Derby City Council

COUNCIL CABINET
15 JULY 2015

ITEM 17

Report of the Leader of the Council

Treasury Management Annual Report 2014/15

SUMMARY

1.1 This report reviews how the Council conducted its borrowing and investments during 2014/15 and reports on the prudential indicator activity for 2014/15 which the Council is required to report under the Local Government Act 2003. The report includes the following:

- A summary of the financial markets 2014/15
- Treasury Management Activity and Deposits/ Investments
- Borrowing and maturity profile
- Prudential Code Indicators and limits.

1.2 The Treasury Management net underspend for 2014/15 was £2,242,640 after moving £6,173,000 to reserves**.** The saving was derived from a combination of delaying borrowing and under borrowing when funding the Council's capital programme.

1.3 The Council has a prudent approach to treasury management in that it does not borrow more than it needs, due to the cost of carry. It only lends to approved financial institutions, and this discipline is enforced by reviewing the approved list of counterparties, which is regularly updated in consultation with the Councils treasury advisors.

1.4 The treasury management advice to the Council continues to be provided by Arlingclose who were appointed as our advisors on 1 April 2011. The service provided includes economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters as and when required. In accordance with the tender specification, this contract will expire on 31 March 2016. The tender process to appoint for treasury management advisors to the Council will therefore begin in the Autumn of 2015.

1.5 For 2014/15 all prudential indicators and limits have been adhered to.

RECOMMENDATIONS

2.1 To approve the Annual Report in respect of Treasury Management activity for 2014/15.

2.2 To note the prudential indicators in respect of the 2014/15 outturn as outlined in the report.

REASONS FOR RECOMMENDATION

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”), members need to approve the annual report for Treasury Management activity in 2014/15.

3.2 Under CIPFA’s Prudential Code for Capital Finance in Local Authorities, members have a statutory duty to adopt a set of annual indicators relating to capital expenditure and treasury management.

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Report of the Acting Chief Executive

SUPPORTING INFORMATION

4. The Financial Markets During 2014/15

4.1 The information relating to the overall global position of the UK financial markets in 2014/15 was provided by our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

4.2 The Bank of England maintained interest rates at 0.5% throughout 2014/15. Earlier forecasts were that there would be a rate rise in the Autumn of 2015. Our treasury advisors have now currently predicted this rise to be June 2016. This interest rate rise will however, continue to be monitored and members will be updated on the proposed interest rate forecasts in future treasury management reports.

5. Treasury Management Activity and Deposits/ Investments

5.1 In accordance with the CIPFA Code of Practice the primary objective of the Council's investment strategy in 2014/15 remained that of obtaining the best rate of return, whilst maintaining effective control of associated risks as advised by the Councils treasury advisors. Only the most secure and most liquid investments were considered which were with institutions on the approved counterparty lending lists. This resulted in a severe narrowing of investment opportunities and a reduction in the Council's average rate of return, despite a higher average portfolio size.

5.2 Table 1 below shows the investment criteria used for the deposits/ investments based on those which were in the Treasury Management Strategy 2014/15, approved by Cabinet in January 2014. This recommended that the Council stipulates only long-term ratings in its deposit/investment strategy, and uses short-term ratings only as an informal guide which improves the stability on the counterparty list without sacrificing security. The long term ratings are shown below and relate to the credit rating agencies Fitch, Moody's and Standards & Poor respectively. In 2014/15 all investments made by the Council, met the investment criteria shown in Table 1 below.

5.3 **Table 1 – Deposit/ Investment Criteria**

Investment Criteria in 2014/15	**Max period**	**Cash limit per counterparty/ local authority**
Banks/ Building - A/AA-	1 year	£15,000,000
Money Market Funds - MMF -	n/a	0.50% of the overall portfolio
Other Local Authorities	1 year	£15,000,000
Lloyds Bank – Operational purposes	Overnight	£15,000,000

5.4 From the 1 April 2014, the Council appointed a new bank for operational purposes – Lloyds Bank who were the successful bidder in a tender exercise for banking services. Members should note that the Co-operative Bank have continued to be used in 2014/15 by the Council during the transitional/ changeover period.

