Report to	Cabinet	**Item**
	9 September 2015	8
Report of	Chief finance officer	
Subject	Treasury management full year review report 2014-15	

Purpose

To review treasury management performance for the year to 31 March 2015

Recommendation

To recommend council note the report and the treasury activity for the year to 31 March 2015

Financial implications

The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources

Ward/s: All Wards

Cabinet member: Councillor Stonard– Resources and income generation

Contact officers

Justine Hartley	01603 212440
Philippa Dransfield	01603 212562

Background documents:

None

Report

1. Background

The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return. Counterparty risk is the term for the potential risks taken by an investor that the bank, building society, local authority or investment counterparty will be unable to repay the money invested.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

As a consequence, treasury management is defined as:

> "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Introduction

Norwich City 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 2014-15. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2014-15 the minimum reporting requirements were that the full council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 18/02/2014)
- a mid year (minimum) treasury update report (Council 10/12/2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This council also confirms that it has complied with the requirement under the code to give prior scrutiny to all of the above treasury management reports by the cabinet before they were reported to the full council. Member training on treasury management issues was undertaken during November 2013 in order to support members' scrutiny role.

This report summarises the following:-

- Capital activity during the year (section 3)
- Impact of this activity on the council's underlying indebtedness (the capital financing requirement) (section 4)

- The actual prudential and treasury indicators (section 4)
- Overall treasury position identifying how the council has borrowed in relation to this indebtedness, and the impact on investment balances (section 5)
- Review of treasury strategy and economic factors (sections 6 & 7)
- Borrowing rates and detailed debt activity (sections 8 & 9)
- Investment rates and detailed investment activity (sections 10 & 11)

3. The council's capital expenditure and financing 2014-15

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need, which will be satisfied by either external or internal borrowing.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m general fund	2013-14 actual	2014-15 mid-year estimate	2014-15 actual
Capital expenditure	3.5	13.4	7.2
Financed in year	3.5	7.9	7.2
(Over) / unfinanced capital expenditure	-	5.5	-

£m HRA	2013-14 actual	2014-15 mid-year estimate	2014-15 actual
Capital expenditure	27.2	44.4	30.5
Financed in year	28.6	44.4	32.0
(Over) / unfinanced capital expenditure	(1.4)	-	(1.5)

4. The council's overall borrowing need

The council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents the 2014-15 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through the public works loan board (PWLB) or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision – MRP, to reduce the CFR. This is effectively a repayment of the non-housing revenue account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

The council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

£m general fund	**2013-14 actual**	**2014-15 mid-year estimate**	**2014-15 actual**
Opening balance	26.8	25.7	25.7
Add: unfinanced capital expenditure (as above)	-	5.5	-
Less: MRP	(1.1)	(1.0)	(1.0)
Closing balance	25.7	30.2	24.7

£m HRA	**2013-14 actual**	**2014-15 mid-year estimate**	**2014-15 actual**
Opening balance	210.3	208.8	208.8
Add: unfinanced capital expenditure (as above)	(1.4)	-	(1.5)
Less: Finance lease repayments	(0.1)	(0.1)	(0.0)
Closing balance	208.8	208.7	207.3

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, must only be for a capital purpose. This essentially means that the council is not borrowing to support revenue expenditure. Gross borrowing should not therefore, except in the short term, have exceeded the CFR for 2014-15 plus the expected changes to the CFR over 2014-15 and 2015-16 from financing the capital programme. This indicator allows the council some flexibility to borrow in advance of its immediate capital needs in 2014-15. The table below highlights the council's gross borrowing position against the CFR. The council has complied with this prudential indicator.

It should be noted that this indicator changed from comparing net borrowing to the CFR with effect from 2014-15; this provides a more appropriate indicator.

£m	2013-14 actual	2014-15 mid-year estimate	2014-15 actual
Gross borrowing	224.2	224.2	224.2
CFR	234.5	238.9	232.0

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

£m	2014-15
Authorised limit	266.0
Maximum gross borrowing position	224.8
Operational boundary	224.4
Average gross borrowing position	224.2
Financing costs as a proportion of net revenue stream	

5. Treasury position as at 31 March 2015

The council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2014-15 the council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31- Mar-14 £m	Rate / Return	Average Life years	31- Mar-15 £m	Rate / Return	Average Life years
Fixed Rate Funding						
- PWLB	218.9	4.42%	11.3	218.9	4.42%	10.3
- Market	5.0	4.80%	40.04	5.0	4.80%	39.04
- Other	0.5	3.00%	Perpetually irredeemable	0.5	3.00%	Perpetually irredeemable
Total debt	224.4			224.4		
CFR	235.4			232.0		
Over /(under) borrowing	(11.0)			(7.6)		
Investments	64.0	1.09%	0.4	67.3	0.83%	0.5
Net Debt	160.4			157.1		

The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	**31-Mar-2015 £m**	**31-Mar-2014 £m**
under 12 months	6.36	1.30
12 months and within 24 months	5.75	5.06
24 months and within 5 years	14.00	17.75
5 years and within 10 years	59.96	59.46
10 years and within 20 years	132.18	132.53
20 years and within 30 years	1.97	4.12
30 years and within 40 years	5.29	5.29
Total	**225.51**	**225.51**

The difference between the amounts in the table above and the total debt disclosed in the previous table is the current repayable debt of £1.3m which relates to accrued interest on the PWLB and Barclays loans.

