| Item No: 8.1 | Classification: Open | Date: 16 July 2014 | Meeting Name: Council Assembly |
|---|---|---|---|
| **Report title:** | | Treasury Management Performance – 2013/14 Annual Report and Prudential Indicators for Capital Finance and Treasury Management | |
| **Wards or Groups affected:** | | All | |
| **From:** | | Strategic Director of Finance and Corporate Services | |

**RECOMMENDATION**

1. That council assembly:

   a) notes the 2013/14 outturn report on treasury management and prudential indicators

   b) notes the investment in the Municipal Bond Agency of up to £200,000.

**BACKGROUND INFORMATION**

2. This item is one of an annual cycle of reports on council debt and investments. Other reports to council assembly on treasury include a strategy report at the start of each financial year and a half year update. The cabinet also receives quarterly updates and the audit and governance committee reviews treasury strategy annually.

3. Treasury activity is supported by a series of prudential indicators (estimates and limits on capital finance, debt and investments), which are agreed by council assembly each year and under financial delegation all executive, managerial and operational decisions are the responsibility of the strategic director of finance and corporate services. This area of finance falls under the Local Government Act 2003 and is supplemented by investment guidance issued by the government and codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

**KEY ISSUES FOR CONSIDERATION**

**Investment management activity and position**

4. Cash balances that are not immediately used in spending are held in low risk investments, ensuring security and liquidity. Over the course of 2013/14 the sums held in investments averaged £240m (£293m in 2012/13) and closed the year with a balance of £157m (£176m at 31 March 2014). The 2013/14 investment balances were affected by cash used in HRA debt refinancing in the fourth quarter of 2013/14, discussed further below.

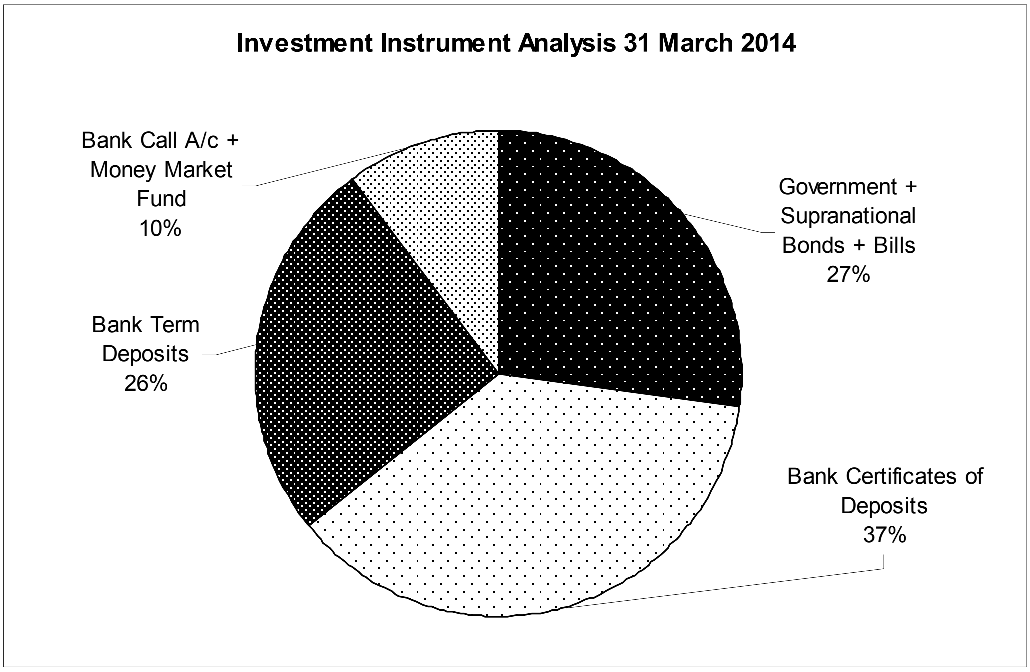
5. The investments are managed by an in-house operation and two fund managers. The focus in-house is on meeting day to day cash requirements using call accounts, money market funds and term deposits diversified across major banks/building societies that, in view of their scale and economic significance, are likely to be supported, in the event it were need. The

managers' invest in UK government and supranational bank bonds, and certificates of deposits issued by major financial institutions. The distribution of investments across counterparties and instruments at 31 March 2014 is set out in the tables and charts below.

