Item No: 7.2	Classification: Open	Date: 8 July 2015	Meeting Name: Council Assembly
Report title:		Treasury Management Performance - 2014/15 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 notes this 2014/15 outturn report on treasury management and in year activity which included:

   a) prudently managing council cash and holding it in money market instruments with major banks and the UK government until it is needed in spend (paragraphs 4 and 5);

   b) updating the investment strategy in February 2015, ensuring that it remains sound under present market conditions where monetary policy is still highly accommodative and the scope for targeting higher returns without increased risk remains low (paragraphs 7 and 8);

   c) ensuring that the council can efficiently and effectively execute the updated investment strategy by continuing to use fund managers (paragraph 8);

   d) reducing the interest on Public Works Loans Board (PWLB) loans outstanding from past capital spend by paying off £5.7m (paragraphs 9 and 10);

   e) reducing the draw on internal borrowing to fund capital spend by £23m and raising the headroom for future housing revenue account (HRA) capital finance by £19m (paragraph 11); and,

   f) holding balances remaining on loans and long term liabilities that pay for past capital spend within the authorised debt limit (paragraph 15) and other prudential limits (Appendix A).

BACKGROUND INFORMATION

2. This report presents the 2014/15 position on the council's cash, borrowing and supporting capital finance and treasury management prudential indicators. The report is one of three to council assembly each year on this subject. The others are a strategy report at the start of each financial year and a half year update. The cabinet receives quarterly updates and the audit and governance committee reviews treasury strategy annually, which it will do again in the third quarter of 2015/16 ahead of the council assembly considering the strategy for 2016/17 in February 2016.

3. The treasury strategy is agreed by council assembly and under financial delegation all executive, managerial and operational decisions are the responsibility of the strategic director of finance and corporate services. The statutory and financial duties affecting this area arise from the Local Government Act 2003, 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

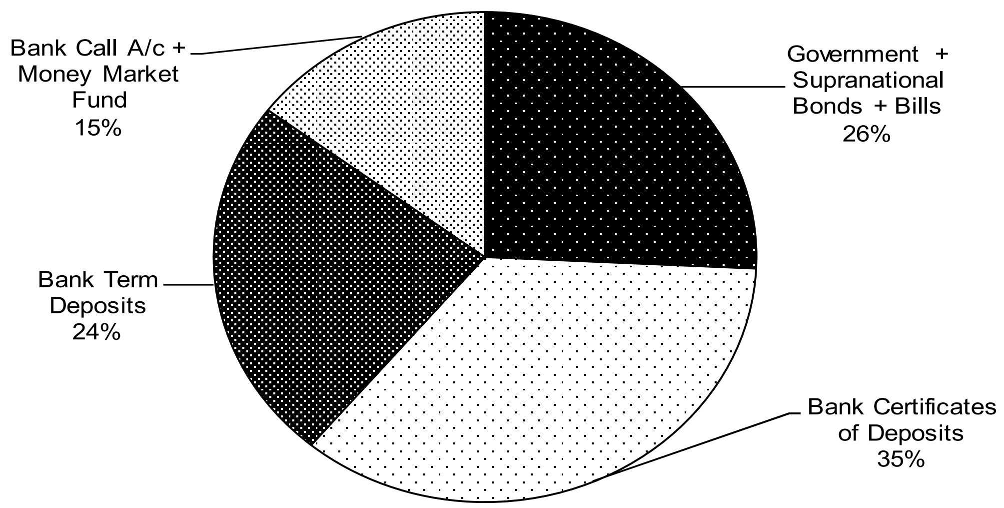
4. Council cash that is not immediately used in spend is held in money market instruments and managed according to a prudent investment strategy. The 2014/15 strategy was agreed in February 2014. Over the course of 2014/15 the sums held in investments averaged £210m (£240m in 2013/14) and, as net cash outflow increased towards the end of the 2014/15, closed the year with a balance of £165m (£157m at 31 March 2014).

5. The investments are managed by an in-house operation and two fund managers: AllianceBernstein and Aberdeen Asset Managers. In-house, the focus is on meeting variable day to day cash requirements using call accounts, money market funds and term deposits diversified across major banks and building societies. The fund managers invest more stable cash over a longer term within a risk controlled framework in UK government gilts, supranational bank bonds, and certificates of deposits issued by major banks/building societies. The distribution of investments across counterparties, maturities and instruments at 31 March 2015 is set out in the tables and charts below.