5.5 The level of deposit/ investment activity in 2014/15 together with a comparison for the previous year is shown in Table 2 below:

Table 2 – Level of Deposit/ Investment activity

	2013/14	2014/15
Number of instant access and money market accounts used	15	15
Number of deposits/withdrawals from money market funds/ call accounts	376	250
Value of deposits/ investments held at 31 March	£40,268,000	£45,015,806
Average Size of deposit/ Investment Portfolio	£56,787,000	£68,312,000
Total interest earned on deposits/ investments	£326,000	£361,000
Average Return on deposits/ investment portfolio	0.52%	0.49%

The number of deposits and withdrawals has fallen in 2014/15 due to the Councils current bank account with Lloyds earning a higher level of interest to some of the money market funds currently held during the year.

5.6 During 2014/15, call accounts utilised attracting fixed interest rates, whilst money markets utilised were offered at variable rates. Both the call accounts and the MMF accounts provided instant access to the deposits/investments held. The list of banks and money market funds used in 2014/15 were as follows:

Call Accounts

- Santander
- Lloyds
- Bank of Scotland
- Barclays
- Handels/Svenska

Money Markets

- IGNIS
- Aberdeen Asset Management
- Black Rock
- Federated
- Invesco AIM
- Global Treasury Fund
- State Street
- Legal & General
- Insight
- Public Sector Deposit Fund.

5.7 All deposit/investment decisions were taken in accordance with advice from the Council's treasury advisors who consistently reviewed the financial markets and counterparties and regularly updated the Council. The Council's deposit/ investment limit with each of these funds was dependent on the fund size, and the absolute total limit for all MMF deposits/ investments remained under the maximum level of 50% of funds available.

6. Borrowing and Maturity Profile 2014/15

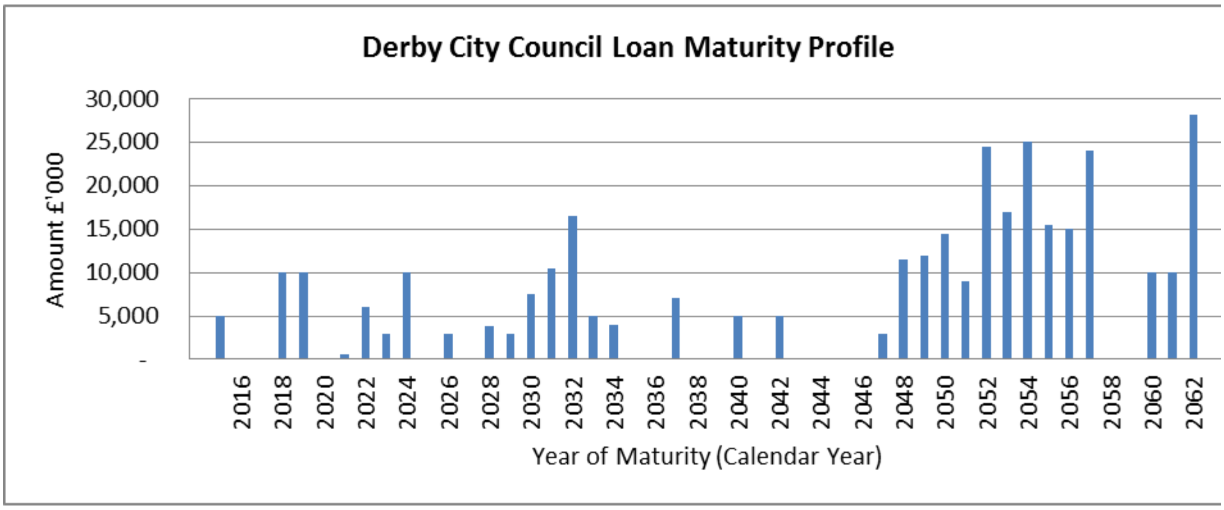
6.1 The level of external debt outstanding at 31 March 2015 in relation to external borrowing is shown in the table 3 below:

