strategy and Treasury Management Strategy, the treasury service manages the Council's cash position to ensure sufficient cash is available to meet the capital payments. This may be through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB) or the money markets), or utilising cash balances held by the Council in the short to medium term.

4.3 Cash Balances and Cash Flow Management

4.3.1 Currently cash balances are estimated to be £35m by 31 March 2016, which means the Council does not expect to take any external borrowing in 2015/16 until such time as either:

Note: Original 2014/15 Prudential Indicators based on the Capital Programme approved by Executive 21 January 2014, 2014/15 Mid Year Review Prudential Indicators based on Capital Programme approved at Special Council meeting 26 August 2014

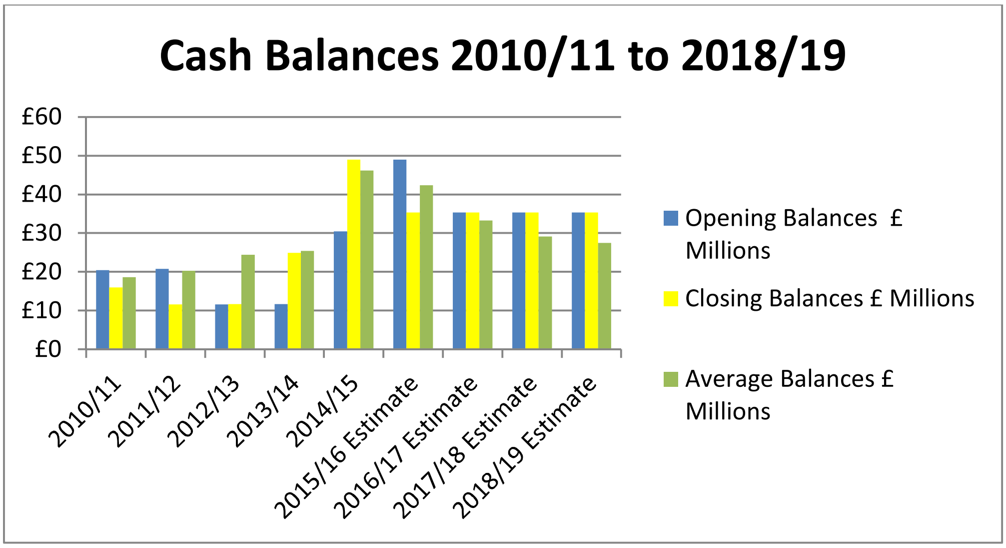
(i) interest rates look as if they will rise and the cost of any future need to borrow for any historic spend is forecast to be more expensive over the whole term of the loan.
or
(ii) cash balances fall below £10m.

4.3.2 The Council's cash balances of £49m at 31 March 2015 were significantly higher compared to previous years (as shown in Chart One in para 4.3.4).

4.3.3 The level of cash balances held by the Council is not indicative to its overall financial health as these balances arise due to the timing differences between when income is received (for example council tax and business rates) and when payments are made (for example debt repayments and successful NDR appeals).

4.3.4 The following chart shows the opening, closing and average cash balances held by the Council over the last five years demonstrating that average balances held during the year have increased over the last three years and significantly in 2014/15. The chart also shows the current projections for the next three years.

Chart One: Cash Balances



4.4 Borrowing and the 2014/15 Capital Financing Requirement (CFR)

4.4.1 As stated in paragraph 4.1.3 the Council did not undertake any new physical borrowing, due to increased cash balances from in part increased Right to Buy sales and slippage on the capital programme.

4.4.2 On average, balances were £46.2m in 2014/15 and much higher than the minimum £10m assessed as required for the running of day to day services. In 2015 the average cash holding between April and July was £58.9m (£37.7m April to July 2014/15). While investment returns are low the "internal" borrowing rate is significantly cheaper than the cost of external borrowing and is a prudent use of the Council's cash balances, unless the conditions in para 4.3.1 (1) apply.

4.4.3 As at the 31 March 2015 the Council had total external borrowing of £215,520,263. The General Fund had £3,605,263 external borrowing, £1,500,000 with another local authority and the remainder with the PWLB. The HRA had external borrowing of £211,915,000 all with the PWLB. The majority of the HRA debt (£194,911,000) was taken out in March 2012 to finance the payment required to central government for self-financing. This debt was arranged over a number of loans with fixed rates and with varying maturities. As at 31 March 2015, the HRA also had £1,727,504 internal borrowing.

