Classification:
Part 1 – Public
Key Decision:
No

Gravesham Borough Council

Report to:	Finance and Audit Committee
Date:	23 June 2015
Reporting officer:	Assistant Director (Finance)
Subject:	Annual Treasury Management Review 2014-15

Purpose and summary of report:

To report on treasury management activity during 2014-15 in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) revised code on Treasury Management 2009.

Recommendations:

The Finance and Audit Committee note the contents of this report.

1. INTRODUCTION

1.1 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).

1.2 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 25 February 2014)
- mid year (minimum) treasury update report (Council 2 December 2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 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.

1.4 This Council also 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 Finance and Audit Committee before they were reported to the Full Council.

2. THE ECONOMY AND INTEREST RATES

2.1 Capita Asset Services Treasury Solutions are currently contracted to act as treasury advisors to the Council, the following summary on the economic climate is provided by them.

2.2 The original market expectation at the beginning of 2014-15 was for the first increase in Bank Rate to occur in quarter 1 of 2014-15 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May 2014, however, the Bank of England 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. In August 2014 the Bank of England 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.

2.3 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 not going to be able to ward off the threat of deflation and recession in the Eurozone. By the end of 2014, it became clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. Consequently it was considered unlikely that the Monetary Policy Committee would start to raise the Bank Rate in 2015 while inflation was around zero and so market expectations for a first increase receded back to 2016.

2.4 There were fears within financial markets about the future of the wider Eurozone economy after the anti-austerity parties won power in Greece in January 2015; developments since then have only heightened fears that Greece might head towards an exit from the euro sooner rather than later. While the European Union and ECB might be able to manage the direct consequences of this, it is very hard to quantify quite what the potential knock-on effects of this would be on other countries in the Eurozone once the theoretical 'impossibility' of a country leaving the Eurozone has been disproved. There was also an increase in concerns around the political risks from an uncertain outcome of the UK general election due in May 2015. On the other hand, strong growth in the US led to an increase in confidence that the US was well on the way to make 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.

3. OVERALL TREASURY POSITION

3.1 The Council's treasury position at the beginning and the end of 2014-15 was as follows:

	31 March 2014 Principal £m	Rate/ Return	31 March 2015 Principal £m	Rate/ Return	Average Life
Total Debt	£109.433	2.975%	£107.369	3.020%	8.60 years
Capital Financing Requirement (CFR)	£110.659	-	£108.471	-	-
Over/ (Under) borrowing	(£1.226)	-	(£1.102)	-	-
Total Investments	£15.845	0.696%	£25.095	0.565%	129.6 days
Net Debt (Total Debt minus Total Investments)	£93.588	-	£82.274	-	-

4. THE STRATEGY FOR 2014-15

4.1 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.

4.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

4.3 Public Works Loan Board (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 BORROWING REQUIREMENT AND DEBT

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2014 Actual £m	31 March 2015 Revised Estimates £m	31 March 2015 Actual £m
CFR General Fund (£m)	£11.001	£10.797	£10.797
CFR HRA (£m)	£99.658	£97.674	£97.674
Total CFR	£110.659	£108.471	£108.471

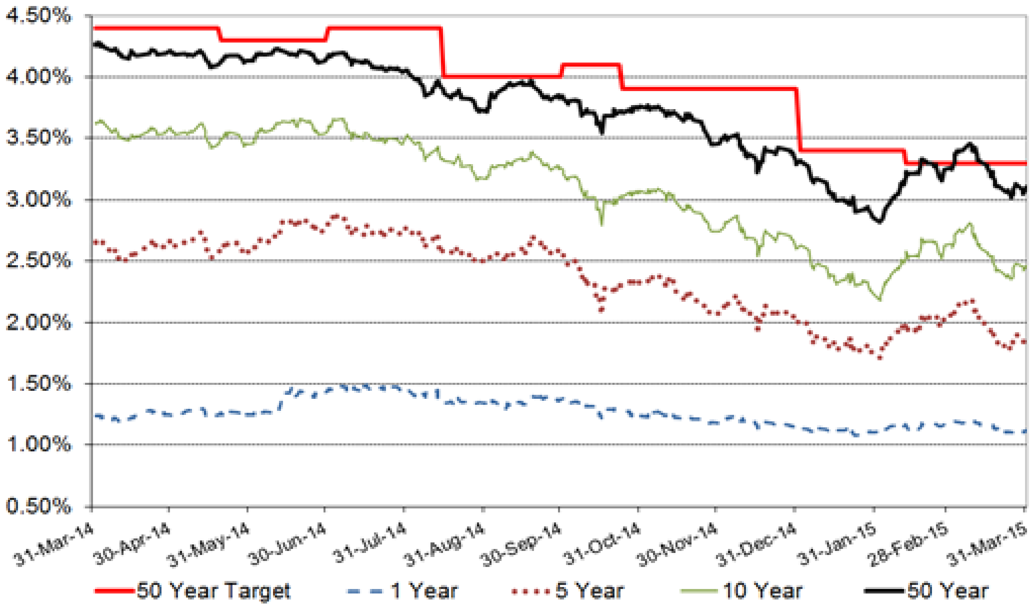
5.1 The overall actual Capital Financing Requirement for 2014-15 was as per the Revised Estimates for the year.

