Report to	Cabinet	**Item**
	25 June 2014	15
Report of	Chief finance officer	
Subject	Treasury Management Full Year Review Report 2013-14	

Purpose

To consider the Treasury Management performance for the year to 31 March 2014

Recommendation

To recommend Council to note the treasury activity for the year to 31 March 2014

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 Waters – Deputy leader and resources

Contact officers

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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

This 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).

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

- an annual treasury strategy in advance of the year (Council 19/02/2013)
- a mid year (minimum) treasury update report (Council 11/12/2013)
- 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 2013-14

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	**2012/13 Actual**	**2013/14 Estimate**	**2013/14 Actual**
Capital expenditure	6.2	8.8	3.5
Financed in year	4.1	8.8	3.5
(Over)/unfinanced capital expenditure	2.1	-	-

£m HRA	**2012/13 Actual**	**2012/13 Estimate**	**2012/13 Actual**
Capital expenditure	24.7	33.3	27.2
Financed in year	26.5	33.3	28.6
(Over)/unfinanced capital expenditure	(1.8)	-	(1.4)

In 2012/13 the General Fund underfinanced expenditure is as result of the appropriation of HRA properties from the HRA to the General Fund to the value of £1.8m, which resulted in the £1.8m over-financing of the HRA capital expenditure..

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 2013/14 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.

CFR £m General Fund	**2012/13 Actual**	**2013/14 Estimate**	**2013/14 Actual**
Opening balance	27.3	26.3	26.3
Add: Unfinanced capital expenditure (as above)	2.1	-	
Less MRP	(1.0)	(1.1)	(1.1)
Rebase and recalculation adjustment	(2.1)	-	-
Closing balance	26.3	25.2	25.2

CFR £m HRA	**2012/13 Actual**	**2013/14 Estimate**	**2013/14 Actual**
Opening balance	202.0	211.6	211.6
Add: Unfinanced capital expenditure (as above)	(1.8)	-	(1.4)
Less PFI & finance lease repayments	(0.1)	(0.1)	(0.1)
Rebase and recalculation adjustment	11.5	-	-
Closing balance	211.6	211.5	210.1

During 2012/13, it was discovered that the HRA CFR had been miscalculated since 2004, which resulted in the HRA CFR being understated and the General Fund CFR being overstated. Both CFR's have been recalculated and adjusted to reflect the true position. This recalculation was agreed with external audit.

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

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2013/14 plus the expected changes to the CFR over 2013/14 and 2014/15 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 net borrowing position against the CFR. The Council has complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator.

£m	**2012/13 Actual**	**2013/14 Estimate**	**2013/14 Actual**
Net borrowing position	179.4	225.9	224.4
CFR	237.9	236.8	235.4

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 2012/13 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	**2013/14**
Authorised limit	266.0
Maximum gross borrowing position	224.8
Operational boundary	224.4
Average gross borrowing position	226.0
Financing costs as a proportion of net revenue stream	5.85%

5. Treasury Position as at 31 March 2014

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 2013/14 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31 March 2013	**Rate / Return**	**Average Life years**	**31 March 2014**	**Rate / Return**	**Average Life years**
Fixed Rate Funding						
- PWLB	£218.9m	4.42%	12.24 yrs	£218.9m	4.42%	11.24yrs
- Market	£5.0m	4.80%	41.04 yrs	£5.0m	4.80%	40.04 yrs
- Other	£0.5m	3.00%	Perpetually irredeemable	£0.5m	3.00%	Perpetually irredeemable
Total debt	£224.4m			£224.4m		
CFR	£237.9m			£235.4m		
Over /(under) borrowing	£(11.9)m			£(11.0)m		
Investments	£49.6m	1.72%	0.72 yrs	£64.0m	1.09%	1.16 yrs

The maturity structure of the debt portfolio was as follows:

£m	**31 March 2013**	**31 March 2014**
Under 12 months	1.3	1.3
12 months and within 24 months	-	5.1
24 months and within 5 years	17.8	17.8
5 years and within 10 years	9.7	59.5
10 years and above	196.9	141.9