INVESTMENT COUNTERPARTY AND RATINGS 31 MARCH 2015								
EXPOSURE £m	Fund				Ratings			
COUNTERPARTY	Aberdeen	Alliance Bernstein	In-house	Total £m	Long	Short	Sovereign	Sove-reign Rating
NORDEA BANK FINLAND	6.5			6.5	AA-	F1+	FINLAND	AAA
BANQUE NAT DE PARIS	3.5	1.0	10.0	14.5	A+	F1	FRANCE	AA
CREDIT INDUST ET COMRCL	3.5			3.5	A+	F1	FRANCE	AA
SOCIETE GENERALE		1.2		1.2	A	F1	FRANCE	AA
CREDIT AGRIC CIB	3.0			3.0	A	F1	FRANCE	AA
DEUTSCHE BANK		1.0	10.0	11.0	A+	F1+	GERMANY	AAA
GOLDMAN SACHS MMF			20.7	20.7		AAA	Money Fund	
BLACKROCK MMF			2.9	2.9		AAA	Money Fund	
ING BANK	3.5	2.0	5.0	10.5	A+	F1+	NETHERLANDS	AAA
RABOBANK	1.1	2.0		3.1	AA-	F1+	NETHERLANDS	AAA
EUROPEAN INV BANK	7.0	5.5		12.5	AAA	F1+	SUPRANATIONAL	AAA
INT BANK RECONST DEVT		4.8		4.8	AAA	F1+	SUPRANATIONAL	AAA
SVENSKA	3.3		10.0	13.3	AA-	F1+	SWEDEN	AAA
CREDIT SUISSE	3.5	2.0		5.5	A	F1	SWITZERLAND	AAA
UBS	3.5	2.0		5.5	A	F1	SWITZERLAND	AAA
BARCLAYS BANK	3.5	2.0		5.5	A	F1	UK	AA+
LLOYDS BANK	3.5		5.0	8.5	A	F1	UK	AA+
NATIONWIDE BSOC	3.3	2.0		5.3	A	F1	UK	AA+
RBS/NATWEST				-	A	F1	UK	AA+
UK TREASURY		25.3		25.3	AA+	F1+	UK	AA+
SANTANDER UK	1.5			1.5	A	F1	UK	AA+
BNY MELLON	0.7	0.1		0.8	AA-	F1+	US	AAA
Total £m	50.9	50.9	63.6	165.4				

INVESTMENT MATURITY PROFILE AND RATING 31 MARCH 2015				
Year Band	A	AA	AAA	Total
Up to 1 Year	60%	25%	9%	94%
1-2 Years			2%	2%
2-5Years		4%		4%
Total £m	60%	29%	11%	100%

INVESTMENT INSTRUMENT ANALYSIS 31 MARCH 2015



Rating	Definition
AAA	Highest credit quality
AA+/AA/AA-	Very high credit quality
A+/A/A-	High credit quality
F1+/F1	Highest short term credit quality; strongest capacity for timely payment (+donates exceptionally strong credit feature)
Ratings issued by Fitch or equivalent (The UK government and its treasury bonds are rated AA+ by Fitch, Aa1 by Moody's and AAA by Standard & Poor's)	

6. The average return on investments in 2014/15 was 0.73% (0.69% 2013/14), reflecting the prudent strategy and the highly accommodative central bank monetary stimulus still in place here and abroad to support financial markets and growth. Base rates have, here in the UK, been held at 0.50% since 2009 and monetary policy since then has intensified investors' search for yields, driving yields lower.

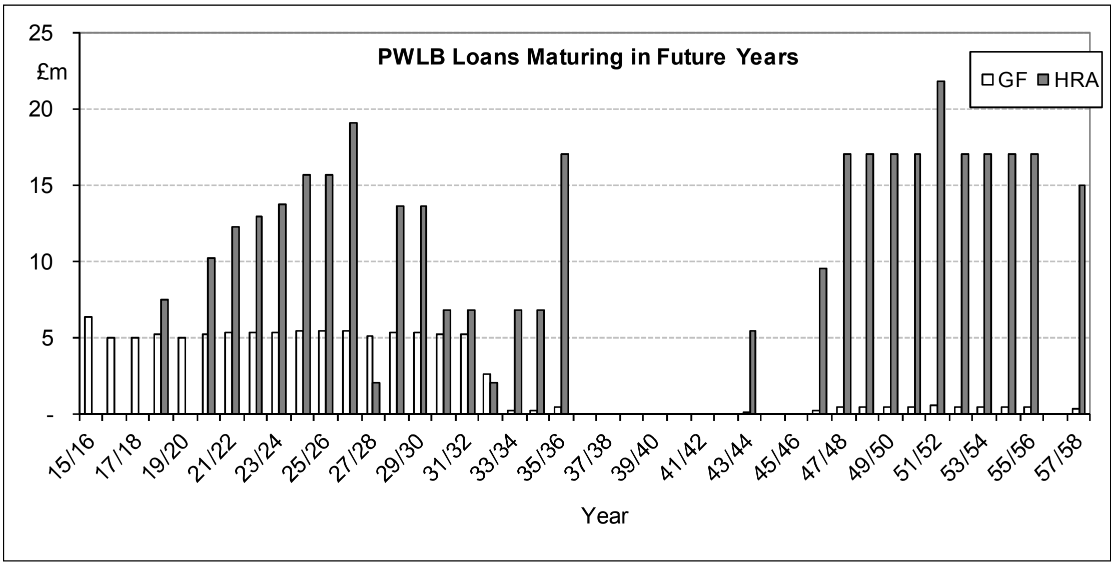
7. To ensure that the investment strategy remains sound under present market conditions, KPMG's specialist investment advisory unit were asked to carry out an independent review. They agreed the council's approach was prudent and considered further flexibility to raise diversification, liquidity and returns at the margin. They also noted that the scope for targeting significantly higher returns without increased risk under current tight credit spreads and low term premium was limited.