4.4.4 The HRA borrowing includes £17,004,000 used to fund the pre 2012 decent homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio.

4.4.5 HRA borrowing is constrained by legislation (unlike the General Fund) and is capped at £217,685,000. As at the 31 March 2015 the "head room" available for new HRA borrowing was £4,042,496.

4.4.6 The Council's CFR for the year is shown below, and is one of the key prudential indicators.

Table Two : Capital Financing Requirement 2013/14 and 2014/15			
CFR Calculation	31 March 2014 (£'000)	31 March 2015 (£'000)	Movement in Year (£'000)
Opening Balance	230,095	229,397	
Closing Capital Financing Requirement (General Fund)	15,755	16,440	685
Closing Capital Financing Requirement (Housing Revenue Account)	213,642	213,643	1
Closing Balance	*229,397	230,083	
Increase/ (Decrease)	(698)	686	686

**There has been a correction to the CFR for 2013/14 of £132k to that previously reported*

4.4.7 The HRA CFR has increased by £1,000 in year due to the appropriation of a General Fund vehicle to the HRA. There were no HRA repayments of debt made in 2014/15, there are repayments of £5.5Million during 2015/16.

4.4.8 The General Fund CFR has increased by £684,606 in year as a result of: the vehicle appropriated to the HRA (reducing the CFR), the Minimum Revenue Provision (MRP) made in year (reducing the CFR) and the additional prudential borrowing needed to fund the capital scheme for 2014/15 (increasing the CFR).

4.4.9 The Council could reduce its CFR by:

- the application of additional capital financing resources (such as unapplied capital receipts) if available; or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP) which would increase the cost to the General Fund or HRA.

4.5 Minimum Revenue Requirement (MRP)

4.5.1 The Council must make its borrowing decisions in accordance with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing for the General Fund is affordable. The Council's MRP policy, as required by CIPFA (Chartered Institute of Public Finance and Accountancy) guidance, is approved annually by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement and the life of the assets for which borrowing was required.

4.5.2 MRP will need to be made regardless of whether actual external borrowing has been taken and hence differs from the treasury management arrangements, the latter considers utilising cash balances when borrowing rates are relatively high compared to investment interest earned (as in paragraph 4.4.2).

4.5.3 In 2014/15 the MRP charged to the General Fund was £623,090.

4.6 Other indicators

4.6.1 The treasury management indicators for 2015/16 onwards have been calculated based on the updated Capital Strategy reported to Executive (14 July 2015) and for any further known adjustments. The 2015/16 Capital Strategy was rebased as part of the Integrated Financial Planning process and there will be a further round of capital bidding for the period 2017/18 to 2019/20 as part of the 2016/17 budget setting process and as such the data relating to future years is indicative only and will be subject to change.

4.6.2 The net borrowing position of the Council as at 31 March 2015 was £166,570,263 of borrowing (total borrowings/loans of £215,520,263 less total investments held of £48,950,000).

4.6.3 The operational boundary and authorised limit refer to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. There were no breaches of either limit in 2014/15.

4.6.4 The ratio of financing costs to net revenue stream (General Fund interest costs divided by the General Fund net revenue income from Council Tax and RSG/NDR). The 2014/15 indicator is 7.09%, 2.77% lower than the estimated 9.86% as the Council used investment balances instead of borrowing to finance its capital programme.

4.6.5 The full list of Treasury Prudential Indicators is shown on Appendix A updated for the 2014/15 out-turn position and revised 2015/16 estimates.

4.7 Treasury Position 31 March 2015

4.7.1 The Council's debt and investment position is managed by the treasury management section to ensure adequate liquidity for revenue and capital activities. In addition investment decisions are based on the security of the investments and spread over a number of counter parties to manage the Council's exposure to risk.

4.7.2 The Council's average investment returns are low reflecting the 0.50% Bank of England Base Rate. In 2014/15 the average rate of interest earned was 0.50% compared to 0.56% earned in 2013/14. However, this still exceeded the 7 day LIBID benchmark rate of 0.35% (source: CAPITA).

4.7.3 In response to increasing cash balances the counterparty limit was increased in the Annual Treasury Management Review 2013/14/Mid-Year Review Report 2014/15 report approved by Council October 2014 as part of the Treasury Management Strategy updates.

4.7.4 In the Treasury Management Strategy approved by Council February 2015 the fixed rate investment limit increased for the remainder of 2014/15 and 2015/16, the latter enabling access to a higher volume of longer term investments and therefore higher returns. Despite this the average rate earned for 2014/15 has remained low as the change happened too late in the year to have any significant impact.