5.2 The general fund CFR continues to include £2m relating to the Council entering into the Local Authority Mortgage Scheme in February 2013. The CFR will be reduced accordingly at the end of the scheme when the indemnity is repaid to the authority.

6. BORROWING RATES IN 2014-15

6.1 **PWLB borrowing rates -** the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.

2014-15 PWLB new borrowing rates 1 to 50 yrs



7. BORROWING OUTTURN FOR 2014-15

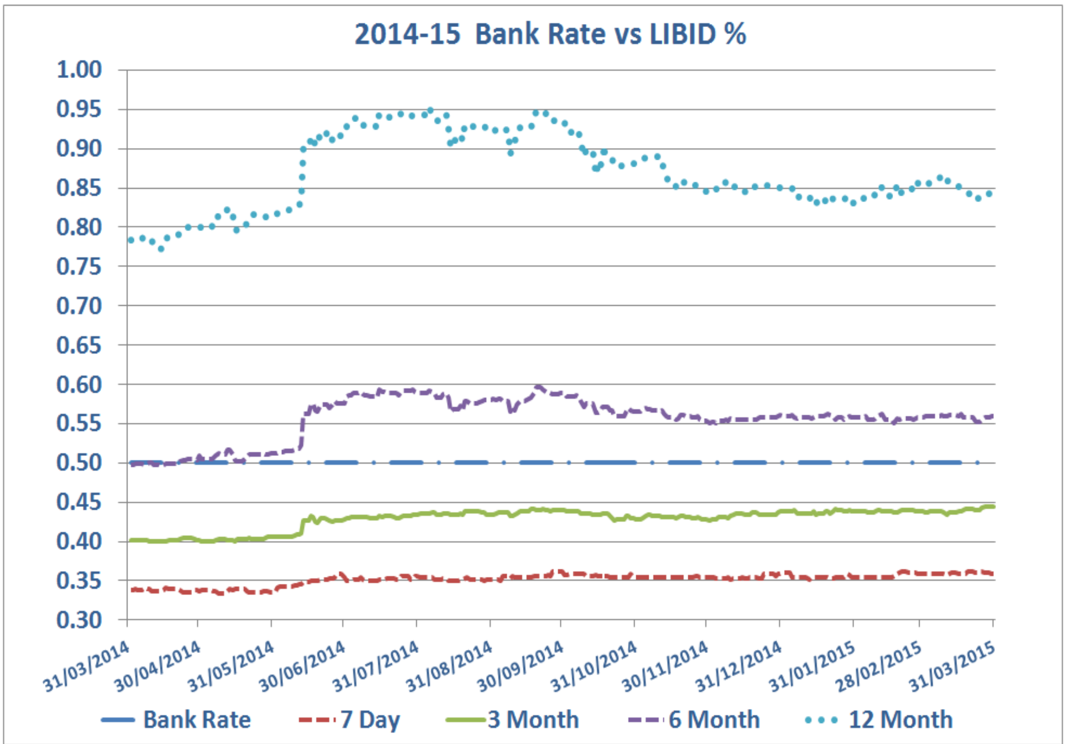
7.1 Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during 2014-15.

7.2 No rescheduling of debts was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.3 On 30 March 2015, a further loan the Council had taken on as a result of HRA self-financing matured. Loan principal totalling £1,984,000 was repaid. The Council has made a voluntary contribution of Minimum Revenue Provision (MRP) equal to the loan principal in order to reduce the CFR accordingly.

8. INVESTMENTS RATES IN 2014-15

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



* London Interbank Bid Rate (LIBID) is the average interest rate which major London banks borrow Eurocurency deposits from other banks.

9. INVESTMENT OUTTURN FOR 2014-15

9.1 **Investment Policy** – the Council's investment policy is governed by the Department for Communities for Local Government (CLG) guidance, which was been implemented in the Annual Investment Strategy approved by the Council on 25 February 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.).

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

9.3 **Investments held by the Council -** the Council maintained an average balance of £26,715,000 of internally managed funds. The internally managed funds earned an average rate of return of 0.578%. The weighted average maturity for the investments was 150 days. The 3 month LIBID rate which is used as the most appropriate comparative performance indicator was 0.439%. Despite the continued low investment yields offered by financial markets, the average rate of return exceeded the benchmark by 0.139%.

10. RISK MANAGEMENT

10.1 The Council has complied with relevant statutory and regulatory requirements which limit the levels of risk associated with the treasury management activities. Nevertheless any such risks associated with this function are managed through the Treasury Management Strategy and the Annual Investment Strategy.

