Agenda Item No. 15

Audit Committee – 23rd September 2014

EXECUTIVE SUMMARY

Report title: Treasury Management Annual Report 2013/14

Wards affected: City-Wide

Strategic Director: Max Wide

Report Author: Peter Gillett - Service Director - Finance

RECOMMENDATION

To note Treasury Management annual report for 2013/14

To note that Council nominates the Audit Committee to be responsible for scrutiny of Treasury Management Strategy and activity.

Key background / detail:

a. Purpose of report:

The Council is required to produce an annual treasury management review of activities and the actual treasury indicators in accordance with Local Government regulations.

b. Key details:

- The Council has complied with treasury management legislative and regulatory requirements during the period and all transactions were in accordance with the approved Treasury Management Strategy.

- No additional borrowing was undertaken in the year. The Council's debt at 31 March 2014 was £415m with an average interest rate of 4.75%.

- Investments were £196m at the 31 March 2014 (£176m at 31 March 2013) with an average rate of 0.89% in 2013/14 (1.16% in 2012/13).

- In 2013/14 the Council reviewed the merits of selling its claim with one of the failed Icelandic banks, Landsbanki. Following financial and legal advice procured by the Local Government Association the council joined with other authorities and sold its residual claim in January 2014.

Agenda Item 8

BRISTOL CITY COUNCIL
CABINET/COUNCIL
2nd September 2013

REPORT TITLE: Treasury Management Annual Report 2013/14

Ward(s) affected by this report: Citywide

Strategic Director:	**Max Wide**
Report author:	**Peter Gillett - Service Director - Finance**
Contact telephone no. & e-mail address:	**Jon Clayton - 0117 922424 jon.clayton@bristol.gov.uk**
Report signed off by Executive member:	**Cllr. Geoffrey Gollop**

Purpose of the report:

1. Under the CIPFA Code of Practice on Treasury Management (the Code) the Section 151 Officer is required to produce an outturn report on activities in the year to account for how the Strategy set at the start of the year has been implemented. This report meets the requirements of both the Code and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

RECOMMENDATION for the Mayor's approval:

That the Treasury Management annual report for 2013/14 is noted

That Council nominates the Audit Committee to be responsible for scrutiny of Treasury Management Strategy and activity.

Background

2. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end.

3. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity.

Council is recommended to delegate that responsibility to the Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

4. 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."

Economic Background for 2013/14

5. The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided. 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 and this forecast rise remains.

6. Economic growth (GDP) in the UK was virtually flat during 2012/13 but rose 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 high and above the 2% target during 2012, by January 2014 it had, 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.

7. Gilt yields were on a rising trend during 2013 but volatility returned in 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 return into UK gilts.

8. 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.

Treasury position as at 31 March 2014

9. The table below indicates the balance of borrowing and investments at the beginning and end of the year:

	31 March 2013		**31 March 2014**	
	£m	**Rate**	**£m**	**Rate**
Long Term Debt (fixed rates) - PWLB	302	5.01%	292	5.01%
Long Term Debt (fixed rates) – Market	123	4.14%	123	4.14%
Short Term Borrowing	-	-	-	-
Total borrowing	**425**	**4.76%**	**415**	**4.76%**
Investments	176	1.16%	196	0.89%
Net Borrowing Position	**249**		**219**	

10. The total borrowing excludes outstanding finance on PFI and embedded leases of £168m at 31 March 2014 (£174m at 31 March 2013).

Long Term Borrowing – Strategy and outturn

11. The 2013–2016 Treasury Strategy (approved 26th February 2013) identified a medium term borrowing requirement of £100m to support the existing and future Capital Programme with the debt servicing costs predominately met from revenue savings from capital investment. It was planned to take £20m long term borrowing in 2013/14 to partly refinance a maturing loan (£10m) with the remaining to finance the Capital programme.

12. The Council's Strategy was to defer borrowing while it has significant levels of cash balances (£196m at March 2014). Deferring borrowing will reduce the "net" revenue interest cost of the Authority as well as reducing the Councils exposure to counter party risk for its investments. The Council recognises that utilising investments in lieu of borrowing clearly has a finite duration and that future borrowing may be required to support capital expenditure (see 2014/15 Treasury Management Strategy approved by Council February 2014).

13. Borrowing activity in year was in accordance with the Strategy approved at the beginning of the year**:**

    - **Borrowing** – No new borrowing was drawn in 2013/14.

    - **Rescheduling –** No debt rescheduling activity was undertaken in 2013/14.

    - **Repayment –** The Council repaid £10m of PWLB debt which matured in the period.

Annual Investment Strategy and Outturn

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.

15. Security of capital remained the Council's main investment objective. This was maintained by following the following the Council's policy for assessing institutions to which the council might lend. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

16. Investments held by the Council **-** the Council maintained an average balance of £263m (£245m 2012/13) of internally managed funds. The internally managed funds received an average return of 0.89% (1.16% 2012/13). The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%. This compares with a budget assumption of an average of £200m investment balances at 0.50% interest rate.