4.7.5 Table three illustrates the rates available to the Council over different terms as at 31st July 2015.

Table Three : Fixed Term Investment Rates Quoted as at 31st July 2015					
Term	HSBC	DMO	Barclays	Nationwide	Lloyds
	%	%	%	%	%
1 Month	0.23	0.25	0.32	0.43	0.40
2 Months	0.28	0.25	0.40	0.46	not quoted
3 Months	0.28	0.25	0.53	0.50	0.57
6 Months	0.38	0.25	0.69	0.66	0.70
9 Months	0.43	not quoted	0.86	0.79	0.80
1 Year	0.48	not quoted	1.02	0.90	1.00
2 Years	not quoted	not quoted	not quoted	not quoted	not quoted
3 Years	not quoted	not quoted	not quoted	not quoted	not quoted
5 Years	not quoted	not quoted	not quoted	not quoted	not quoted

4.7.6 While borrowing costs for loans of between 8 to 10 years are around 2.5-3.0% it is still prudent to utilise the Council's high cash balances (as shown in paragraph 4.3.4) for short-term internal borrowing. However, as borrowing costs start to increase this position may change as future borrowing becomes more expensive. The decision and timing of when to borrow is being monitored by officers.

4.7.7 The Council's treasury position for the year was as follows;

Table Four Treasury Position as at 31 March 2015						
	2013/14			2014/15		
	31 March 2014 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2015 Principal £'000s	Rate / Return %	Average Life (Yrs)
Fixed rate loans - PWLB	214,283	3.37	19.50	214,020	3.37	18.27
Local Authority Loans	1,500	1.98	5.00	1,500	1.98	3.26
Total Borrowing	**215,783**	**3.34**	**19.50**	**215,520**	**3.34**	**18.14**
CFR	229,397			230,083		
Over/(under) borrowing*	(13,614)			(14,563)		
Investments Portfolio	**24,920**	**0.56**		**48,950**	**0.50**	

** financed by internal borrowing.*

Increase in Under-Borrowing as at 31st March 2015	£'000's
Prudential borrowing identified for 2014/15 Capital Programme	1,309
Actual borrowing taken out in year	0
Actual borrowing repaid in the year	263
MRP reduces CFR, consequently reduces the under-borrowing by	(623)
Total Effect is to increase Under-Borrowing	949

Under-Borrowing 2014/15			
	CFR £'000	Gross Borrowing £'000	Unfinanced CFR £'000
Regeneration	7,743	3,605	4,138
General Fund	8,697	0	8,697
HRA	213,643	211,915	1,728
Total	**230,083**	**215,520**	**14,563**

Note: Original 2014/15 Prudential Indicators based on the Capital Programme approved by Executive 21 January 2014, 2014/15 Mid Year Review Prudential Indicators based on Capital Programme approved at Special Council meeting 26 August 2014

4.7.8 The maturity structure of the debt portfolio was as follows (see also Appendix B):

Table Five Maturity of Debt Portfolio for 2013/14 and 2014/15		
Time to maturity	**31 March 2014 Actual £'000's**	**31 March 2015 Actual £'000's**
Maturing within one year	263	5,763
1 year or more and less than 2 years	5,763	263
2 years or more and less than 5 years	5,504	6,030
5 years or more and less than 10 years	1,579	789
10 years or more	202,674	202,674
Total	**215,783**	**215,520**

4.7.9 There is one investment of £2 Million with Glasgow City Council which is due to mature early December 2017. All other investments held during 2014/15 were due to mature within one year. A summary of the Council's exposure to fixed and variable rate investments is shown below in Table Six. (See also Appendix B).

Table Six : Fixed and Variable Rate Investment Totals		
	31 March 2014 Actual £'000's	**31 March 2015 Actual £'000's**
Fixed rate principal	3,000	15,800
Variable rate principal	21,920	33,150
Total	**24,920**	**48,950**

4.7.10 The Debt Management Office (DMO) is used as a 'safe haven' and the Treasury Management Strategy allows for unlimited deposits here. When cash balances are high the DMO is used so that counter party limits are not breached. No investments have been deposited with the DMO since October 2014 when Treasury Management limit changes were implemented.

4.8 Compliance with Prudential Limits 2014/15

4.8.1 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

4.8.2 The full list of approved Treasury Prudential Indicators and their corresponding actual expenditure for 2014/15 are shown in Appendix A.