| INVESTMENT COUNTERPARTY AND RATINGS 31 MARCH 2014 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| EXPOSURE £m | Fund | | | | Ratings | | | | |
| COUNTERPARTY | Aberdeen | Alliance Bernstein | In-house | Total £m | Long | Short | Sup-port | Sovereign | Sove-reign Rating |
| COMMONW BANK AUSTRALIA | | | 15.00 | 15.00 | AA- | F1+ | 1 | AUSTRALIA | AAA |
| TORONTO DOMINION | | 2.00 | | 2.00 | AA- | F1+ | 1 | CANADA | AAA |
| NORDEA BANK FINLAND | 3.50 | | | 3.50 | AA- | F1+ | 1 | FINLAND | AAA |
| BANQUE NAT DE PARIS | 3.50 | 2.00 | | 5.50 | A+ | F1 | 1 | FRANCE | AA+ |
| CREDIT INDUST ET COMRCL | 3.50 | | | 3.50 | A+ | F1 | 1 | FRANCE | AA+ |
| SOCIETE GENERALE | 3.50 | 1.00 | | 4.50 | A | F1 | 1 | FRANCE | AA+ |
| DEUTSCHE BANK | | 3.00 | | 3.00 | A+ | F1+ | 1 | GERMANY | AAA |
| GLOBAL TREAS FUNDS-MMF | | | 0.10 | 0.10 | | AAA | | | |
| ABN AMRO BANK | 3.50 | 2.00 | | 5.50 | A+ | F1+ | 1 | NETHERLANDS | AAA |
| ING BANK | 3.40 | 2.00 | | 5.40 | A+ | F1+ | 1 | NETHERLANDS | AAA |
| RABOBANK | | 2.00 | | 2.00 | AA- | F1+ | 1 | NETHERLANDS | AAA |
| DNB BANK | 3.50 | | | 3.50 | A+ | F1 | 1 | NORWAY | AAA |
| EUROPEAN INV BANK | 7.00 | 6.50 | | 13.50 | AAA | F1+ | | SUPRANATIONAL | AAA |
| INT BANK RECONST DEVT | 3.50 | 6.80 | | 10.30 | AAA | F1+ | | SUPRANATIONAL | AAA |
| SKANDINAVISKA | 3.50 | 2.00 | | 5.50 | A+ | F1 | 1 | SWEDEN | AAA |
| SVENSKA | 3.30 | | | 3.30 | AA- | F1+ | 1 | SWEDEN | AAA |
| CREDIT SUISSE | 3.50 | 2.00 | | 5.50 | A | F1 | 1 | SWITZERLAND | AAA |
| BARCLAYS BANK | 2.00 | | | 2.00 | A | F1 | 1 | UK | AA+ |
| LLOYDS BANK | | | 15.00 | 15.00 | A | F1 | 1 | UK | AA+ |
| NATIONWIDE BSOC | 3.30 | | 10.10 | 13.40 | A | F1 | 1 | UK | AA+ |
| RBS/NATWEST | | | 15.80 | 15.80 | A | F1 | 1 | UK | AA+ |
| UK TREASURY | | 19.20 | | 19.20 | AA+ | F1+ | 0 | UK | AA+ |
| BNY MELLON | 0.10 | 0.10 | | 0.20 | AA- | F1+ | 1 | US | AAA |
| Total £m | 50.60 | 50.60 | 56.00 | 157.20 | | | | | |

