FAREHAM
BOROUGH COUNCIL

Report to the Executive for Decision
07 July 2014

Portfolio:	Policy and Resources
Subject:	**Treasury Management Annual Report 2013/14**
Report of:	Director of Finance and Resources
Strategy/Policy:	Finance and Treasury Management Strategies
Corporate Objective:	A dynamic, prudent and progressive Council

Purpose:
The Annual Report on Treasury Management for 2013/14 has been prepared in order to comply with the reporting requirements of the Code of Practice for Treasury Management produced by the Chartered Institute of Public Finance and Accountancy and adopted by the Council.

Executive summary:
The financial year 2013/14 continued the challenging environment of previous years namely low investment returns although levels of counterparty risk had subdued somewhat.

Full details of investment and borrowing activity in 2013/14 are set out in the main body of this report. Investment activity in 2013/14 is summarised below:

	£m
Investments as at 1 April 2013	**32.8**
Investments made in 2013/14	146.8
Investments repaid in 2013/14	138.8
Investments as at 31 March 2014	**40.8**

Total investment interest receivable for the year was £431,414. The total of external interest paid on borrowing and other amounts invested with the Council was £1,404,759.

The net total of £973,346 has been allocated to the Council's funds as shown in the following table:

	£
Net amount credited to the General Fund	770,881
Net amount credited to the Whiteley Fund	3,260
Net amount debited to the Housing Revenue Account	(1,747,487)
Net Total	**(973,346)**

During 2013/14, the Council complied with its legislative and regulatory requirements of the Prudential Code.

Recommendation:
That the Treasury Management Annual Report for 2013/14 be noted.

Reason:
This report has been prepared in order to comply with the reporting requirements of the Code of Practice for Treasury Management.

Cost of proposals:
Not applicable.

Appendices: **A:** Total Investment Activity 2013/14
B: Prudential and Treasury Indicators 2013/14

Background papers: None

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Executive Briefing Paper

Date: 07 July 2014

Subject: Treasury Management Annual Report 2013/14

Briefing by: Director of Finance and Resources

Portfolio: Policy and Resources

INTRODUCTION

1. The 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 2013/14. 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).

2. During 2013/14 the minimum reporting requirements were that full Council should receive the following reports:

   - An annual treasury strategy at the start of the year (Council 22 February 2013);
   - A mid-year (minimum) treasury update report (Council 12 December 2013);
   - An annual report following the year describing the activity compared to the strategy (this report).

3. In addition, the Council has received quarterly treasury management update reports on 2 September 2013, 4 November 2013 and 10 February 2014 which were received by the Executive.

4. 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.

5. The Council also confirms that it has complied with the requirement under the Code to give scrutiny to treasury management activity, by the Audit and Governance Committee. Member training on treasury management issues was undertaken during the year on 25 November 2013 in order to support members' scrutiny role.

THE ECONOMY AND INTEREST RATES

6. The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015.

7. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during 2013/14. Consequently there was no additional quantitative easing and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

8. The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

9. The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget), reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

10. The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern

THE TREASURY MANAGEMENT STRATEGY FOR 2013/14

11. The expectation for interest rates within the Treasury Management Strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 2 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. 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.

12. The actual movement in gilt yields meant PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases

by the Fed. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

THE BORROWING REQUIREMENT AND DEBT

13. The Council has £40m of fixed rate PWLB loans due to the abolishment of the housing subsidy system in March 2012, as shown below.

Principal	Interest Rate	Duration Remaining (years)
£4m	3.52%	38.5
£4m	3.51%	39.5
£4m	3.51%	40.5
£4m	3.51%	41.5
£4m	3.50%	42.5
£4m	3.50%	43.5
£4m	3.50%	44.5
£4m	3.49%	45.5
£4m	3.49%	46.5
£4m	3.48%	47.5

14. In addition to the fixed rate loans, the Council holds investments from Portchester Crematorium Joint Committee and the Cocks' Bequest Trust Fund which are treated as temporary loans.

15. Total interest payable by the Council in 2013/14 amounted to £1,404,759, as shown below:

	£
Interest payable to PWLB	1,400,400
Interest payable on investments with the Council	1,322
Other interest payable (e.g. HMRC, bonds)	3,037
Total	**1,404,759**

INVESTMENT RATES IN 2013/14

16. Bank Rate remained at its historic low of 0.5% throughout the year. It has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening ended up at early 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed during the whole of the year, although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.