Table 3 – External Borrowing Debt at 31 March 2015

External Borrowing	**£**
Fixed Rate PWLB	273,459,383
Fixed Rate Market (LOBO)	20,000,000
Other Local Authorities	40,000,000
Local Enterprise Partnership	530,764
Total External Borrowing debt at 31 March 2015	**333,990,147**

6.2 Treasury Management officers will continue to regularly monitor the rates from other local authorities and the PWLB for future borrowing as these continue to be a factor in the management of interest rate risk. Table 4 below shows the maturity profile of the above outstanding debt. Any decisions regarding early repayment of debt will be taken in conjunction with advice from the Councils treasury advisors.

Table 4 – Loan Maturity File



7. The Prudential Code Indicators and Limits

7.1 The Local Government Act 2003, requires the Council to adopt the CIPFA Prudential Code and produce a set of indicators when determining how much money it can afford to borrow. The Prudential Code also requires that the capital investment plan of the Council is affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

7.2 This report includes the outturn position for the prudential indicators and reports on treasury management activity during 2014/15. It demonstrates that the Council has fulfilled the objectives of the Code.

7.3 The prudential indicators adopted by the Council relate to:

- affordability, specifically with reference to the impact of the capital programme and treasury management costs
- prudence, comparing actual Council borrowing with its need to borrow
- capital expenditure, highlighting the planned expenditure of the Council and its impact on the need to borrow
- external debt, specifying the limit determined by Council above which further borrowing is not permitted
- treasury management, outlining the limits relating to interest rate exposure and principal exposure on both investments and borrowing.

8 Affordability Indicator

8.1 The ‘affordability’ indicator within the Prudential Code provides an indication of the revenue impact of the Council’s overall capital programme and how it decides to finance this.

8.2 The Prudential Code does not recommend that any upper limit be placed on this ratio. However, it does state that the objective of the indicator is to ensure that “the total capital investment of the authority remains within sustainable limits”.

8.3 The Prudential Code requires that a ratio of net financing costs to the net revenue stream be produced to measure the relative cost of maintaining debt year-on-year. This is a key affordability indicator and shows the long-term trend of financing costs, basically, the cost of maintaining debt less any investment income from cash balances. Based on the capital outturn position for 2014/15, the indicators for Derby’s General Fund - GF - and Housing Revenue Account - HRA, (with the previous year’s figures shown for information) are shown in Table 5 below:

Table 5 – Affordability Indicator

	General Fund	**HRA**
Actual 2013/14	7.12%	17.69%
Actual 2014/15	7.06%	19.60%

8.4 The decrease in the general fund reflects the slight reduction in the level of investment income earned in 2014/15 and the increase in the HRA indicator is due to the full financial year effect of the restructure of the HRA borrowing debt in March 2014.

8.5 When the budget was set by Cabinet in January 2014 the affordability Indicator was set at 9.50% for the General Fund and 17.85% for HRA. The variance of 2.44% reduction for the general fund against budget reflects the slight reduction in the level of investment income earned in 2014/15 offset against the borrowing costs paid. The variance on the HRA of an increase of 1.75% is again due to the full financial year effect of the restructure of the HRA borrowing debt in March 2014

9. Prudence Indicator – Capital Financing Requirement

9.1 Prudence relates to the extent of the Council borrowing amount needed against its actual borrowing requirement. The Councils borrowing requirement is commonly known as the Capital Financing Requirement - CFR.

9.2 In recent years the risks associated with holding on to high cash balances have increased, as has the differential between investment and borrowing interest rates. It has therefore been deemed sensible by Council treasury management officers to use a large proportion of the Council's cash balances in 2014/15 to temporarily postpone the need to take on external debt, reducing risk and at the same time making short-term revenue savings.