11. BACKGROUND PAPERS

11.1 There are no Background Papers pertaining to this Report.

Prudential and treasury indicators Appendix 1

1. PRUDENTIAL INDICATORS	2013-14	2014-15	2014-15
	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	£1,251	£2,530	£3,206
HRA	£8,696	£8,882	£9,338
TOTAL	£9,947	£11,412	£12,544
Ratio of financing costs to net revenue stream (This is the proportion of annual debt financing costs as a percentage of the council's annual budget requirement)			
Non - HRA	2.83%		2.72%
HRA	20.41%		19.06%
Gross borrowing requirement			
brought forward 1 April	£111,557	£109,433	£109,433
carried forward 31 March	£109,433	£107,367	£107,369
in year borrowing requirement	£2,124	£2,066	£2,064
Gross Debt	£109,433	£107,367	£107,369
Capital Financing Requirement (CFR) as at 31 March (This is the amount of capital spending that has not been financed by capital receipts, capital grants of contributions from revenue)			
Non – HRA	£11,001	£10,767	£10,797
HRA (applies only to housing authorities)	£99,658	£97,704	£97,674
TOTAL	£110,659	£108,471	£108,471
Annual change in Cap. Financing Requirement			
Non – HRA	(£2,074)	(£204)	(£204)
HRA (applies only to housing authorities)	(£180)	(£1,984)	(£1,984)
TOTAL	(£2,253)	(£2,188)	(£2,188)
Incremental impact of capital investment decisions	£ p		£ p
Increase in council tax (band D) per annum *	£2.78		£3.08
Increase in average housing rent per week	N/A		N/A

2. TREASURY MANAGEMENT INDICATORS	**2013/14**	**2014/15**	**2014/15**
	Actual	**Original**	**Actual**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a temporary basis to manage cash flow demands)			
borrowing	£126,500	£126,500	£126,500
other long term liabilities	£1,600	£1,600	£1,600
TOTAL	£128,100	£128,100	£128,100
Operational Boundary for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a day to day basis and must not be breached other than for temporary cash flow demand purposes)			
borrowing	£125,000	£125,000	£125,000
other long term liabilities	£1,500	£1,500	£1,500
TOTAL	£126,500	£126,500	£126,500
Actual external debt	£109,433	£107,368	£107.368
Upper limit for fixed interest rate exposure			
Net interest re fixed rate borrowing / investments	100 %	100 %	100 %
Upper limit for variable rate exposure			
Net interest re variable rate borrowing / investments	25 %	25 %	25 %
Upper limit for total principal sums invested for over 364 days	£10,000	£10,000	£10,000

Maturity structure of fixed rate borrowing during 2014/15	Lower limit	Upper limit
under 12 months	0%	50%
12 months and within 24 months	0%	50%
24 months and within 5 years	0%	75%
5 years and within 10 years	0%	75%
10 years and within 15 years	0%	100%
15 years and within 20 years	0%	100%
Greater than 20 years	0%	100%

Note: The figures shown in the tables above reflect the position as at the date of reporting. They are subject to change during the final accounts process.

<table>
<tr><th>IMPLICATIONS</th><th>APPENDIX 2</th></tr>
<tr><td>Legal</td><td>As per Section 1.13B.67 of the Council’s constitution, the Chief Finance Officer has delegated responsibility from Cabinet

“in respect of borrowing and investments to arrange such loans as are legally permitted to meet the Council’s borrowing requirements”</td></tr>
<tr><td>Finance and Value for Money</td><td>Due to the nature of the report, the financial implications are contained throughout the report.

In order to achieve a balanced budget, the authority relies upon generating maximum interest from its investments whilst minimising the exposure to risk. In order to achieve this, investments are only placed with institutions which are included on the investment counterparty list. Investment durations do not exceed those as advised by Capita Asset Services - Treasury Solutions credit ratings which are associated with the specific institutions.

Where the authority is required to borrow to meet the needs of the authority, officers will seek advice from Capita Asset Services on timings and options in order to ensure the best deal for the authority.</td></tr>
<tr><td>Risk Assessment</td><td>A summary of the perceived risks associated with Treasury Management were identified in the Treasury Management Strategy approved by Council on 25 February 2014. Officers continue to monitor the risks on a day to day basis and identify mitigating actions to minimise the risks.</td></tr>
<tr><td>Equality Impact Assessment</td><td>
<table>
<tr><th colspan="3">Screening for Equality Impacts</th></tr>
<tr><th>Question</th><th>Answer</th><th>Explanation</th></tr>
<tr><td>a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?</td><td>No</td><td></td></tr>
<tr><td>b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?</td><td>N/A</td><td></td></tr>
<tr><td>c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?</td><td>N/A</td><td></td></tr>
<tr><td colspan="3">In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above</td></tr>
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Corporate Business Plan	Area of Focus – 17: Managing the Council's Business
Crime and Disorder	Treasury Management activities are carried out in accordance with the Treasury Management Strategy and Annual Investment Strategy which minimises the risk of criminal activities.