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

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

Investments £'000	Treasury Management Strategy	Actual 31 March 2013	Movement			Actual 31 March 2014
			Invested	Matured	Transferred to Short Term	
Long Term						
Banks		12,500	-	-	(12,500)	-
Local Authorities		3,000	-	-	-	3,000
Short term						
Banks		19,000	30,060	(27,060)	12,500	34,500
Building Societies		6,000	58,800	(57,800)	-	7,000
Local Authorities		3,000	-	(3,000)	-	-
Cash Equivalents						
Banks		6,100	268,179	(264,279)	-	10,000
Building Societies		-	213,650	(204,150)	-	9,500
Debt Management Office		-	10,100	(10,100)	-	-
Total	**40,000**	**49,600**	**580,780**	**(566,389)**	**-**	**64,000**

The maturity structure of the investment portfolio was as follows:

£m	**31 March 2013**	**31 March 2014**
Longer than 1 year	15.5	3.0
Under 1 year	34.1	61.0

6. The Strategy for 2013/14

The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), 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.

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 were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. 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.

7. The Economy and Interest Rates

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. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 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.

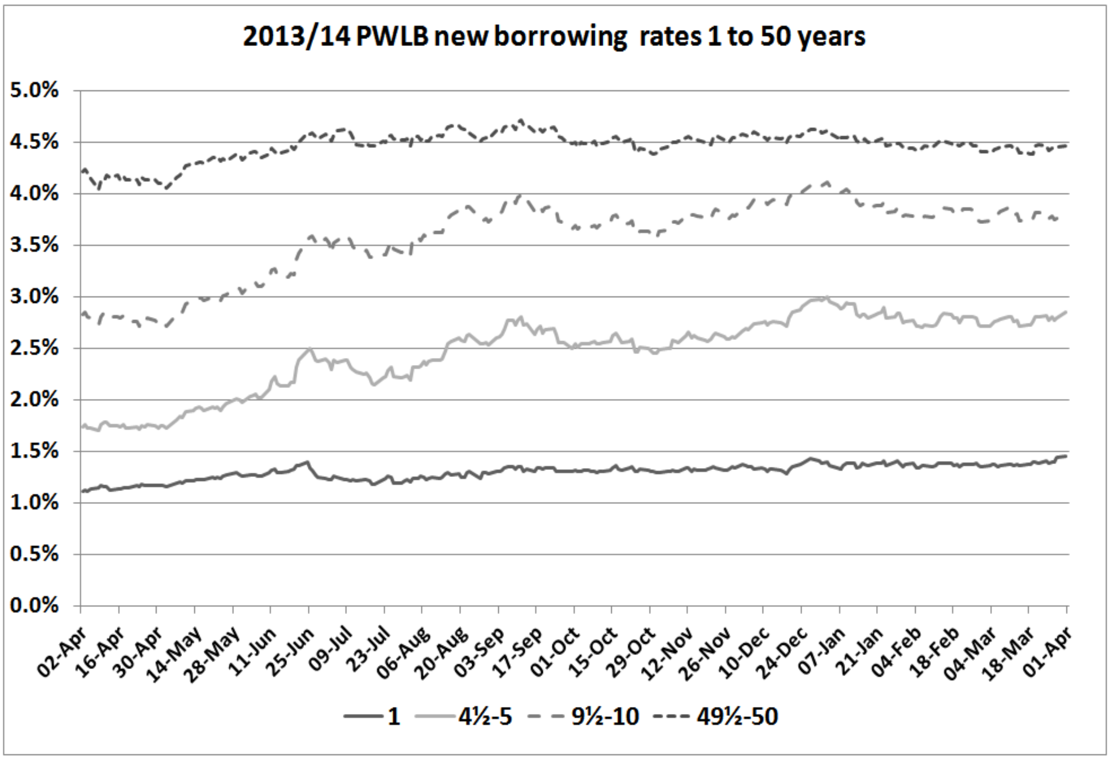
Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then 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.

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

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.

8. Borrowing Rates in 2013/14

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 2013/14

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

Borrowings by the Council

During 2013/14 the council paid £9,930,599 in interest cost, this compares to a budget assumption of £9,945,187.