| INVESTMENT MATURITY PROFILE AND RATING 31 March 2014 | | | | |
|---|---|---|---|---|
| Year Band | A | AA | AAA | Total |
| Up to 1 Year | 56% | 24% | 5% | 85% |
| 1-2 Years | | | 6% | 6% |
| 2-5Years | | 5% | 4% | 9% |
| Total £m | 56% | 29% | 15% | 100% |

| Rating | Definition |
|---|---|
| AAA | Highest credit quality |
| AA | Very high credit quality |
| A | High credit quality |
| F1 | Highest short term credit quality; strongest capacity for timely payment (+donates exceptionally strong credit feature) |
| 1 | Extremely high probability of support, if it were needed |
| Ratings issued by Fitch or equivalent | |




6. The return on investments remains low. The 2013/14 return was 0.65% (0.89% 2012/13) and reflects the prudent strategy in place since the financial crisis and the stimulatory monetary policies that central banks here and abroad have been maintaining. Official rates in advanced economies have remained at historically low levels. In the UK, base rates have been held at 0.50% since 2009. A gradual move up in UK rates is being signalled from late 2014 and early 2015 as its economy improves, but policy rates in Europe and the US may lag and rise more slowly, supporting financial markets and long term rates for longer.

**Debt management activity and position**

7. The council has loans from the Public Works Loans Board (PWLB, the local authority lending arm of the government) that were taken to fund past capital spend. The balance outstanding on PWLB loans at 31 March 2014 was £475m (£371m HRA and £104m General Fund). £85m loans were paid off in 2013/14 and lowered the average interest rate, which has been falling since 2006/07, referred to in the table below.

| Year | Closing debt | Annual interest payable | Average interest rate |
|---|---|---|---|
| | £m | £m | % |
| 2006/07 | 693.7 | 60.9 | 8.8% |
| 2007/08 | 738.3 | 54.6 | 7.6% |
| 2008/09 | 770.7 | 52.0 | 7.0% |
| 2009/10 | 761.7 | 52.8 | 6.9% |
| 2010/11 | 761.7 | 52.8 | 6.9% |
| 2011/12* | 462.5 | 55.6 | 6.9% |
| 2012/13 | 560.0 | 33.2 | 6.0% |
| 2013/14 | 474.9 | 33.1 | 5.4% |

*Under HRA self-financing reforms, the debt was lowered by £199.2m in March 2012, HRA subsidy ended and the risks from HRA debt passed to the council.

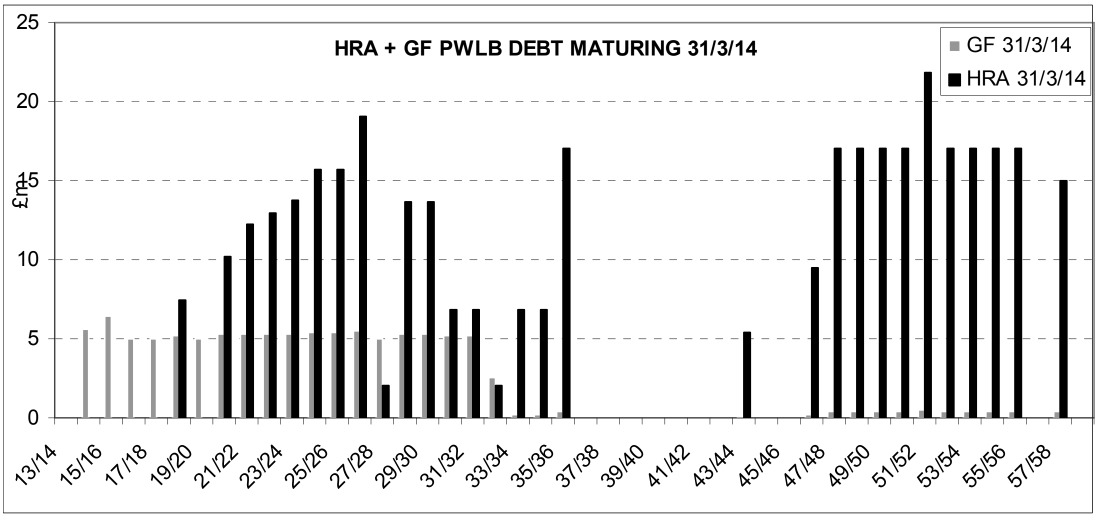
8. Of the £85m paid off in 2013/14, £80m was HRA and £5m was General Fund. This is the first time that HRA loans have been reduced outside of self-financing reforms since 2003/04.