Compliance with Treasury Limits and Treasury Related Prudential Indicators

17. The Council can confirm that:

- All treasury related transactions were undertaken by authorised officers and within the limits and parameters approved by the Council;

- All investments were to counterparties on the approved lending list

- The Council operated within the Prudential Indicators (Appendix 2)

Performance Indicators set for 2013/14

18. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

19. This service has set the following performance indicators:

- Average rate of borrowing for the year compared to average available - No short-term borrowing was undertaken in 2013/14.
- No long-term borrowing was undertaken in 2013/14. The target rate for the year is 25 year PWLB, the annual average for the year was 4.08%
- Debt – Average rate movement year on year
- Pool rate in 2013/14: 4.77 %
- Pool rate in 2012/13: 4.76%
- Investments – Internal returns above the 7 day LIBID rate
- Average rate for the year 0.89% vs. annual average 7 day LIBID of 0.35%

Icelandic Banks

20. Early in October 2008 the Icelandic banks Landsbanki, Kaupthing and Glitnir collapsed and the UK subsidiaries of the banks went into administration. The Authority had £8m deposited, the majority of which has now been recovered:

- Landsbanki - following financial and legal advice procured by the Local Government Association the Council joined with other authorities and sold its claim in January 2014.

- Glitnir Bank - the administrator paid out 100% of the outstanding monies, 79% being received by the Council, whilst the remainder (in Icelandic Kroner-ISK) is being held in an escrow account with a high credit quality Scandinavian bank and is accruing interest at a market rate.

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Consultation and scrutiny input

21. The report does not require any internal consultation to be undertaken. The report has been discussed with the Council's external treasury management advisers.

Risk Assessment

22. The principal risks associated with treasury management are:

- The risk of loss as a result of failure of counterparties
- This is mitigated by limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties;
- The risk of loss as a result of borrowing at high rates of interest/lending at low rates of interest
- This is mitigated by planning and undertaking borrowing and lending in the light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Public sector equality duties:

23. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

24. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

25. Legal**-** The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

    Legal advice provided by Shahzia Daya

Financial

(a) Revenue

26. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

    Advice given by Jon Clayton (Corporate Accountant)

(b) Capital

27. There is no direct capital investment implications contained within this report.

Land

28. There are no direct implications for this report.

Personnel

29. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2013/14

Appendix 2: Prudential Indicators

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

30. Treasury Management Strategy 2013/14

Appendix 1

Annual Report on the Treasury Management Service 2013/14 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

- The capital activity during the year
- What resources the Council applied to pay for this activity;
- The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The reporting of the required prudential indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- A summary of interest rate movements in the year;
- The detailed debt activity;
- The detailed investment activity;
- Icelandic Banks; and
- Local Issues

The Council's Capital Expenditure and Financing 2013/14

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of 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.

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

	2012/13 Actual £m	**2013/14 Original Budget £m**	**2013/14 Current Budget £m**	**2013/14 Actual £m**
Non-HRA capital expenditure	69	182	142	115
HRA capital expenditure	28	39	39	31
Total capital expenditure	**97**	**221**	**181**	**146**
Resourced by:				

Capital receipts	9	11	11	7
Capital grants	42	95	95	98
HRA Self Financing	25	30	30	29
Prudential borrowing	9	65	25	1
Revenue	12	20	20	11
Total Resources	**97**	**221**	**181**	**146**

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2013/14 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.

7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

   - the application of additional capital resources (such as unapplied capital receipts); or

   - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

8. The Council's 2013/14 MRP Policy (as required by CLG Guidance) was approved on 26 February 2013.

9. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	General Fund 31 March 2013 Actual £m	General Fund 31 March 2014 Actual £m	HRA 31 March 2013 Actual £m	HRA 31 March 2014 Actual £m	Total CFR 31 March 2014 Actual £m
Opening balance	**463**	**456**	**245**	**245**	**701**
Add unfinanced capital expenditure (as above)	9	1	-	-	1
Add adjustment for HRA reform	-	-	-	-	-
Less MRP/VRP	(13)	(13)	-	-	(13)
Less PFI & finance lease repayments	(3)	(5)	-	-	(5)
Closing balance	**456**	**439**	**245**	**245**	**684**

Treasury Position at 31 March 2014

10. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:

- Borrowing to the CFR; or
- Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
- Borrowing for future increases in the CFR (borrowing in advance of need).

11. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

	31 March 2013		**31 March 2014**	
	Principal £m	**Average Rate**	**Principal £m**	**Average Rate**
Fixed Interest Rate Debt	425	4.76%	415	4.77%
Variable Interest Rate Debt	-	-	-	-
PFI & embedded leases	174	-	168	-
Total Debt	**599**	**4.76%**	**583**	**4.77%**
Capital Financing Requirement	701		684	
Over/(Under) borrowing	(102)		(101)	
Investment position				
Investments (Fixed & Call)	184	1.43%	196	0.89%
Net borrowing position (excl leasing arrangements)	**241**	**-**	**219**	**-**

12. The fixed Interest rate debt is apportioned between the General Fund and HRA as set out in the table below.

Fixed Interest Rate Debt	31 March 2013 £m		31 March 2014 £m	
	Principal £m	Average Rate	Principal £m	Average Rate
General Fund	180	4.97%	175	4.96%
HRA	245	4.63%	240	4.62%
Total	425	4.76%	415	4.77%

13. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit	Approved Max Limit	31 March 2013		31 March 2014	
			Actual £m	%	Actual £m	%
Under 12 Months	0%	20%	10	2.46%	-	0.00%
1 to 2 years	0%	20%	-	0.00%	-	0.00%
2 to 5 years	0%	40%	3	0.71%	3	0.72%
5 to 10 years	0%	40%	15	3.52%	15	3.61%
10 years and over	25%	100%	397	93.31%	397	95.67%
Total			**425**	**100%**	**415**	**100%**

14. The authority borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk. Therefore the authority has not undertaken any new borrowing during the year.

Prudential Indicators and Compliance Issues

15. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

16. **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. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual £m	31 March 2014 Latest Indicator £m	31 March 2014 Actual £m
Net borrowing position	241	275	219
CFR (excluding PFI)	527	539	516

17. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2013/14 the Council has maintained gross borrowing within its Authorised Limit.

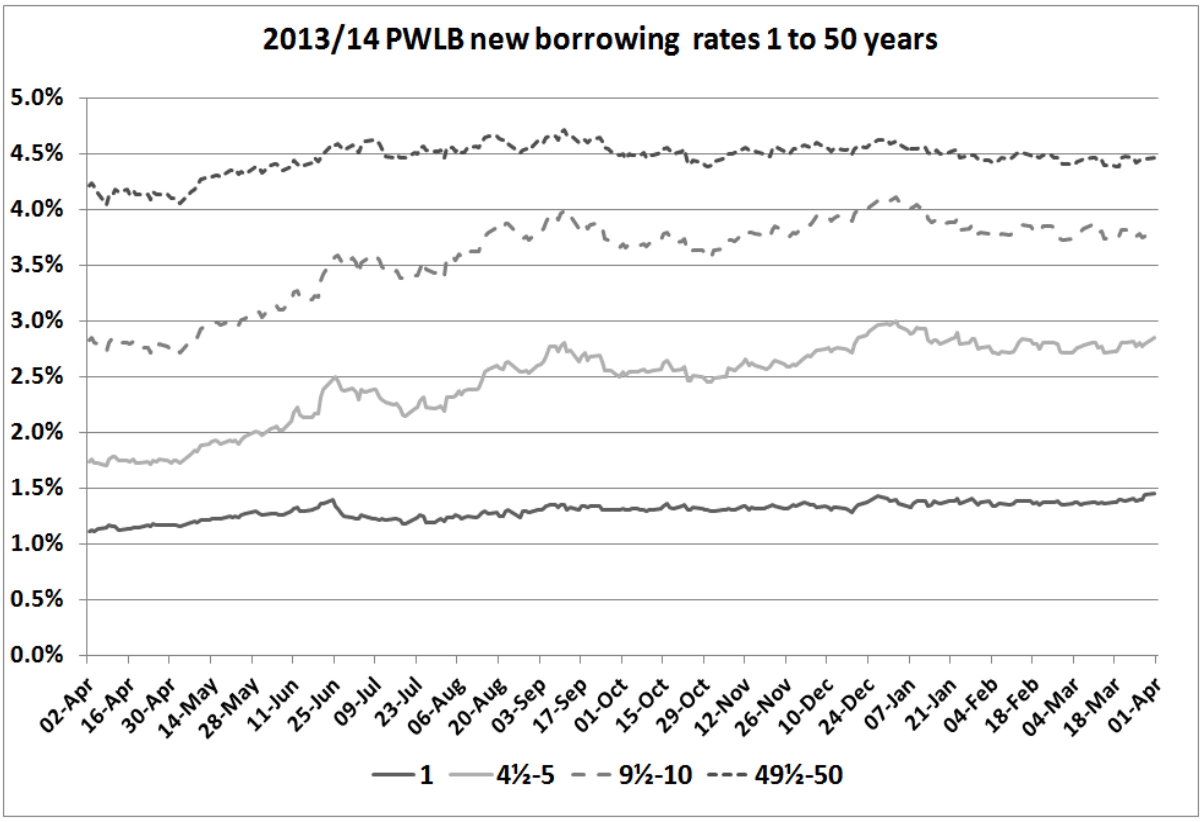
18. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