INVESTMENT OUTTURN FOR 2013/14

17. The Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 22 February 2013. 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.).

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

19. The Council maintained an average balance of £36m of internally managed funds earning an average rate of return of 0.86%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.34%.

20. The Council uses the external fund manager Tradition UK Ltd to invest up to £13m of the Council's cash balances. The use of the external fund manager is a chargeable arrangement and has been in place since 2000. The performance of the fund was 1.13% compared to the 7-day LIBID benchmark return of 0.34%.

21. The list of approved institutions for the investment of the Council's surplus funds has been reviewed on a regular basis, taking account of the grading system for investment institutions operated by the Council's treasury management advisors, Capita Asset Services.

22. The Council's investments were £32.8m on 1 April 2013, which increased to £40.8m on 31 March 2014. However, at times during the year the level of investment was higher, as shown in the following table:

The Overall Level of Investments	
Date	£m
1 April 2013	32.8
30 June 2013	41.6
30 September 2013	45.5
31 December 2013	47.7
31 March 2014	40.8

23. An analysis of internally and externally managed investment activity and call accounts used during the year is shown in the table below.

	Externally Managed £m	Internally Managed £m	Call Accounts £m	Total £m
Investments at 1 April 2013	**10.0**	**12.0**	**10.8**	**32.8**
New investments	10.0	18.0	118.8	146.8
Investments repaid	10.0	12.0	116.8	138.8
Investments at 31 March 2014	**10.0**	**18.0**	**12.8**	**40.8**

24. The level of investment activity with each authorised institution is set out in Appendix A.

25. As the base rate has remained unchanged at 0.5% since March 2009, this has had a major impact on the rate of return on the Council's investments as the longer-term investments have matured.

26. The following table shows the range of interest rates for the investment portfolio

at the end of the year compared with the position in the previous year:

At 31 Mar 2013 (£m)	Investments	At 31 March 2014	
		£m	**%**
17.8	Interest Rate between 0.51% and 1.00%	34.8	85
3.0	Interest Rate between 1.00% and 1.50%	6.0	15
0	Interest Rate between 1.51% and 2.00%	0	0
0	Interest Rate between 2.01% and 2.50%	0	0
10.0	Interest Rate between 2.51% and 3.00%	0	0
2.0	Interest Rate between 3.01% and 3.50%	0	0
32.8	**Total**	**40.8**	**100**

27. The total interest received in respect of the 2013/14 investment activity and other interest received from car loans and housing association loan payments is as follows:

	£
Investments	283,388
Call Accounts	139,791
Other	8,234
Total	**431,413**

COMMERCIAL PROPERTY INVESTMENT ACQUISITIONS

28. In January 2013, the Executive agreed £3m to fund a commercial property investment acquisition programme as a means to optimise returns on Council investments. A further £5m was agreed by the Executive in November 2013.

29. Three purchases were made during 2013/14 as follows:

	Premises Type	£
Clifton House, Segensworth	Industrial	1,700,000
122-134 Seaside, Eastbourne	Convenience Store	825,000
86-88 Mitcham Lane, Streatham	Convenience Store	1,300,000
Total		**3,825,000**

30. The three premises will generate additional rental income of £296,000 per annum at a weighted average return of 8%.

INTEREST ALLOCATION

31. The interest receivable by the Council of £431,413 is allocated between the General Fund and the Housing Revenue Account (HRA). Interest is also payable in respect of the balances on the Whiteley Fund.

32. The allocation of interest to the HRA is based on the average balance for the year on the HRA itself, the Housing Repairs Account and the Major Repairs Reserve, using the average interest rate earned on external investments. The interest credited to the other funds is calculated in a similar way:

	£
Total interest receivable	431,413
Less:	
Amount due to Housing Revenue Account	123,486
Amount due to Whiteley Fund	3,260
Balance credited to the General Fund	304,667

33. The interest payable by the Council of £1,404,759 is also allocated between the General Fund and the HRA. The amount payable by the HRA is made up of the interest payable on external PWLB loans, internal General Fund loan and the HRA capital financing requirement.

34. This calculation means that the amount payable by the HRA to the General Fund is actually greater than the amount payable by the General Fund, as shown in the following table:

	£
Total interest payable by the General Fund	1,404,759
Less:	
Amount chargeable to the HRA	1,870,973
Surplus accruing to the General Fund	(466,214)

35. The net balance credited to the General Fund of £770,881 is shown in the General Fund as “Interest on Balances” for which the revised budget was £770,000.