9. The HRA debt that became council responsibility under self-financing is expensive without support and cabinet in their review of HRA finances recognised that it needed addressing to raise the headroom for new investment. £80m was therefore paid off in the fourth quarter of 2013/14 with a premium of £10m. The loans were due for refinance in 2014/15 and 2015/16 and had an annual interest of £7.5m (average rate 9.31%). This interest will now no longer be payable to the PWLB, but instead be applied to finance the principal and the premium. The HRA has made a £36m HRA debt financing contribution, plus applied £4m towards premium, in 2013/14, and increased the headroom for renewal and new investment by £36m. Further debt financing contributions out of interest savings are planned each year thereafter, increasing headroom further, until the remaining £44m (£80m less £36m) is fully financed.

10. The £5m general fund loan repayment in 2013/14 has been financed out of prudent annual minimum revenue provisions (MRP), which the council is required to make each year. The MRP is also used to pay off internal borrowing in respect of the acquisition of the freehold interest in the council's Tooley Street headquarters in 2012. The total MRP to repay borrowings was £9.3m in 2013/14.

11. All PWLB debt is at fixed rates and the average rate of interest following the repayments is 5.97% on HRA debt and 3.58% on general fund debt. The maturity profile of the £475m balance outstanding at 31/3/14 is set out in the chart below.

12. £6m general fund debt falls due in 2014/15 and as in 2013/14 can be met out of annual minimum revenue provisions. No HRA debt falls due in 2014/15, but the HRA will continue applying interest saved on the £80m that was paid off towards financing the debt repayments.




## Prudential indicators outturn

13. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance and the Treasury Management in the Public Services Code of Practice and Guidance published by the Chartered institute of Public Finance and Accountancy and backed by the Local Government Act 2003. The codes recommend councils agree a series of indicators and limits each year. The 2013/14 indicators were agreed in

February 2013, before the start of the year. The outturn 2013/14 position on each indicator drawn from the council's 2013/14 draft accounts are set out at appendix A.

14. The indicators include the authorised debt limit, which is a self imposed cap on borrowing and other long term liabilities (like leases and PFI schemes) outstanding on any one day. The limit for 2013/14 was £970m and included operational flexibility for temporary borrowing, prudent refinancing and replacement of internal borrowing with external loans, within a risk controlled framework. The council was within its cap and actual debt and long term liabilities did not exceed £658m at any time during 2013/14.

**Municipal bond agency**

15. The dominant source of loans to local authorities for capital investment is the PWLB. Its rates are determined by the government, which currently requires it to add a margin of 0.80% above gilts (the cost of the government's own borrowing) when lending to councils across the country, though limited funds are available at a lower margin to councils outside London on certain schemes developed in conjunction with Local Enterprise Partnerships. In the past, the margin for most councils has been as high as 1.00% above gilts and despite the drop to 0.80%, it is still higher than some other sources of finance.