Investment Rates in 2013/14

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 unchanged 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.

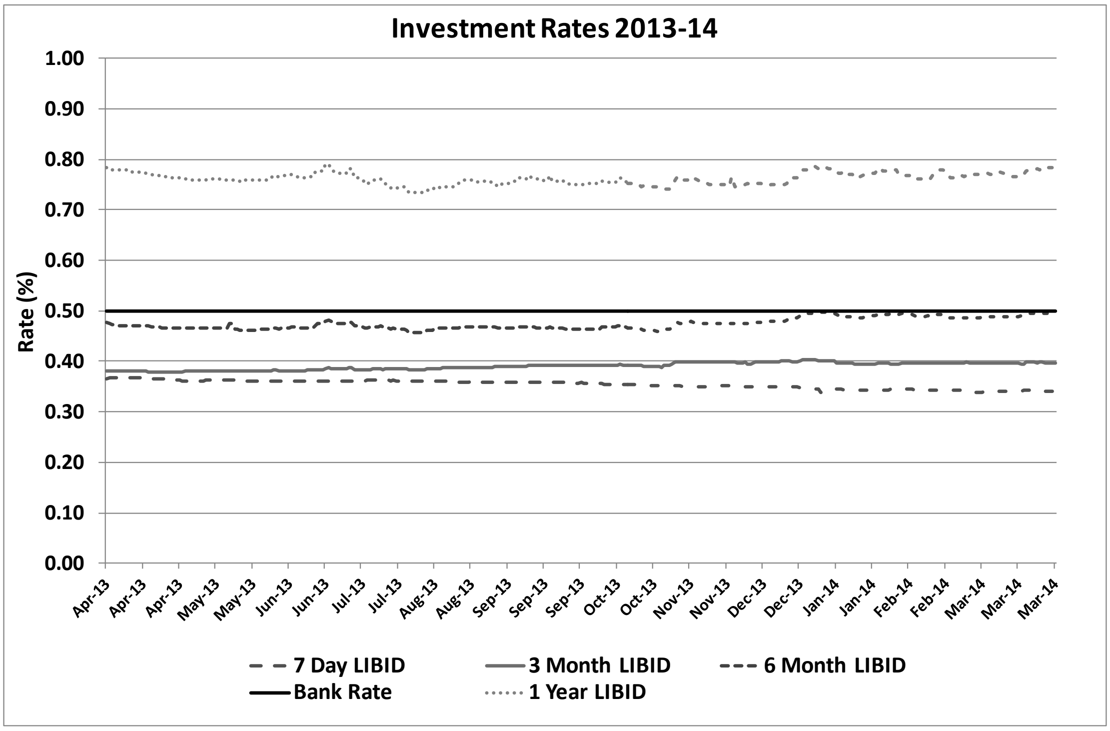
10. Investment Outturn for 2013/14

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 19 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 [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 March 2013**	**31 March 2014**
Balances	32.7	
Earmarked Reserves	2.7	
Useable Capital receipts	15.2	
Capital grants Unapplied	1.6	
Total	52.2	



Investments held by the Council - the Council maintained an average balance of £64.4m of internally managed funds. The internally managed funds earned an average rate of return of 1.235%. The comparable performance indicator is the average 7-day LIBID rate, which was

0.342%. This compares with a budget assumption of £50m investment balances earning an average rate of 1.2%. The average of the population of 214 local authorities was 0.70% and that of 85 non-met authorities was 0.73%. The average for the other LGSS community was 0.63%.

The Council's investment return for 2013/14 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 & 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 year end by the Council as being highest of the benchmarking group with highest risk and longest time to maturity when compared to the rest of the benchmarking group.

Council	WARoR	WA Risk	WAM	WA Tot. time
Norwich	1.09%	4.8	147	425
A	0.85%	3.4	139	208
B	0.69%	3.9	145	185
C	0.87%	3.9	46	260
D	0.94%	3.9	103	236
E	0.65%	4.4	142	180
F	0.71%	4.5	102	127

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 4.8 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:	25 June 2104
Head of service:	Caroline Ryba
Report subject:	Full Year Treasury Management Report
Date assessed:	2 June 2104
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