8. The 2015/16 investment strategy was updated following the KPMG review and agreed by council assembly in February 2015. The changes mean the council can place funds in further high rated supranational banks supported by many

governments, high rated foreign sovereigns, quasi-sovereigns or agencies sponsored by a government, region, local municipality or representative body (for example Network Rail or Transport for London here in the UK). The updated strategy will also be able to access high rated secure covered bonds which, in the unlikely event a major bank were to fail, may not be written down. In addition, there is to be no exposure to any securities longer than 5.5 years and all exposure beyond a year will be sovereign linked or backed by collateral. The changes will help the council respond more flexibly to still challenging financial markets, preserve capital, maintain liquidity, and secure a reasonable return. The council has access to two fund managers to efficiently and effectively implement the updated strategy. The managers' contracts were reviewed in May 2015 and are going to continue for a further three years.

Debt Management Activity and Position

9. The council has balances remaining on long term loans to pay for investment in housing and general fund capital spend carried out many years ago when rates were high. The loans are all from the Public Works Loans Board (PWLB, the local authority lending arm of the government) at fixed rates. In 2014/15, £5.7m loans (all General Fund) fell for repayment and were paid off. The balance remaining on all PWLB loans at 31 March 2015 was £469m (£371m HRA and £98m General Fund). The amounts falling due for repayment in the future are set out in the chart below.



10. PWLB debt levels and interest payments have fallen since 2006/07 as loans have been paid off, refer 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%
2014/15	469.2	25.7	5.5%

(*) 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.

11. Each year, the General Fund sets aside sums known as the minimum revenue provision (MRP) to reduce its borrowing liabilities and in 2014/15 the set-aside was £9m. This helped ensure that the £5.7m that matured in 2014/15 could be paid off without taking on new loans. The HRA is also setting aside sums to reduce its own borrowing liabilities. In 2014/15 the HRA set-aside was £19m and raised the headroom for future capital finance by that to £176m. The sums set-aside also reduced the draw on internal borrowing to support past capital spend. Following the set-asides, the level of internal borrowing in 2014/15 fell by £23m and closed the year at £208m (£183m General Fund, £25m HRA). Internal borrowing is cheaper than external borrowing and helps lower financing cost at a time the council faces significant budget pressures. However should cash supporting internal borrowing be needed in the future for spend, external borrowing would be needed. Borrowing may also be taken to replace maturing debt or prudently manage long term financing risks.

12. Earlier this year, the government announced that it would transfer the lending functions carried out by the PWLB to another agency. Although a consultation has yet to be published, it has been indicated that the change is about governance (i.e. the machinery of government) and no change to policy on lending to local authorities is expected. The PWLB is the dominant source of local authority borrowing and developments are being watched with interest.

Municipal Bond Agency

13. The Local Government Association has reported interest from up to 60 councils to launch a municipal bond agency as an alternative to the PWLB. The agency has around £4m in pledges to launch its first bond issue in 2015. The LGA itself is contributing £500,000. The council's own contribution is £200,000. The agency is looking to lend funds at a slightly lower rate than the PWLB. The terms will be fixed when the first bond is issued and potential borrowers will assess any savings in the rate against any joint and several guarantee or other conditions the agency places. However any borrowing the council itself needs will be from whichever source is the cheapest having regard to any conditions.

Prudential Indicators Outturn

14. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related Guidance published by the Chartered institute of Public Finance and Accountancy. The codes recommend councils agree a series of indicators and limits each year. The 2014/15 indicators were agreed in February 2014, before the start of the year and enabled the strategic director of finance and corporate services to carry out his responsibilities in this area. Existing budgets take account of capital finance and treasury activity and the indicators themselves have no impact on those budgets. The 2014/15 outturn on each indicator is set out at Appendix A.

15. The indicators include the authorised debt limit, which is a self imposed cap on borrowing and other long term liabilities (e.g. PFI schemes) outstanding on any one day, which the Local Government Act 2003 requires councils determine annually. The limit for 2014/15 was £935m and included operational flexibility for prudent temporary borrowing, 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 £589m during 2014/15.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Legal Services

16. 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.

17. 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.

18. 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.

19. 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.

20. 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 – 2014/15 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	12 June 2015	
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		24 June 2015