16. For some time now, the Local Government Association (LGA) has been working on updating proposals for a Municipal Bond Agency, with a view to it becoming an attractive alternative to the PWLB and at the same time a better investment proposition for long term bond investors in the Agency. The LGA now proposes, in its revised business case, that local authorities borrowing from the Agency would give a joint and several guarantee of each other's borrowing and that borrowers would give up between 3 and 5 percent of loans taken as risk capital to absorb any borrower defaults. Local authorities are already regarded as safe borrowers on account of the legal protection that debtors have under Section 13 of the Local Government Act 2003. This protection would apply to the Agency and in the unlikely event of a borrower defaulting, the Agency would pursue the defaulter before drawing on the joint and several guarantee. The guarantee and risk capital, taken together, however, represent significant credit enhancements and should, over the long run, lower the margin that funds are lent at closer to 0.60% above gilts. The Agency would also undertake a financial assessment of borrowers, providing additional assurance to financial markets as well as those providing guarantees.

17. The main risk to the Agency is the dominance of the PWLB. The current margin over gilts is a gain to the PWLB and it could easily be lowered if the government should decide that it is warranted.

18. The LGA is now moving its proposals for the Agency to the next stage and is asking interested councils to invest in it as shareholder in the Agency providing it with initial setup up cost and capital of up to £10m as it launches its first bond issue next year. The strategic director of finance and corporate services recommends an investment of up to £200,000 in the Agency subject to final terms. It would ensure that the council can participate in and have a positive influence in the development of the Agency. The investment would earn a return after five or so years should the Agency be successful. However, if unsuccessful, the whole sum but no more, would be at risk. The return would be additional to savings from potentially cheaper Agency borrowing. Furthermore, a failure because the government decides to lower the PWLB

margin would also result in cheaper borrowing and would easily make up for any loss on the initial investment.

19. The £200,000 investment would be regarded as capital expenditure in accounting terms and will be subject to separate approval, in line with the council standing orders. Local authorities are able to make such investments under Section 12 of the Local Government Act 2003 and general powers of competence in Section 1 of the Localism Act 2011. The investment would be subject to final terms agreed by the strategic director of finance and corporate resources, who together with the director of legal services shall execute and complete all legal documentation.

**SUPPLEMENTAL ADVICE FROM OTHER OFFICERS**

**Director of Legal Services**

20. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit and governance committee.

21. Financial standing orders require the strategic director of finance and corporate services to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a quarterly basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and corporate services.

22. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

23. Section 15(1) of the 2003 Act requires a local authority “to have regard (a) to such guidance as the Secretary of State may issue”. This guidance is found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) produced under amendments made to section 21(1A) of the 2003 Act by section 238(2) of the Local Government and the Public Involvement in Health Act 2007.

24. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

**BACKGROUND DOCUMENTS**

| Background Papers | Held at | Contact |
|---|---|---|
| None | | |

**APPENDICES**

| No. | Title |
|---|---|
| Appendix A | Prudential Indicators – 2013/14 Outturn |

**AUDIT TRAIL**

| | | |
|---|---|---|
| **Lead Officer** | Duncan Whitfield, Strategic Director of Finance and Corporate Services | |
| **Report Author** | Jennifer Seeley, Deputy Finance Director | |
| **Version** | Final | |
| **Version Date** | 3 July 2014 | |
| **Key Decision** | Yes | |
| **CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER** | | |
| **Officer Title** | **Comments sought** | **Comments included** |
| Director of Legal Services | Yes | Yes |
| Strategic Director of Finance and Corporate Services | N/a | N/a |
| Cabinet Member | Yes | Yes |
| **Final Report Sent to Constitutional Team** | | 3 July 2014 |

# APPENDIX A

## PRUDENTIAL INDICATORS – 2013/14 OUTTURN

### BACKGROUND

1. Capital finance, borrowing and investment arrangements are supported by a series of prudential indicators, drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice plus Guidance, published by CIPFA. The Local Government Act 2003 requires that councils have regard to these codes and this appendix sets out the 2013/14 outturn indicators drawn from the council's draft accounts for that year.

2. The indicators are grouped into three broad areas: affordability and prudence, capital finance and treasury management. The indicators are of a technical nature and existing budgets take account of capital finance and treasury activities and the indicators themselves have no effect on those budgets.

