

TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 30 JUNE 2014

TREASURY MANAGEMENT - 2013/14 ANNUAL REPORT AND 2014/15 TO DATE

REPORT OF THE ASSISTANT DIRECTOR: FINANCE, AUDIT & INFORMATION GOVERNANCE (CHIEF FINANCIAL OFFICER)

PART A) – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

The report updates members on the outcome of Treasury Management activities for 2013/14 and details the position for 2014/15 to date.

2013/14 Treasury Outturn

The treasury portfolio ended the year with net indebtedness of £102.1m (borrowing: £125.6m less investments: £23.5m), an increase of £22.9m compared to the position at 31 March 2013. Base rate was 0.5% for the whole year and is predicted to stay at 0.5% until 2016.

The borrowing strategy for 13/14 was to use maturing investments to reduce borrowing where possible. Borrowing was £15m higher at 31 March 2014 compared to 31 March 2013 which was due to capital expenditure that led to an increase in temporary borrowing at year end. Short term borrowing was used to fund short term cash flow requirements during the year at favourable interest rates.

The investment strategy for 13/14 was to gain maximum benefit with security of capital being the key consideration. The average return on investments for the year was 3.38% against a benchmark of only 0.41%; further, comparative information from our treasury advisors, Arlingclose, highlights that our rate of return is once again very significantly higher than their other local authority clients.

Overall, treasury delivered a net over-achievement of £1.546m against the budget in 2013/14. This includes £0.250m generated as a one-off saving in 2013/14 as a result of changing our accounting policy in relation to capitalisation of interest on capital projects pending their completion. As well as generating a significant one-off revenue benefit this change in accounting policy will also help facilitate commercial developments (including potentially building houses for rent) more in line with private sector practices.

A very significant one-off benefit of £4.884m was also generated from back-dating the change in accounting treatment of the calculation of Minimum Revenue Provision – this has been transferred to a reserve in accordance with the agreed service and financial planning strategy for 2014/15 to fund the debt charges for the Pride in Your Community Initiative for the next 12 years.

In total, therefore, treasury management activities contributed one off benefits to the Council totalling just under £6.5m over budget assumptions during the year – equivalent to around £90 for every household in the Borough.

2014/15 Update

The strategy for 2014/15 remains consistent with that of the previous year. Investment opportunities will be reviewed as they arise, where possible maturing investments will be used to reduce the need to borrow, and we will seek to gain maximum benefit within the agreed risk parameters.

All the temporary borrowing (£26m) at 31/3/14 has been repaid and there has been no new borrowing undertaken to date in 2014/15. Investments were £35m at 31 May 2014.

On Thursday 12th June the Governor of the Bank of England, Mark Carney, in his Mansion House speech, indicated that interest rates may have to increase sooner than assumed by the market. This will have to be taken account of in the Council's Treasury activities in 2014/15.

Prudential Indicators

There are a number of amendments to prudential indicators to accommodate very significant capital regeneration projects.

2. RECOMMENDATIONS

Audit Committee Members are asked to:-

- 2.1 note the contents of the report
- 2.2 note the performance against Prudential Indicators.
- 2.3 approve the proposed amendment to non UK sovereign counterparty limits
- 2.4 recommend that Council approves the increases in Authorised and Operational limits for 2014/15 to facilitate the Council to potentially undertake very significant capital regeneration investments of a commercial nature and approve the other changes to prudential indicators

3. SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT Do these proposals contribute to specific priority plan objectives?

Yes/No Efficient Community Focussed Council

Will the proposals impact on specific groups of people?

Yes/No

**TARGET
COMPLETION /
DELIVERY DATE**

Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.

FINANCIAL/VALUE FOR MONEY IMPACT	Yes/No	Where appropriate these are detailed in the body of the report.
LEGAL ISSUES	Yes/No	The AD: Finance, Audit and IG (Section 151 Officer), has responsibility for the administration of the financial affairs of the Council. In providing this report the Section 151 Officer is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee."
OTHER IMPACTS, RISKS AND OPPORTUNITIES	Yes/No	The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.
IMPACT ON SPECIFIC WARDS	Yes/No	

4. **PREVIOUS MINUTES**
 Council 7 March 2013
 Audit Committee 25 June 2013
 Audit Committee 28 January 2014
 Council 27 February 2014

PART B – ADDITIONAL INFORMATION

5. **BACKGROUND**

Treasury Management in local government is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services: Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities.