The following table shows the movement in investments in the year.

Investments £'000	Actual 31 March 2014	Movement			Actual 31 March 2015
		Invested	Matured	Transferred to Short Term	
Long Term					
Banks	-	3,000	-	-	3,000
Local Authorities	3,000	-	-	(3,000)	-
Short term					
Banks	34,500	15,000	(34,500)	-	15,000
Building Societies	7,000	35,000	(12,000)	-	30,000
Local Authorities	-	2,000	-	3,000	5,000
Cash Equivalents					-
Banks	10,000	99,846	(99,846)	-	10,000
Building Societies	9,500	504,495	(509,745)	-	4,250
Local Authorities	-	6,000	(6,000)	-	-
Total	**64,000**	**665,341**	**(662,091)**	**-**	**67,250**

The maturity structure of the investment portfolio was as follows:

£'000	31-Mar-15	31-Mar-14
Longer than 1 year	3,000	3,000
Under 1 year	64,250	61,000
	67,250	**64,000**

6. The strategy for 2014-15

The expectation for interest rates within the strategy for 2014-15 anticipated low but rising bank rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014-15. 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.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

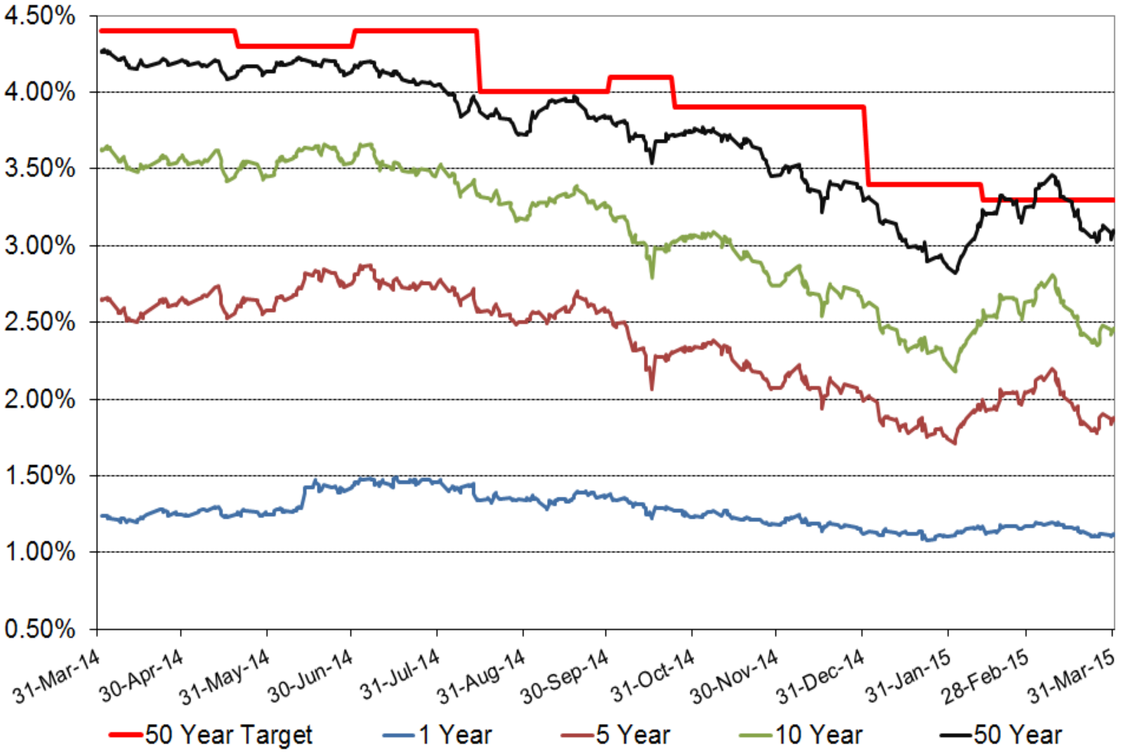
7. The economy and interest rates

The original market expectation at the beginning of 2014/15 was for the first increase in bank rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in bank rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise bank rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014-15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone(EZ) once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

8. Borrowing rates in 2014-15

PWLB borrowing rates - the graphs and table for PWLB maturity rates below show for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