### INDICATORS ON AFFORDABILITY AND PRUDENCE

Indicator one: estimates of the ratio of financing costs to net revenue stream

3. The financing ratio is a technical measure of the cost of financing capital expenditure (including PFI and leases) net of cash income as a proportion of the net revenue stream. The general fund ratio in 2013/14 includes the full year effects of 2012/13 capital financing and the HRA ratio reflects financing in respect of the PFI funded district heating network, supplying low carbon heating and hot water to housing estates, and early settlement of debt.

| Financing Ratios | 2012/13 | 2013/14 |
|---|---:|---:|
| HRA | 15% | 16% |
| GF | 6% | 7% |

Indicator two: estimates of the incremental impact of capital investment on the council tax and housing rents

4. This is a measure of the effect of capital spend proposals on council tax and HRA rents. No increase in either was sought as a result of the programme and spend was managed within resources.

| Notional Rent or Council Tax Increases | 2012/13 | 2013/14 |
|---|---:|---:|
| Weekly housing rent increase as a result of capital programme | Nil | Nil |
| Council tax band D increase as a result of capital programme | Nil | Nil |

## INDICATORS ON CAPITAL FINANCE

Indicator three: debt and capital financing requirement

5. This indicator compares actual debt to the capital financing requirement (CFR), consisting of funding for capital plus long term liabilities (like PFI and leases). Debt should not exceed the CFR over the medium term, but may do so over the short-term in the interest of prudent financing of capital expenditure and management of debt. Under this indicator the actual debt at 31/3/14 was £475m, below the 2013/14 £804m closing CFR.

Indicator four: estimates of capital expenditure

6. The capital expenditure for 2013/14 drawn from the draft accounts is set out below. The 2013/14 HRA projection includes spend on the district heating network, supplying low carbon heating and hot water to housing estates.

| Capital Expenditure | 2012/13 £m | 2013/14 £m |
|---|---|---|
| HRA | 86 | 123 |
| GF | 262 | 67 |
| **Total** | **348** | **190** |

Indicator five: actual and estimates of capital financing requirements.

7. The capital financing requirement (CFR), consisting of funding for capital plus long term liabilities (like PFI and leases), is set out below. Both the general fund and the HRA CFR reflect sums set-aside to reduce debt liabilities and PFI financing.

| CFR At year end | 2012/13 £m | 2013/14 £m |
|---|---|---|
| HRA | 451 | 419 |
| General Fund | 397 | 385 |
| **Total** | **848** | **804** |

## INDICATORS ON TREASURY MANAGEMENT

Indicator six: HRA limit on indebtedness

8. The HRA limit on indebtedness is the limit imposed by the government on HRA debt under self-financing. The indebtedness limit from 2012/13 indicated in the self-financing determination issued in February 2012 is £577m. The actual HRA indebtedness at 31/3/14 was £419m.

Indicator seven: the authorised limit and operational boundary

9. The authorised limit and operational boundary accommodate existing debts and long term liabilities (leases and PFI) outstanding on any one day. The average level of borrowing in any one year is usually close to the capital financing requirement before PFI and leases but may be higher or lower on any one day depending on cash flow needs and timing of borrowing.

10. As well as accommodating existing debts and liabilities, the operational boundary includes flexibility to refinance debt or replace internal borrowing with external loans where prudent. The authorised limit is a higher limit with additional capacity to prudently raise debt temporarily should it be necessary within a risk controlled framework to protect the council's interests. The council remained within both the operational boundary and authorised limits in 2013/14.

| Operational Boundary and Authorised Limits for External debt | 2012/13 Actual Max £m | 2013/14 Limit £m | 2013/14 Actual Max £m |
|---|---|---|---|
| **Operational Boundary for Debt** | | | |
| Borrowing | 562 | 815 | 560 |
| Other long term liabilities | 107 | 115 | 98 |
| **Total Operational (*)** | **669** | **930** | **658** |
| **Authorised Limit for Debt -** | | | |
| Borrowing | 562 | 850 | 560 |
| Other long term liabilities | 107 | 120 | 98 |
| **Total Authorised (*)** | **669** | **970** | **658** |

Note * - The strategic director of finance and corporate services has discretion to allow activity to go outside the operational boundary and vary the mix between long term liabilities and debt should it be prudent and justified. Activity must nevertheless remain within the overall authorised limit.