PRUDENTIAL AND TREASURY INDICATORS

36. During 2013/14, the Council complied with its legislative and regulatory requirements. Appendix B shows the actual prudential and treasury indicators for 2013/14. Detailed information on actual capital expenditure and how this was financed can be found in a separate report on this agenda.

SUMMARY

37. This report gives details of the treasury management activity in 2013/14 in accordance with the reporting requirements set out in the CIPFA Code of Practice for Treasury Management. Members of the Executive are asked to note the report.

RISK ASSESSMENT

38. There are no significant risk considerations in relation to this report.

Reference Papers: CIPFA Code of Practice for Treasury Management

APPENDIX A

Total Investment Activity 2013/14 with Each Approved Institution

	Externally Managed £	Internally Managed £	Call Accounts £	Total £
Clearing Banks				
RBS (incl Nat West)	3,000,000	3,000,000	115,600,000	121,600,000
Barclays Bank	2,000,000	6,000,000		8,000,000
Lloyds Bank	2,000,000	14,000,000		16,000,000
HSBC			6,000,000	6,000,000
Other Banks				
Santander UK	2,000,000		8,000,000	10,000,000
Building Societies				
Nationwide	6,000,000	3,000,000		9,000,000
Skipton	2,000,000			2,000,000
Principality	1,000,000	1,000,000		2,000,000
West Bromwich	2,000,000			2,000,000
Other				
Glasgow City Council		3,000,000		3,000,000
Total Investments	**20,000,000**	**30,000,000**	**129,600,000**	**179,600,000**

APPENDIX B

2013/14 Prudential and Treasury Indicators - Actual Performance

Indicator	Description	2013/14 Indicator	2013/14 Actual
Aff.1	***Affordability Measure: Financing Costs as a percentage of net revenue stream***		
	Overall Position	2%	5%
1a	General Fund	-14%	-9%
1b	Housing Revenue Account	15%	15%
Aff.2	***Affordability Measure: Incremental impact of capital investment on Council Tax and Housing Rents***		
2a	Council Tax increases, borrowing costs only	£1.15	£0.00
2b	Housing Rent increases, borrowing costs only	£0.65	£0.00
Aff.3	***Affordability Measure: Capital Expenditure (£'000s)***		
	General Fund	£3,081	£7,566
	Housing Revenue Account	£5,333	£3,230
	Total Capital Expenditure	**£8,414**	**£10,796**
Aff.4	***Affordability Measure: External Debt Level (£'000s)***		
	Authorised limit, comprising	£61,000	£42,311
	- borrowing	*£57,000*	*£41,830*
	- other long term liabilities	*£4,000*	*£481*
	Operational boundary, comprising	£49,000	£42,311
	- borrowing	*£47,000*	*£41,830*
	- other long term liabilities	*£2,000*	*£481*
Aff.5	***Affordability Measure: Capital Financing Requirement (CFR) (£'000s)***	£51,051	£51,051
	General Fund CFR closing balance in the year	-£2,754	-£2,754
	HRA CFR closing balance in the year	£53,805	£53,805
Pru.1	***Prudence Measure: Gross Debt and Capital Financing Requirement (CFR) (£'000s)***		
	Gross Debt	£42,271	£41,830
	CFR (for last, current and next 2 years)	£204,204	£204,204
	Has measure been achieved?	Achieved	Achieved
	Memorandum Item : Prudence margin	£161,933	£162,374
Pru.2	***Prudence Measure: Adoption of the CIPFA Treasury Management Code of Practice***		
	Has the Code been adopted in its entirety?	Yes	Yes
Pru.3	***Prudence Measure: Upper Limits to fixed and variable interest rate exposure***		
	Upper limit to variable interest rate exposures	25%	0%
	Upper limit to fixed interest rate exposures	100%	100%
Pru.4	***Prudence Measure: Maturity structure of borrowing***	Upper Limit	
	Loans maturing within 1 year	25%	£40m long term loans from PWLB
	Loans maturing within 1 - 2 years	25%	
	Loans maturing within 2 - 5 years	25%	
	Loans maturing within 5 - 10 years	50%	
	Loans maturing in over 10 years	100%	
Pru.5	***Prudence Measure: Total Principal sums invested for periods of more than 364 days (£'000s)***		
	Upper Investment Limit for the year	£16,000	£2,000