9.3 The Council's treasury management budget policy continues to be based on the assumption that the Council will on a rolling basis borrow less than required by the capital programme. The assumption being that the Council's cash balances will provide temporary funding until the borrowing is actually undertaken at a later date.

9.4 The actual timing of the borrowing will be driven mainly by the Council's plans to use its cash balances, reserves, and the need to optimise our opportunities to borrow at favourable rates.

9.5 The Prudential Code requires a comparison between total net external borrowing and the Council's CFR. This is to ensure that overall external borrowing exposure is not excessive. The requirement of the code is that external borrowing, net of any investments, should not exceed the CFR at the end of the final year of a three year programme.

9.6 The CFR for 2014/15 and 2013/14 are shown in Table 6 below:

Table 6 – Capital Financing Requirement

CFR	**GF**	**HRA**	**Total**
	£m	£m	£m
2013/14 Actual	335.9	229.7	565.6
2014/15 Actual	353.9	229.7	583.6
Difference	18.0	0	18.0

Generally, an increase in the General Fund CFR shows the extent to which the capital programme has been financed from borrowing. No borrowing in relation to the HRA has been undertaken in 2014/15.

9.7 Table 7 sets out the prudential indicator which compares the Council's overall debt with its CFR The indicator considers the prudential indicator and also the local indicator which includes debt that was transferred to the Council from Derbyshire County Council on local government reorganisation in 1997.

Table 7 – Overall debt Comparison to Capital Finance Requirement

	Actual 2013/14 £m	Actual 2014/15 £m
Prudential Indicator		
- Gross External Debt	440.0	432.6
- Investment Balances	-40.3	-45.0
- Net External Debt	399.70	387.60
- CFR	565.6	583.6
- Variance	-165.9	-196.0
Local Indicator		
- Gross External Debt	440.0	432.6
- Transferred Debt	33.6	32.3
- Deposit/ Investment Balances	-40.3	-45.0
- Net External Debt	433.3	419.9
- CFR	565.6	583.6
- Variance	-132.3	-163.7

9.8 The prudential indicator at 31 March 2015 showed net external debt of £387,600,000 well below the current CFR of £583,600,000. The variance of £196,000 in the indicator highlights the assumption that all debt would be financed by borrowing. This effectively means that the council has under borrowed and utilised cash balances instead of borrowing.

10 Capital Expenditure and Borrowing Indicator

10.1 The final capital outturn for 2014/15 is reported to Cabinet in the 2014/15 Capital Outturn Report, elsewhere on this agenda. The actual indicators, consistent with this outturn are as follows, split between General Fund including unsupported borrowing, and Housing Revenue Account are shown in Table 8 below.

Table 8 – Capital Expenditure and Borrowing

	General Fund (GF)	Housing Revenue Account (HRA)	Total
	£m	£m	£m
Capital expenditure 2014/15	85.7	16.9	102.6
of which – borrowing	30.8	0.0	30.3
of which – other sources	54.9	16.9	71.8
Borrowing percentage	**36%**	**0%**	**29%**
Capital expenditure 2013/14	85.5	13.3	98.8
of which - borrowing	40.0	0.0	40.0
of which – other sources	45.5	13.3	58.8
Borrowing percentage	**47%**	**0%**	**40%**

10.2 Table 8 shows a 11% reduction in the borrowing percentage and the proportion of the capital programme funded from borrowing in 2014/15 as compared to 2013/14.