<u>Indicator eight: gross and net debt</u>

11. This is an indicator on the upper limit on net debt (i.e. gross debt less investments) as a percentage of gross debt. The net debt is currently lower than the gross as revenue balances, provisions and working capital are held in investments. To ensure the funds are available when they are needed, the upper limit on net debt as a percentage of gross debt is 100%, the actual exposure is set out below.

| Gross and Net Debt | 2012/13 Max | 2013/14 Limit | 2013/14 Max |
|---|---|---|---|
| Upper Limit on Net Debt as a % of Gross Debt | 68% | 100% | 68% |

<u>Indicator nine: adoption of the CIPFA code of practice on treasury management in the public services</u>

12. This indicator concerns the adoption of the Treasury Management in the Public Services Code of Practice issued by CIPFA. The council adopted the 2009 code at its meeting in February 2010. The code was updated for HRA self-financing in 2011 and basic principles remained unchanged.

<u>Indicator ten: interest rate exposures – fixed rate limit</u>
<u>Indicator eleven: interest rate exposures – variable rate limit, and</u>
<u>Indicator twelve: maturity limits</u>

13. The fixed and variable rate limits draw on the authorised debt limit and the maturity limit accommodates existing debt. The limits contain flexibility to carry out refinancing, including replacing internal borrowing and maturing debt with external fixed or variable rate borrowing, where prudent. Actual activity is

subject to developments in funding markets and is only carried out within a risk controlled framework and existing financial delegation. The actual position against these limits is set out below.

| LIMITS ON FIXED AND VARIABLE RATES | 2012/13 Actual £m | 2013/14 Limit £m | 2013/14 Actual £m |
|---|---|---|---|
| Upper limit for fixed interest rate exposure | 562 | 850 | 562 |
| Upper limit for variable rate exposure | 0 | 215 | 0 |

| Maturity structure of fixed rate borrowing at start of year | 2012/13 Actual | 2013/14 Lower Limit | 2013/14 Upper Limit | 2013/14 Actual |
|---|---|---|---|---|
| Under 12 months | 0% | 0% | 30% | 1% |
| 12 months and within 24 months | 0% | 0% | 30% | 6% |
| 24 months and within 5 years | 18% | 0% | 60% | 13% |
| 5 years and within 10 years | 7% | 0% | 80% | 12% |
| 10 years and within 20 years | 27% | 0% | 100% | 28% |
| 20 years and within 30 years | 7% | 0% | 100% | 6% |
| 30 years and within 40 years | 23% | 0% | 100% | 22% |
| 40 years and within 50 years | 18% | 0% | 100% | 12% |

<u>Indicator thirteen: total principal sums invested for periods longer than 364 days.</u>

14. Exposure to investments with a maturity beyond one year raises investment options and potential returns. However, as returns can be vulnerable to unexpected market volatility, limits are placed on such exposure. The council remained cautious amid continued market volatility and actual exposure was within limits.

| Upper limit on investments greater than 364 days | 2012/13 Actual | 2013/14 Limit | 2013/14 Actual |
|---|---|---|---|
| Upper limit / Actual | Actual max exposure15% of investments greater than 364 days<br><br>Overall maximum average maturity 7 months<br><br>Longest investment 5 years | Up to 50% of investments greater than 364 days<br><br>Overall average maturity 3 years, but any one investment may be longer as referred to in the Annual Investment Strategy | Actual max exposure15% of investments greater than 364 days<br><br>Overall maximum average maturity 8 months<br><br>Longest investment 5 years |