A requirement of the Council's Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council's treasury management activities in that year (this annual treasury report).

6. 2013/14

The annual report is covered in paragraphs 6-15 and deals with: -

- 2013/14 Portfolio position;
- the borrowing strategy for 2013/14;
- the borrowing outturn for 2013/14;
- compliance with treasury limits;
- investments strategy for 2013/14;
- investments outturn for 2013/14;
- debt rescheduling;
- Shropshire Council debt
- overall outturn position
- leasing

7. 2013/14 PORTFOLIO POSITION

The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2013		31 March 2014	
	Principal £m	Rate %	Principal £m	Rate %
Borrowing	110.614	3.49	125.583	3.37
Investments	31.426	3.86	23.510	3.38
Net Indebtedness	(79.188)		(102.073)	

There was new temporary borrowing and repayment of £11m PWLB during 2013/14; temporary borrowing was £26.1m at 31 March 2014. The capital programme was funded from a combination of borrowing, capital receipts, grants and other external contributions plus funds from maturing investments; this has resulted in an increase in net indebtedness during the year. Prudential borrowing increased in 2013/14 due to planned capital expenditure approved as part of the capital programme.

The Adopted Treasury Strategy was to:-

- Monitor borrowing opportunities determined by the prevailing markets.
- To use maturing investments to reduce borrowing where possible.
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- To achieve optimum return on investments commensurate with proper levels of security and liquidity.

9. COUNCILS RESPONSE TO ECONOMIC CLIMATE

- 9.1 2013/14 saw continued difficulties with both sovereign and individual bank credit ratings. Base rate remained at 0.5% throughout the whole of 2013/14. The UK economy has started to improve but the Monetary

Policy Committee remains cautious. Base rate has generally been predicted to stay at 0.5% until mid 2016 although Mark Carney, Governor of the Bank of England has recently indicated that the first rate increase may be sooner than generally expected.

9.2 The Council has reduced both the amount and duration of its investments and as other investments mature, total investments will be reduced further. These funds were used to reduce the need to borrow and reduce exposure to investment risk.

9.3 We have closely followed guidance issued by our Treasury Advisors in relation to credit ratings, financial standing and duration.

10. **BORROWING 2013/14**

10.1 **Original Economic Projections**

The Expectation for Interest Rates – When the budget was set for 2013/14 the “average” City view anticipated that Bank Rate would remain at 0.5% until mid 2015 before starting to rise gradually back towards more normal levels in 2015, though Bank Rate would take a long time to return to around 4.5%.

10.2 **Outturn 2013/14**

During 2013/14 the Monetary Policy Committee (MPC) was focused on helping the economy to recover, but with inflation falling to target level.

The MPC also maintained the level of quantitative easing at £375bn.

The dominant focus in 2013/14 was on quarterly GDP growth figures and the unemployment rate. Overall for 2013/14 the economy grew by 2.7%.

Inflation had been a major concern of the MPC but this has fallen from 2.8% in March 2013 to 1.6% in March 2014. Inflation is predicted to increase back to the 2% target level within the 2 year horizon.

Borrowing and Investment Rates in 2013/14

The overnight investment rate has varied little during the year. The 3 month investment rate has fallen slightly during the year to stand at 0.38% at year end having started the year at 0.44%.

Treasury Borrowing and Rescheduling

The borrowing strategy for the current year has been to use maturing investments to reduce the Council’s exposure to interest and market volatility and reduce borrowing where possible.

During the year we borrowed no new PWLB loans, although we did have some maturities totalling £11m.

PWLB Repayments & Discounts

No loans were repaid early or rescheduled during the year.

An analysis of the maturity structure of our debt is shown below.

Analysis of Debt Maturity as at 31st March

	2013		2014	
	£'000	%	£'000	%
Maturing in less than 1 year	11,093	10.0	37,063	29.5
Maturing in 1-2 years	11,001	9.9	1,001	0.8
Maturing in 2-5 years	3,002	2.7	3,002	2.4
Maturing in 5-10 years	2,506	2.3	1,506	1.2
Maturing in more than 10 years*	<u>83,012</u>	75.1	<u>83,011</u>	66.1
	<u>110,614</u>	100.0	<u>125,583</u>	100.0

* this includes £60m LOBO (Lenders Option Borrowers Option) loans that are potentially callable at certain points before the maturity date. There is therefore the potential that these loans would have to be replaced sooner exposing the council to the prevailing market at that time. To-date, none of our LOBOs have been called before maturity.