11 Authorised limit and operational boundary for external debt

11.1 Section 3 of the 2003 Local Government Act imposes a duty on the Council to set a limit on how much money it can afford to borrow and to keep this under review. The “authorised limit‟ is the affordable borrowing limit of which the Council does not have the power to borrow above this level. This is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

11.2 Additionally, the Council must set an “operational boundary‟ for borrowing. This is based on the Councils estimate of most likely, i.e. prudent, but not worst case scenario of external debt. Periods where the actual position is either below or over the boundary are acceptable providing the authorised limit is not breached

11.3 In line with paragraph 11.2 above, in January 2014 as part of the 2014/15 strategy report the Councils operational boundary and authorised limit for 2014/15 were set at £610,000,000 and £710,000,000 respectively. It sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council The Authorised Limit was set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.
The Councils actual external borrowing plus transferred debt at the end of the year was £464,900,000. This is within the operational boundary and within the authorised limit and indicates that the Council did not breach any of the borrowing limits.

12. Interest rate exposure indicator

12.1 The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It also shows the split of borrowing between fixed and variable rates, and the maturity profile of long term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

The split in respect of borrowing as at 31 March 2015, and the comparative figures for the previous year, are shown in Table 9 below:

Table 9 – Interest Rate Exposure

	2013/14	2014/15
	%	%
Upper Limit on fixed interest rate Exposure	100	100
Actual	90.39	89.21
Upper Limit on variable interest rate exposure	20	20
Actual	9.61	10.79

12.2 These figures show that the Council has not exceeded any limits for the fixed and variable rate borrowing.

12.3 Future borrowing in 2015/16 will be a combination of borrowing from local authorities and PWLB and borrowing from other institutions as agreed in the treasury management strategy. Borrowing from the PWLB will be at a reduction of 20 basis points (bps) on the Standard rate due to the adoption of the Certainty Rate introduced by the PWLB in November 2012 which the Council applied for and has exercised its right to continue to do so in 2015/16.

12.4 It is still not advisable for the Council to fix all of its borrowing in the immediate future. This is because borrowing rates still greatly outweigh investment rates, giving a heavy ‘cost of carry’ which the Council would have to bear in its revenue budget. It therefore still remains largely preferable for the Council to continue to be in a state of readiness to borrow if it looks like borrowing rates are likely to rise quickly. Our treasury advisors are providing regular advice and interest rate forecasts to assist the Council in this area.

13. Loan Maturity Limits

13.1 One of the treasury management indicators relates to the current loan maturity limit profile, approved by Cabinet in January 2014 which is then compared with the actual structure of borrowing as at 31 March 2015. Table 10 below shows that this indicator has been met as follows:

Table 10 – Maturity Structure of Borrowing

Number of Years to Maturity	Borrowing Profile Set per the 2014/15 Strategy %	Actual Profile of Borrowing at 31 March 2015 %
Up to 1 year	10	1.5
Up to 2 years	15	1.5
Up to 5 years	20	7.49
Up to 10 years	50	13.33
Up to 20 years	70	29.29
Up to 30 years	80	34.38
Up to 40 years	90	73.90
Up to 50 years	100	100

13.2 The final treasury management indicator required relates to the limit at any one time on investments with a period to maturity of no greater than 365 days. Investments made in 2014/15 were in accordance with this criteria and no investment made was greater than 365 days.

OTHER OPTIONS CONSIDERED

14.1 None Considered

This report has been approved by the following officers:

Legal officer	Not Applicable
Financial officer	Amanda Fletcher Head of Finance
Human Resources officer	Not Applicable
Estates/Property officer	Not Applicable
Service Director(s)	Martyn Marples, Director of Finance & Procurement
Other(s)	Not Applicable

For more information contact:	Nicola Goodacre Group Accountant Capital & Treasury Management 01332 643352 e-mail nicola.goodacre@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As described in the report.

Legal

2.1 None directly arising.

Personnel

3.1 None directly arising.

IT

4.1 None directly arising.

Equalities Impact

5.1 None directly arising.

Health and Safety

6.1 None directly arising.

Environmental Sustainability

7.1 None directly arising.

Property and Asset Management

8.1 None directly arising.

Risk Management

9.1 As detailed in the report at paragraphs 5.1, 6.2, and 9.2.

Corporate objectives and priorities for change

10.1 None directly arising.