Public
Key Decision – No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title:	**2013/14 Treasury Management Annual Report**
Meeting/Date:	**Cabinet** 17 July 2014
Executive Portfolio:	**Resources: Councillor J A Gray**
Report by:	**Head of Resources**
Ward(s) affected:	**All Wards**

Executive Summary:
The Council's Treasury Management processes are underpinned by CIPFA's Code of Practice on Treasury Management, the Code requires the Council to produce an annual Treasury Management Strategy, for 2013/14 this was approved by Council on the 20th February 2013. The code of practice also recommends that members are informed of treasury management activity at least twice a year; the first report, the 2013/14 mid-year report was reported to Cabinet on the 12th December 2013 and this is the second of the two reports.

The Council will during the course of its normal business borrow and invest substantial sums of money, and as a consequence is exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates.

The identification and monitoring of these risks are central to the Council's Treasury Management Strategy. The main points of the Treasury Management Strategy are;

- Ensuring the Council has sufficient cash to meet its day to day obligations.
- Borrowing when necessary to fund capital expenditure, including borrowing in anticipation of need when rates are considered to be low.
- Investing surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.

Throughout 2013/14 there has been a moderate reduction in the credit rating of financial institutions, in order to mitigate the risk from this the Council has mainly invested on a short-term basis, with significant use made of call accounts, where access to funds is instant. Borrowing has also been made mainly on a short-term basis.

The Council's banker, NatWest was downgraded in March 2014 and as a consequence was removed from the counterparty list. NatWest will not be used for investments but will continue to be used for operational banking requirements.

The average interest rate paid for borrowing was 2.94%, and the average interest rate received for investing was 2.29%.

Recommendation(s):
- That Cabinet note the content of this report and annexes

1. INTRODUCTION

1.1 Council approves the Treasury Management Strategy for the coming year when it approves the budget and MTP each February. It also receives a mid-year report and an annual report after the end of the financial year. The Strategy is scrutinised by the Economic Well-being Panel.

1.2 The key points in the 2013/14 Strategy were:

- Ensuring the Council has sufficient cash to meet its day to day obligations.
- Borrowing when necessary to fund capital expenditure, including borrowing in anticipation of need when rates are considered to be low.
- Investing surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.

2. ECONOMIC REVIEW

2.1 An economic review of the year provided by our Treasury Management advisors, Arlingclose, is attached as Annex A.

3. PERFORMANCE OF FUNDS

3.1 The following table summarises the treasury management transactions undertaken during the 2013/14 financial year and the details of the investments and loans held as at 31st March 2014 are shown in detail in Annex B.

3.2

	Principal Amount £m	**Interest Rate %**
Investments		
at 31st March 2013	6.4	3.93
less matured in year	-188.0	
plus arranged in year	+185.1	
at 31st March 2014	3.5	1.74
Average Investments	**10.6**	**2.29**
Borrowing		
at 31st March 2013	16.0	2.56
less repaid in year	-31.6	
plus arranged in year	+33.0	
at 31st March 2014	17.4	2.55
Average Borrowing	**14.4**	**2.94**

3.3 The average rate of interest on all investments was 2.29%, 1.96% above the 7-day benchmark rate of 0.33%. This good performance was due to £5m of the investments being locked into higher rates before the year started together with the use of liquidity accounts with major banks and building societies and Money Market Funds which gave the added safety of instant access together with interest rates in excess of the benchmark.

3.4 If only short-term cash flow investment activity is considered, the rate of interest on investments was 0.94%, which is still more than double the 7-day benchmark rate of 0.33%.

3.5 The Council's exposure to interest rate risk at the end of the year was:

- £11.4m long term borrowing from the PWLB, at a weighted average rate of 3.70%.
- £6.0m short term borrowing for 1 month at a weighted average rate of 0.37%.

This gave an overall weighted average borrowing rate of 2.55%.

3.6 The actual net investment interest payable (after deduction of interest receivable on loans) was £182,000 which is £57,000 (24%) less than the original budget. This is mainly due to higher than expected reserves reducing the need to borrow externally.

4. STRATEGY – BORROWING

4.1 **Long-term borrowing**. The strategy allowed for 'must borrow' to finance that part of the capital programme that could not be met from internal funds. There was also a provision for 'may borrow' which allowed borrowing in anticipation of need, based on whether longer term rates seemed low compared with future likely levels. Long-term borrowing of £1.5m was obtained from PWLB to fund a loan to Huntingdonshire Regional College. Short-term borrowing rates were very low, as a result short-term borrowing and internal borrowing was used for funding.

4.2 **Short-term borrowing**. The Authority needed to borrow short-term during the year to manage its cash flow; it averaged £3.4m per day.

5. STRATEGY - INVESTMENTS

5.1 The Council's strategy for 2013/14 was based on all investments being managed in-house. The investments were of three types:

- time deposits,
- liquidity (call) accounts (with banks with a high credit rating and the top 25 building societies by asset value), and
- money market funds

5.2 In March 2014 the long-term rating of both the Royal Bank of Scotland and

NatWest Bank were downgraded to Baa1. This rating is below the Council's minimum investment credit criterion of AA-, as a consequence the bank was withdrawn from the Council's counterparty list for investment purposes. The NatWest will continue to be used for operational banking purposes (cash flow and day-to-day banking) but not for investments. All bank accounts held by NatWest are maintained at or near to zero.

5.3 The strategy includes limits on the size of investments with each organisation and country limits. The limits are shown in Annex C**.**

5.4 The strategy was reviewed during the course of the year and the mid-year report was reported to Cabinet on the 12th December 2013.

6. RISK MANAGEMENT

6.1 The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return.

6.2 **Security** is managed by investing short-term with highly-rated banks, building societies and local authorities in the UK. The Authority received regular updates from its advisors, Arlingclose, sometimes daily, on changes to the credit rating of counterparties. This allowed the Council to amend its counterparty list and not invest where there is concern about the credit rating.

6.3 **Liquidity.** The majority of the Council's invested funds have been held in liquidity accounts or Money Market Funds, which have a rate of interest above base rate and provide instant access to funds.

6.4 Overall, liquidity was managed by producing daily cash flow forecasts that help set the limit on the duration of the investments in time deposits. The projections turned out to be cautious which sometimes resulted in funds being available before they were needed with any surplus being invested on a temporary basis.

6.5 **Return on investments.** Security and liquidity took precedence over the return on investments, which resulted in investments during 2013/14 generally being of short duration due to the benefit of good rates on liquidity and growing concerns over the credit rating of counterparties. With the Bank of England base rate being set at historically low levels, the rates of return available from the market are consequently also low.

7. COMPLIANCE WITH REGULATIONS AND CODES

7.1 All the treasury management activity undertaken during the financial year complied with the approved strategy, the CIPFA Code of Practice, and relevant legislation.

7.2 The Code requires the Council to approve both Treasury Management and Prudential Indicators. Those for 2013/14 were approved at the Council meeting on 20th February 2013. Annex D shows the relevant indicators and the actual results.

8 CONCLUSION

8.1 Considering that interest rates for the year remained exceptionally low, the Council's performance on the investment of funds significantly exceeds the benchmark and the budgeted investment interest.

8.2 In a year of uncertainty in the financial markets all of the Council's investments were repaid in full and on time.

8.3 The Authority has carried out its treasury management activities with due regard to minimising risk, and in accordance with legislation. During the year it reviewed its strategy in the light of external events in the markets.

9. COMMENTS OF OVERVIEW & SCRUTINY PANEL

9.1 The Overview & Scrutiny Panel (Economic Well-Being) considered the Council's treasury management performance at their meeting on 12 June 2014. The Panel noted the report and associated annexes.

10 RECOMMENDATION

10.1 It is recommended that Cabinet note this report.

BACKGROUND INFORMATION
2013/14 cash management files and working papers
Reports to the Cabinet and Treasury Management Advisory Group
CIPFA Code on Treasury Management

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ANNEX A

ECONOMIC REVIEW OF 2013/14

1.1 At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a 'triple-dip' alongside falling real wages (i.e. after inflation) and the paucity of business investment were a concern for the Bank of England's Monetary Policy Committee. Only two major economies – the US and Germany – had growth above pre financial crisis levels, albeit these were still below trend. The Eurozone had navigated through a turbulent period for its disparate sovereigns and the likelihood of a near-term disorderly collapse had significantly diminished. The US government had just managed to avoid the fiscal cliff and a technical default in early 2013, only for the problem to re-emerge later in the year.

1.2 With new Governor Mark Carney at the helm, the Bank of England unveiled forward guidance in August pledging to not consider raising interest rates until the ILO unemployment rate fell below the 7% threshold. In the Bank's initial forecast, this level was only expected to be reached in 2016. Although the Bank stressed that this level was a threshold for consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.

1.3 The recovery in the UK surprised with strong economic activity and growth. Q4 2014 GDP showed year-on-year growth of 2.7%. Much of the improvement was down to the dominant service sector, and an increase in household consumption buoyed by the pick-up in housing transactions which were driven by higher consumer confidence, greater availability of credit and strengthening house prices which were partly boosted by government initiatives such as Help-to-Buy. However, business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth. Worries of a housing bubble were tempered by evidence that net mortgage lending was up by only around 1% annually.

1.4 CPI fell from 2.8% in March 2013 to 1.7% in February 2014, the lowest rate since October 2009, helped largely by the easing commodity prices and discounting by retailers, reducing the pressure on the Bank to raise rates. Although the fall in unemployment (down from 7.8% in March 2013 to 7.2% in January 2014) was faster than the Bank of England or indeed many analysts had forecast, it hid a stubbornly high level of underemployment. Importantly, average earnings growth remained muted and real wage growth (i.e. after inflation) was negative. In February the Bank stepped back from forward guidance relying on a single indicator – the unemployment rate – to more complex measures which included spare capacity within the economy. The Bank also implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

1.5 The Office of Budget Responsibility's 2.7% forecast for economic growth in 2014 forecast a quicker fall in public borrowing over the next few years.

However, the Chancellor resisted the temptation to spend some of the proceeds of higher economic growth. In his 2013 Autumn Statement and the 2014 Budget, apart from the rise in the personal tax allowance and pension changes, there were no significant giveaways and the coalition's austerity measures remained on track.

1.6 The Federal Reserve's then Chairman Ben Bernanke's announcement in May that the Fed's quantitative easing (QE) programme may be 'tapered' caught markets by surprise. Investors began to factor in not just an end to QE but also rapid rises in interest rates. 'Tapering' (a slowing in the rate of QE) began in December 2013. By March 2014, asset purchases had been cut from $75bn to $55bn per month with expectation that QE would end by October 2014. This had particular implications for global markets which had hitherto benefited from, and got very accustomed to, the high levels of global liquidity afforded by QE. The impact went further than a rise in the dollar and higher US Treasury bond yields. Gilt yields also rose as a consequence and emerging markets, which had previously benefited as investors searched for yield through riskier asset, suffered large capital outflows in December and January.

1.7 With the Eurozone struggling to show sustainable growth, the European Central Bank cut main policy interest rates by 0.25% to 0.25% and the deposit rate to zero. Markets were disappointed by the lack of action by the ECB despite CPI inflation below 1% and a looming threat of deflation. Data pointed to an economic slowdown in China which, alongside a weakening property market and a highly leveraged shadow banking sector, could prove challenging for its authorities.

1.8 Russia's annexation of the Ukraine in March heightened geopolitical tensions and risk. The response from the West which began with sanctions against Russia which is the second largest gas producer in the world and which supplies nearly 30% of European natural gas needs and is also a significant supplier of crude oil – any major disruption to their supply would have serious ramifications for energy prices.

1.9 Gilt Yields and Money Market Rates: Gilt yields ended the year higher than the start in April. The peak in yields was during autumn 2013. The biggest increase was in 5-year gilt yields which increased by nearly 1.3% from 0.70% to 1.97%. 10-year gilt yields rose by nearly 1% ending the year at 2.73%. The increase was less pronounced for longer dated gilts; 20-year yields rose from 2.74% to 3.37% and 50-year yields rose from 3.23% to 3.44%. 3-month, 6-month and 12-month Libid rates remained at levels below 1% through the year.

ANNEX B

BORROWING AND INVESTMENTS AT 31 MARCH 2014

	Short-term Rating		Date Invested/ Borrowed	Amount		Interest Rate	Year of Maturity
	Fitch	**Moody's**		**£m**	**£m**		
BORROWING							
Short-term							
Portsmouth City Council	Not rated		14/03/14	4.000		0.40%	2014/15
South Lanarkshire Council	Not rated		18/03/14	2.000		0.32%	2014/15
					6.000		
Long-term							
PWLB			07/08/13	1.433		2.24%	2023/24
PWLB			19/12/08	5.000		3.91%	2057/58
PWLB			19/12/08	5.000		3.90%	2058/59
					11.433		
Total Borrowing					**17.433**		
INVESTMENTS IN-HOUSE							
Investments							
NatWest Liquidity	F1	P2		0.034m		0.50%	On-call
Cambridge Building Society	Not rated			0.100m		0.50%	On-call
Santander	F1	P1		1.150m		0.50%	On-call
Public Sector Deposit Fund	AAAmmf			0.650m		0.33%	On-call
					1.934		
Loans							
Alconbury Parish Council	Not rated			0.010m		0.50%	2016/17
Huntingdonshire Regional College	Not rated			1.436m		3.34%	2023/24
Huntingdon Gym	Not rated			0.072m		5.13%	2023/24
					1.518		
Total Investments					**3.452**		
Net Borrowing					**13.981**		

IN-HOUSE FUND MANAGEMENT (IF NO FURTHER ADVANCE BORROWING)

Duration of investments	No investment shall be longer than 5 years. Maximum duration for a Building Society with no rating is 1 month.
Types of investments	Fixed term Deposits Deposits at call, two or seven day notice Corporate bonds Money market funds UK Government bonds and Supranational Bank bonds Loans to organisations
Credit Ratings	**Building Societies** All Building Societies with ratings of BBB or above. Building Societies with no ratings. **Money Market Funds** AAA credit rating **Local Authorities or UK Government** No rating required **Non-Building Societies** Short term rating F1 by Fitch or equivalent. Long-term rating of AA- by Fitch or equivalent if the investment is longer than 1 year. **Loans to Organisations** These will not require a specific credit rating but will be subject to individual approval by Cabinet.
Maximum limits per counterparty (group), country or non-specified category	F1+ or have a legal position that guarantees repayment for the period of the investment — £5M F1 — £4M Building Society with assets over £2bn in top 25 (Currently 10) — £5M Building Society with assets over £1bn if in top 25 (Currently 3) — £4M Building Society with assets under £1bn in top 25 — £3M Liquidity (Call) Account with a credit rating of F1+ or with a legal position that guarantees repayment or a Building Society. — £5M BUT total invested with counterparty/group shall not exceed — £8M Money market fund AAA Credit rating — £4m **Limit for Non-specified investments** – £10M in time deposits more than one year – £5M in corporate bonds – £10M in any other types. – £15M in total **Country limits** – UK - unlimited – £5M in a country outside the EU – £10M in a country within the EU (excluding UK) – £20M in EU countries combined (excluding UK) – Country of Domicile for Money Market Funds – unlimited, providing the fund is AAA. No investment will be made in country with a sovereign rating of less than AA. These limits will be applied when considering any new investment from 23 February 2012. Lower limits may be set during the course of the year or for later years to avoid too high a proportion of the Council's funds being with any counterparty. **Loans to Organisations** No limit in value or period.
Benchmark	LGC 7 day rate

Annex D

CIPFA Prudential Indicators for Capital Finance in Local Authorities
Prudential Indications and Treasury Management Indications for 2013/14
Comparison of actual results with limits

PRUDENTIAL MANAGEMENT INDICATORS

1. Actual and Estimated Capital Expenditure.

	2013/14 Estimate £000	2013/14 Actual £000
Gross	17.9	15.5
Net	8.7	10.1

2. The proportion of the budget financed from government grants and council tax that is spent on interest and the provision for debt repayment.

2013/14 Estimate	2013/14 Actual
7%	6%

3. The impact of schemes with capital expenditure on the level of council tax.
This item is only provided to demonstrate affordability at budget setting and has already been superseded by the equivalent figure in the 2014/15 Treasury Management Strategy indicators.

4. The capital financing requirement.
This represents the estimated need for the Authority to borrow to finance capital expenditure less the estimated provision for redemption of debt (the MRP) with no allowance for funding in advance.

2013/14 Estimate £m	2013/14 Actual £m
35.6	34.7

5. Net borrowing and the capital financing requirement.
Net external borrowing as at the 31st March 2014, was £14.0m, this is £20.7m less that than the capital financing requirement. Thereby confirming that the council has not borrowed for revenue purposes other than in the short-term for cash flow purposes.

6. **The actual external long-term borrowing at 31 March 2014**

£11.4m

7. **Adoption of the CIPFA Code**

The Council has adopted the 2011 edition of the CIPFA Treasury Management Code of Practice.

TREASURY MANAGEMENT INDICATORS

8. **The authorised limit for external debt.**

This is the maximum limit for borrowing and is based on a worst-case scenario.

	2013/14 Limit £m	**2013/14 Actual £m**
Short-Term	20.0	6.0
Long Term assuming maximum borrowing in advance	48.0	11.4
Other long-term liabilities (leases)	5.0	0.5
Total	**73.0**	**20.0**

9. **The operational boundary for external debt.**

This reflects a less extreme position. Although the figure can be exceeded without further approval, it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

	2013/14 Limit £m	**2013/14 Actual £m**
Short-Term	15.0	6.0
Long Term	48.0	11.4
Other long-term liabilities (leases)	5.0	0.5
Total	**68.0**	**20.0**

Both of these actual results reflect the fact that long term rates were not considered low enough to borrow in anticipation of need

10. Exposure to investments with fixed interest and variable interest.

These limits are given as a percentage of total investments. Investments of less than 12 months count as variable rate.

		Limits		Actual
		Max.	Min.	As at 31.3.14
Borrowing:				
longer than 1 year	Fixed	100%	75%	100%
	Variable	25%	0%	0%
Investments:				
longer than 1 year	Fixed	100%	100%	100%
	Variable	0%	0%	0%

11. Borrowing Repayment Profile

The proportion of 2013/14 borrowing that matured in successive periods.

Borrowing	Upper limit	Lower limit	Actual As at 31.3.14
Under 12 months	86%	0%	34%
12 months and within 24 months	86%	0%	0%
24 months and within 5 years	86%	0%	0%
5 years and within 10 years	86%	0%	0%
10 years and above	100%	14%	66%

12. Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days.

	Limit £m	Actual £m
Limit on principal invested beyond year end (31 March 2014)	32.6	0