Debt Performance

As highlighted in section 7 the average debt portfolio rate has fallen over the course of the year from 3.49% to 3.37%. This is due to temporary borrowing the council undertaken in 2013/14 as compared to 2012/13. The low rates of this in 2013/14 reduced the overall interest rate of the portfolio in that year.

11. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the Treasury Limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement apart from borrowing exceeding the operational limit for some of the year due to a significantly changed pattern of cashflows arising from the new local government finance system introduced on 1st April 2013 and previously advised to Audit Committee members. However at all times we remained within the Council's Authorised Borrowing Limit and there are no consequences for the temporary breach of the operational limit. The outturn for the Prudential Indicators are detailed in Appendix 1 which shows that no limits were breached during the year.

12. INVESTMENTS 2013/14

12.1 Strategy

Internally Managed Investments - The authority currently manages all of its investments in-house and invests within the institutions complying with its counterparty limits and credit ratings. Some investments are short term related to cash flows and others include longer term investment instruments that benefited returns in 2013/14.

Investment Strategy - The agreed short term investment strategy for 2012/13 was to achieve optimum return on investments commensurate with proper levels of security and liquidity and to use maturing investments to reduce the need to borrow, where possible.

12.2 Outturn 2013/14

Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return *
<u>Internally Managed</u>				
Investments	£46.609m	3.38%	3.38%	0.41%

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year. This performance is significantly better than all other local authority clients of our Treasury Management Advisors, Arlingclose.

13. SHROPSHIRE COUNCIL DEBT

The Council makes an annual contribution (£1.968m in 2013/14) towards County Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.56% last year. The rate of interest paid on this is managed by Shropshire and is considerably higher than the rate payable by Telford & Wrekin Council on its borrowing.

14. OVERALL OUTTURN FOR 2013/14

The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus proactive treasury management activities. The budget reflected the position when the budget was set, the underspend has been achieved through active management of debt principal and the low interest rates prevailing for the year. Overall a net saving of just over £1.5m was made against budget for the year with a further one-off benefit of £4.884m arising from the change in accounting policy relating to the calculation of Minimum Revenue Provision.

Summary of Outturn Position

	Estimate £m	Outturn £m	Variance £m
Interest Received	(1.275)	(1.581)	(0.306)
Principal Repayments	5.314	4.562	(0.752)
MRP saving from change of policy	0.000	(4.884)	(4.884)
Set up MRP provision	0.000	4.884	4.884
Capitalisation of Interest	(0.000)	(0.252)	(0.252)
Interest Paid	4.380	4.095	(0.285)
Net Position	10.374	8.828	(1.546)

15 **LEASING**

Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

The final drawdown for 2013/14 was completed in March. The drawdown from Siemens totalled £0.052m and funded the purchase of gym equipment over five years at an interest rate of 2.05%.

16. **2014/15 UPDATE**

The remainder of this report deals with the current financial year based largely on information to 31 May 2014.

16.1 **Strategy**

The strategy for 2014/15 is to continue to use maturing investments, where possible, to reduce the need to borrow thus reducing investment exposure. We will review investment opportunities if they arise and also review borrowing opportunities as we progress through the year and look to take advantage of the advantageous interest rates if possible. 2014/15 and 2015/16 could see the Council investing in significant regeneration projects including the MoD logistics hub and building homes and commercial property for rent to the private sector as well as potential investment in a solar farm. As referred to in the Council's 2014/15 Service and Financial Planning Strategy report, investment in these projects would necessitate an increase in the Council's borrowing limits and this report recommends that as the business cases are now being fine tuned that it is appropriate to increase these limits to facilitate these investments subject to final agreement of the business cases.

16.2 **Interest Rates**

Base rate began the year at 0.5% and has remained there. The current expectation is that there will be no increase before June 2016.

16.3 **Prudential Regime**

This Council agreed its required indicators at Council on 27 February 2014. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £220m for 2014/15 and an Authorised limit of £234m. Our total borrowing outstanding (including PFI) is £159m which is within both limits.