9. Borrowing outturn for 2014-15

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

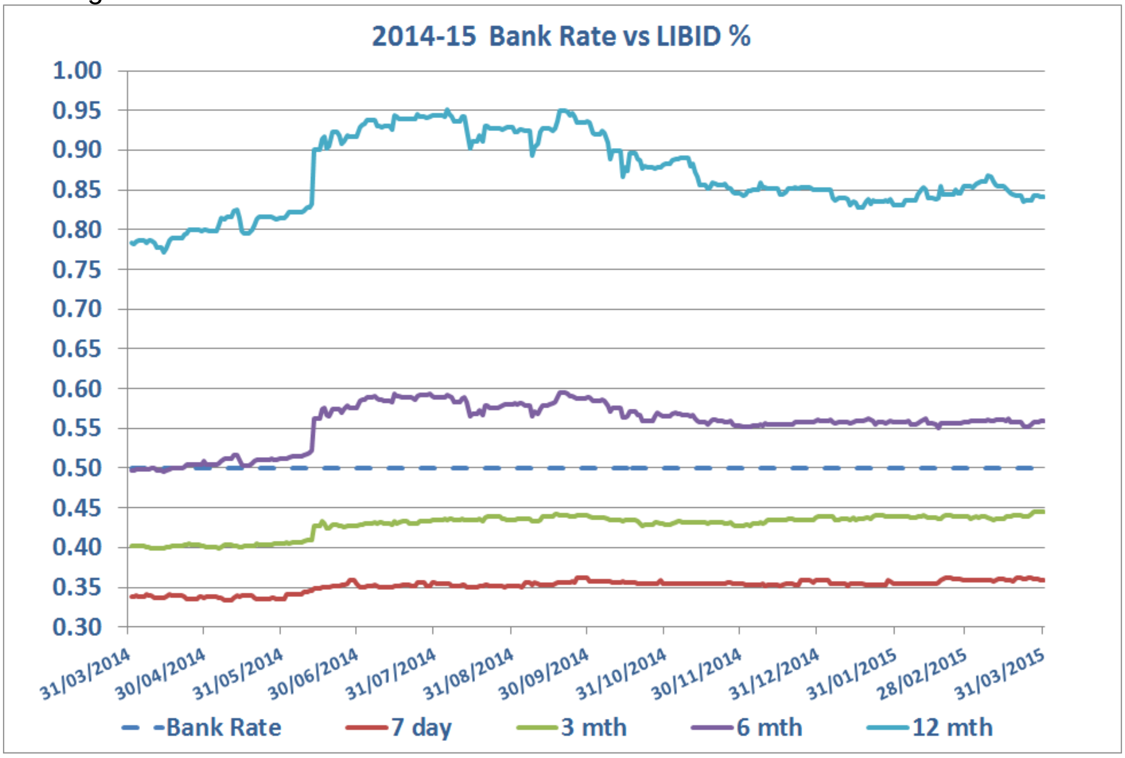
Borrowings by the council

During 2014-15 the council paid £9,928,046 in interest cost, this compares to a budget assumption of £9,931,540

Investment rates in 2014-15

Bank rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for

Lending Scheme



10. Investment outturn for 2014-15

Investment policy – the council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the council on 18 February 2014. 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 [a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event]., bank share prices etc.).

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

Resources – the council's cash balances comprise revenue and capital resources and cash flow monies. The council's core cash resources comprised as follows:

£m Balance Sheet Resources	**31-Mar-15**	**31-Mar-14**
Balances	29.8	33.4
Earmarked Reserves	4.1	2.6
Useable Capital receipts	24.9	19.8
Capital grants Unapplied	5.1	3.9
Total	**63.9**	**59.8**

Investments held by the council - the council maintained an average balance of £67.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.935%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.352%. This compares with a budget assumption of £60m investment balances earning an average rate of 1.0%. The average of the population of 206 local authorities was 0.70% and that of 87 non-met authorities was 0.72%.

The council's investment return for 2014-15 is £1,027,445 which is £427,445 above the amount budgeted for the year of £600,000. The variance is due to having a higher average balance to invest.

The council is part of a benchmarking group across Norfolk, Suffolk and Cambridgeshire, the table below shows the performance of the council's investments compared to the other councils (who have been made anonymous). This shows that the rate of return that will be achieved by investments held at the yearend by the council as being the 3rd highest and with highest risk when compared to the rest of the benchmarking group.

Council	**WARoR**		**WA Risk**		**WAM**		**WA Tot. time**	
	31-Mar-15	**31-Mar-14**	**31-Mar-15**	**31-Mar-14**	**31-Mar-15**	**31-Mar-14**	**31-Mar-15**	**31-Mar-14**
Norwich	0.83%	1.09%	4.7	4.8	173	147	329	425
A	0.90%	0.85%	2.9	3.4	216	139	419	208
B	0.51%	0.69%	2.6	3.9	51	145	80	185
C	0.75%	0.87%	3.5	3.9	27	46	218	260
D	0.78%	0.94%	3.9	3.9	114	103	217	236
E	0.68%	0.65%	3.5	4.4	136	142	204	180
F	0.75%	0.71%	4.0	4.5	92	102	172	127
G	0.79%	N/A	3.2	N/A	201	N/A	281	N/A
H	0.89%	N/A	4.3	N/A	54	N/A	216	N/A

WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

WA risk – Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated.

1 Up to 5 years

2 Up to 2 years

3 Up to 1 year

4 Up to 6 months

5 Up to 3 months

6 0 months

A number of 4.7 means between 3 to 6 months

WAM – Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

WA Tot. Time – Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

Integrated impact assessment

NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	9 September 2015
Head of service:	Justine Hartley
Report subject:	Full Year Treasury Management Report
Date assessed:	18 August 2015
Description:	

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues