Public
Key Decision - No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title/Subject Matter:	Treasury Management Annual Report 2014/15
Meeting/Date:	Overview & Scrutiny Economic – 4th June 2015 Cabinet – 18th June 2015
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 2014/15 this was approved by Council on the 13th February 2014. The code of practice also recommends that members are informed of treasury management activity at least twice a year; the first report, the 2014/15 mid-year report was reported to Cabinet on the 20th November 2014 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 2014/15 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 3.24%, and the average interest rate received for investing was 1.20%.

Recommendation(s):

- That Cabinet comment on the 2014/15 Treasury Management performance.

1. WHAT IS THIS REPORT ABOUT/PURPOSE?

1.1 Council approves the Treasury Management Strategy for the coming year when it approves the Budget and the Medium Term Financial Strategy (MTFS) 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 Overview & Scrutiny: Economic Panel.

2. BACKGROUND

2.1 This report covers treasury activity and the associated monitoring and control of risk.

2.2 The key points in the 2014/15 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.

Economic Review

2.3 An economic review of the year has been provided by our Treasury Management advisors, Arlingclose and is attached in Appendix A.

Performance of Funds

2.4 The following table summarises the treasury management transactions undertaken during the 2014/15 financial year and the details of the investments and loans held as at 31st March 2015 are shown in detail in Appendix B.

	Principal Amount £m	**Interest Rate %**
Investments		
at 31st March 2014	3.5	1.74
less matured in year	-189.1	
plus arranged in year	+189.5	
at 31st March 2015	3.9	0.38
Average Investments	**7.9**	**1.20**
Borrowing		
at 31st March 2014	17.4	2.55
less repaid in year	-25.1	
plus arranged in year	+19.0	
at 31st March 2015	11.3	3.73
Average Borrowing	**13.1**	**3.24**

2.5 The average rate of interest on all investments was 1.20%, 0.85% above the 7-day benchmark rate of 0.35%, this represents a return of over three times the bench-mark rate. This good performance was due to £1.4m of the investments being locked into higher rates before the year started together with the use of liquidity accounts with major banks and Money Market Funds which gave the added safety of instant access together with interest rates in excess of the benchmark.

2.6 If only short-term cash flow investment activity is considered, the rate of interest on investments was 0.46%, which is around 30% higher than the 7-day benchmark rate of 0.35%.

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

- £11.3m long term borrowing from the PWLB, at a weighted average rate of 3.71%.
- Short term borrowing at 31 March 2015 was nil.

2.8 The actual net investment interest payable (after deduction of interest receivable on loans) was £331,000. This is a saving of £13,000 against the original budget. This is mainly due to higher than expected reserves reducing the need to borrow externally, because use can be made of internal funds.

Strategy - Borrowing

2.9 **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. Short-term borrowing rates were very low, as a result short-term borrowing and internal borrowing was used for funding.

2.10 **Short-term borrowing**. The Authority needed to borrow short-term during the year to manage its cash flow; it averaged £1.8m per day.

Strategy - Investments

2.11 The Council's strategy for 2014/15 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)
- Money Market Funds

2.12 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, following advice from ArlingClose, the council's treasury management advisors, the bank was withdrawn from the Council's counterparty list for investment purposes. The NatWest bank will continue to be used for operational banking purposes (cash flow and day-to-day banking) but not for investments. All bank accounts held with NatWest are maintained at or as close to zero as day to banking processes allow.

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

2.14 The strategy was reviewed during the course of the year and the mid-year report was reported to Cabinet on the 20th November 2014.

Risk Management

2.15 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.

2.16 **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.

2.17 **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.

2.18 **Cash Flow.** 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.

2.19 **Return on investments.** Security and liquidity took precedence over the return on investments, which resulted in investments during 2014/15 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.

Compliance with Regulations and Codes

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

2.21 The Code requires the Council to approve both Treasury Management and Prudential Indicators. Those for 2014/15 were approved at the Council meeting on 26th February 2014. Annex D shows the relevant prudential indicators and the actual results.

3. OPTIONS CONSIDERED/ANALYSIS

3.1 Option analysis was not considered for this report.

4. COMMENTS OF OVERVIEW & SCRUTINY PANEL

4.1 This report is to be considered at the meeting held on the 4th of June 2015.

5. KEY IMPACTS/RISKS? HOW WILL THEY BE ADDRESSED?

5.1 The risks arising from treasury management activities are highlighted in the report and are measured by reference to the prudential indicators in appendix D.

6. WHAT ACTIONS WILL BE TAKEN/TIMETABLE FOR IMPLEMENTATION

6.1 Treasury management activities will continue to be monitored, in order to mitigate security and liquidity risks.

7. LINK TO THE CORPORATE PLAN

7.1 Treasury management activities have contributed to local community by the advancing of loans to two local organisations,and by ensuring that funds are available to continue to provide council services.

8. CONSULTATION

8.1 No consultation has taken place.

9. LEGAL IMPLICATIONS

9.1 No direct, material legal implications arise out of this report.

10. RESOURCE IMPLICATIONS

10. 1 The resource implications are explained within this report.

11. OTHER IMPLICATIONS

11.1 No other implications are expected to arise from this report.

12 REASONS FOR THE RECOMMENDED DECISIONS

12.1 The treasury management activity continues to be monitored, to ensure that risk arising are mitigated.

13. LIST OF APPENDICES INCLUDED

Appendix A – Economic review prepared by Arlingclose
Appendix B – Borrowing and investments as at 31st March 2015
Appendix C – In House Fund Management
Appendix D – CIPFA Prudential Indicators

BACKGROUND PAPERS

Working papers in Resources
CIPFA Treasury Management Code of Practice

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APPENDIX A
ECONOMIC REVIEW OF 2014/15 PROVIDED BY ARLINGCLOSE

1.1 **Growth:** The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.

1.2 **Inflation:** Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to $44.35 a barrel a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

1.3 **Labour Market:** The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

1.4 **UK Monetary Policy:** The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.

1.5 **UK Political Environment:** Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, however this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament; English MPs in turn demanding separate laws for England) lingers on. The highly politicised March Budget heralded the start of a closely contested general election campaign and markets braced for yet another hung parliament.

1.6 **The Eurozone Political:** On the continent, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was from -0.10% to -0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the central bank at its January meeting in an effort to steer the euro area away from deflation and invigorate its moribund economies. The size was at the high end of market expectations and it will involve buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing March 2015 through to September 2016.

The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

1.7 **The US Economy:** The US economy rebounded strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with ‘tapering’, i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough the weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word “patient” from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

1.8 **Market reaction:** From July, gilt yields were driven lower by a combination of factors: geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the big slide in the price of oil and its transmission though into lower prices globally. 5-, 10- and 20-year gilt yields fell to their lows in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively.

APPENDIX B

BORROWING AND INVESTMENTS AT 31 MARCH 2015

	Short-term Rating		Date Invested/ Borrowed	Amount		Interest Rate	Year of Maturity
	Fitch	Moody's		£m	£m		
Borrowing							
Short-term							
NIL							
Long-term							
PWLB			07/08/13	1.296		2.24%	2023/24
PWLB			19/12/08	5.000		3.91%	2057/58
PWLB			19/12/08	5.000		3.90%	2058/59
					11.296		
Total Borrowing					**11.296**		
Investments In-House							
Investments							
NatWest Liquidity	F1	P2		0.079m		0.25%	On-call
Cambridge Building Society	Not rated			0.100m		0.50%	On-call
Santander	F1	P1		0.100m		0.50%	On-call
Blackrock	AAAmmf			1.120m		0.46%	On-call
Handelsbanken				0.435m		0.30%	On-call
Barclays				0.255m		0.45%	On-call
Public Sector Deposit Fund	AAAmmf			0.650m		0.33%	On-call
Total Investments					**2.534**		
Loans							
Alconbury Parish Council	Not rated			0.006m		0.50%	2016/17
Huntingdon Regional College	Not rated			1.305m		3.34%	2023/24
Huntingdon Gym	Not rated			0.064m		5.13%	2023/24
Total Loans					**1.375**		
Total Investments					**3.909**		
Net Borrowing					**7.387**		

APPENDIX C

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 Pooled Property Funds
Credit Ratings	**Building Societies** All Building Societies with ratings of BBB or above. Building Societies with no ratings. (maximum duration 1 month) **Money Market Funds** AAA credit rating **Pooled Property Funds** (such funds are not credit rated as they are investments in non-liquid assets) **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 F2 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. – £10m Pooled Property funds – £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. Except for Money Market Funds, 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 27 February 2014. 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

APPENDIX D

CIPFA Prudential Indicators for Capital Finance in Local Authorities
Prudential Indications and Treasury Management Indications for 2014/15
Comparison of actual results with limits

PRUDENTIAL MANAGEMENT INDICATORS

1. Actual and Estimated Capital Expenditure.

	2014/15 Estimate £000	2014/15 Actual £000
Gross	6.3	7.5
Net	4.6	3.2

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

2014/15 Estimate	2014/15 Actual
10%	8.6%

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 2015/16 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.

2014/15 Estimate £m	2014/15 Actual £m
40.0	35.5

5. Net borrowing and the capital financing requirement.
Net external borrowing as at the 31st March 2015, was £7.4m, this is £28.1m 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 2015

£11.3m

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.

	2014/15 Limit £m	2014/15 Actual £m
Short-Term	25.0	0.0
Long Term assuming maximum borrowing in advance	55.0	11.3
Other long-term liabilities (leases)	5.0	0.5
Total	**85.0**	**11.8**

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	20.0	0.0
Long Term	55.0	11.3
Other long-term liabilities (leases)	5.0	0.5
Total	**80.0**	**11.8**

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 31.3.15
Borrowing:				
longer than 1 year	Fixed	100%	75%	100%
	Variable	25%	0%	0%
Investments:				
longer than 1 year	Fixed	100%	100%	0%
	Variable	0%	0%	0%

11. Borrowing Repayment Profile

The proportion of 2014/15 borrowing that matured in successive periods.

Borrowing	Upper limit	Lower limit	Actual As at 31.3.15
Under 12 months	92%	0%	0%
12 months and within 24 months	92%	0%	3%

Borrowing	Upper limit	Lower limit	Actual As at 31.3.15
24 months and within 5 years	92%	0%	4%
5 years and within 10 years	93%	1%	5%
10 years and above	100%	7%	88%

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 2015)	32.7	0