4.9 Economic Review & Interest Rate Outlook

4.9.1 **UK Growth** - UK GDP growth was 0.8%, 0.6% and 0.6% in quarters 2, 3 and 4 respectively in 2014, and 0.4% in the first quarter of 2015.

4.9.2 **Wage inflation** – The unemployment rate among those aged 16 and above, has fallen over the last year to 5.7% (February 2015). Average disposable income is only starting to gradually increase as a result of wage inflation now running marginally above the depressed rate of CPI inflation, though some consumers will not have seen that benefit come through for them.

4.9.3 **UK Credit Rating** - In June 2014, Standard & Poor restored the UK's AAA credit rating by removing the 'negative outlook' to reflect the broadening economic recovery in the UK. There has been no change to the UK credit rating of AA+ by Moody (February 2013) or Fitch (April 2013).

4.9.4 **UK Debt** - The March 2015 Budget forecasted borrowing to decrease to £90.2bn by the end of 2014/15, and to further decrease to £75.3bn in 2015/16 and an overall surplus of £5.2bn is anticipated in 2018/19.

4.9.5 **Inflation -** Consumer Price Index (CPI) slipped into deflation in April 2015 at -0.10% and in May 2015 CPI was 0.10% due to increased petrol prices. This is below Monetary Policy Committee (MPC) target of 2%, it is forecast that there will be a rise in inflation to being slightly above the 2% target in two to three year time.

4.9.6 **Interest Rate** – 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. The latest forecast by the Council's Treasury advisor Capita Asset Services is an increase in the Base Bank Rate in Quarter 2 of 2016.

4.9.7 Capita Asset Services has provided the following interest rate forecast (as at 23 July 2015):

Economic Forecasts – Capita Asset Services July 2015

	End Q3 2015	End Q4 2015	End Q1 2016	End Q2 2016	End Q3 2016	End Q4 2016	End Q1 2017	End Q2 2017	End Q3 2017	End Q4 2017	End Q1 2018
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2014/15. Any consequential financial impacts of the Strategy have been reflected in the July Capital Strategy update and the 4th Quarter 2014/15 budget monitoring report.

5.2 Legal Implications

5.1.2 Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.2 Risk Implications

5.1.3 The table below identifies the risks if the recommendations are agreed. The risks have been assessed in accordance with the Council's risk management strategy.

Description of risk		Mitigation	Residual Risk Level
1.	Investment balances increase and monies placed with banking groups exceed approved Counter Party Limits	The Treasury Team would actively seek to find alternative Counter Parties to lend to, or seek Council approval to increase the Counter Party Limits	M
2.	There is an increase in the capital programme which cannot be resourced from available resources and can exceed the Council's borrowing limit.	Operational and authorised boundary should have sufficient headroom above CFR to meet the Council's borrowing requirement arising from the Capital Strategy.	L
3	The Council is unable to defer spend within the General Fund capital programme in future years or identify resources to fund the unsupported borrowing in the Capital Strategy.	This would increase the cost of borrowing to the General Fund and would require funding.	M
4	The Council invests funds with a bank which is unable to meet the repayment.	The Counter Party ratings are reviewed on a weekly basis and should prevent placing funds with banks at risk. The Council has a very strict lending criteria.	L

Note: Original 2014/15 Prudential Indicators based on the Capital Programme approved by Executive 21 January 2014, 2014/15 Mid Year Review Prudential Indicators based on Capital Programme approved at Special Council meeting 26 August 2014

5.4 Equalities and Diversity Implications

5.4.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

BACKGROUND DOCUMENTS

- BD1 Annual Treasury Management Review 2013/14 and Mid-Year Review Report 2014/15 (8 October 2014 Council) http://www.stevenage.gov.uk/content/committees/117036/117040/117104/124299
- BD2 Prudential Code Indicators and Treasury Management Strategy 2014/15 (26 February 2014 Council) http://www.stevenage.gov.uk/content/committees/87812/87816/87820/Council-26-February-2014-Item12.pdf

APPENDICES

- Appendix A – Prudential Indicators 2014/15 Actuals, 2015/16 revised
- Appendix B – Investments and Borrowing Portfolio

Note: Original 2014/15 Prudential Indicators based on the Capital Programme approved by Executive 21 January 2014, 2014/15 Mid Year Review Prudential Indicators based on Capital Programme approved at Special Council meeting 26 August 2014