16.4 **Borrowing**

We have not taken any new borrowing in 2014/15 and have had no maturities to-date. In total we have £11m maturing during 2014/15.

16.5. **Internally Managed Investments**

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the 7 day deposit rate. As mentioned above, we will also continue to use maturing investments, where possible, to reduce the need to borrow. For the period to 31 May 2014 some £438m worth of investments have been made in our overnight call

accounts. Rates have ranged from 0.35% to 0.40%. As at 31 May 2014 internal investments stood at £34.97m.

Potentially the Council can place up to £20.0m with any Counterparty. At the end of May the greatest exposure with a single counterparty was £19.9m with Santander (56.9% of the portfolio). We currently have no investments with non UK sovereigns. A detailed breakdown is shown in Appendix 2.

16.6 Non UK Sovereign Counterparty Limits

At present we have a non UK sovereign counterparty limit set at 20% of the portfolio. This was set when we had a much greater level of external investments, since then we have reduced both the total amount and length of our external investments. Since most of our investments are short term for cashflow purposes and the amount of investments can vary constantly a limit of 20% is difficult to manage from a treasury perspective. **We are therefore proposing to amend this limit to a total of £20m for all investments with any non UK sovereigns, but always subject to them meeting our requirements in terms of security of the counterparty.**

16.7 Amendments to Prudential Indicators for 2014/15

The Council is considering undertaking 2 major capital regeneration projects (Housing and MOD), as well as potentially building a solar farm and to accommodate the additional spending in 2014/15 it is necessary to increase a number of prudential indicators as follows;. The Authorised and Operational limits can only be approved by Full Council.

- **Capital Expenditure. It is anticipated that an additional £51m will be spent in 2014/15. This will increase capital expenditure from £115.650m approved by Council in February to £166.650, of which £51.304m will be prudential.**
- **Gross Debt will increase from £133.3m to £184.3m for borrowing and £244.7m in total.**
- **Capital Financing Limit will increase from £270.3 at 31/3/15 to £321.3m**
- **Authorised Limit for External Debt will increase by £70m to £240m for borrowing and £304m in total**
- **Operational Limit for External Debt will increase by £65m to £223m for borrowing and £285m in total.**

17 Background Papers

CIPFA Code of Practice for Treasury Management in Local Authorities;
Fund Manager Valuations; Temporary Borrowing records; PWLB records
Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2012/13	2013/14	2013/14
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£m	£m	£m
	Actual Outturn	Original Estimate	Actual Outturn
Capital Expenditure			
TOTAL	71.7	99.1	84.6
Ratio of financing costs to net revenue stream			
General fund	3.15%	3.11%	3.11%
Net borrowing requirement			
brought forward 1 April	147.7	121.7	110.6
carried forward 31 March	110.6	110.3	125.6
in year borrowing requirement	-31.1	-11.4	+15.0
Capital Financing Requirement as at 31 March			
TOTAL	242.0	237.9	271.1
Annual change in Cap. Financing Requirement			
TOTAL	-7.8	-3.8	+29.1
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in council tax (band D) per annum (not cumulative)	-0.53	-3.71	-3.71

PRUDENTIAL INDICATOR	2012/13	2013/14	2013/14
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£m	£m	£m
	final	original	final
Authorised limit for external debt -			
borrowing	230	145	145
other long term liabilities	6	65	65
TOTAL	236	210	210
Operational boundary for external debt -			
borrowing	210	125	125
other long term liabilities	4	63	63
TOTAL	214	188	188
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments:-	80%	80%	80%
Upper limit for total principal sums invested for over 364 days			
(per maturity date)	95%	95%	95%

Maturity structure of fixed rate borrowing during 2013/14	lower limit	upper limit
under 12 months	0%	40%
12 months and within 24 months	0%	25%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Summary of Investments at 31 May 2014

	Sovereign Credit Rating	Individual credit Rating	Total £m	%
Call Accounts				
HSBC	UK AA+	F1+AA- support 1 viability a+	5.033	
Santander	UK AA+	F1A support 1 viability a	19.935	
			24.968	71.40
Fixed Deposits				
Barclays	UK AA+	F1A support 1 viability a	5.000	
Close Brothers	UK AA+	F1A support 5 viability a	5.000	
			10.000	28.60
Variable Deposit				
			0	
Total			34.968	100.00