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

	2013/14 £m
Authorised Limit	742
Operational Boundary	593
Average gross borrowing position (excluding PFI)	415
Financing costs as a proportion of net revenue stream: General Fund HRA	 8.58% 9.34%

Borrowing Rates in 2013/14

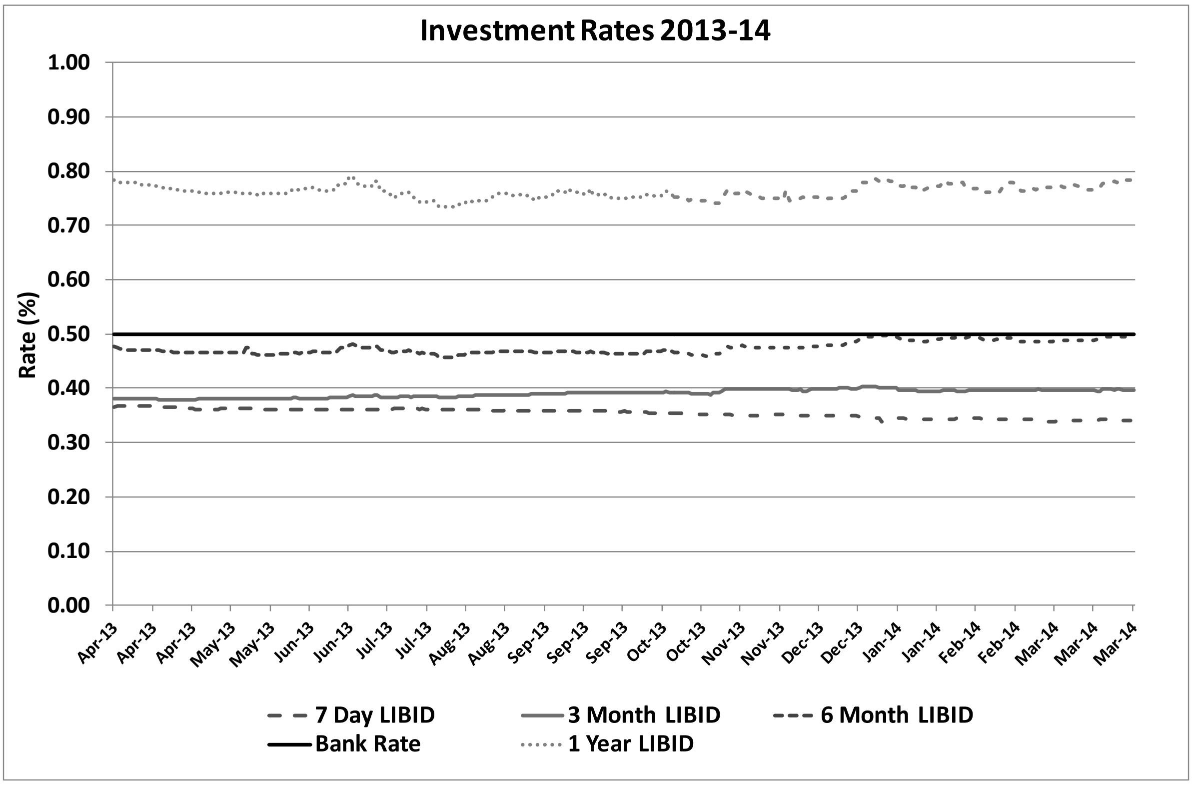
20. PWLB borrowing rates - the graph below shows how PWLB maturity "certainty" rates have risen marginally for short and long term maturities, more so for medium term maturities.



21. **Summary of Debt Transactions –** The overall position of the debt activity resulted in a marginal rise in the average interest rate from 4.76% (31/03/2013) to 4.77%, due to the repayment of debt with a lower coupon.

Investment Rates in 2013/14

22. Bank Rate 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.



23. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 26th February 2013. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Local Issues

24. **Ethical Investment Policy-** The Ethical Investment Policy was approved by Cabinet on 15th December 2011. There are no breaches to report.

Regulatory Framework, Risk and Performance

25. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

    - The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
    - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2011/12);
    - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
    - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
    - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
    - Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.
    - Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

26. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

27. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council's highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.

Appendix 2

Prudential Indicators	2013/14 Original	2013/14 Latest	2013/14 Actual
Planned capital expenditure (£m)			
General	£182m	£142m	£115m
HRA	£39m	£39m	£31m
	£221m	£181m	£146m
Capital financing requirement (£m)(taking account of new capital expenditure and repayment of debt)			
General	£353m	£294m	£271m
PFI	£168m	£168m	£168m
HRA	£245m	£245m	£245m
	£766m	£707m	£684m
Note that the general fund figure includes ex-Avon debt managed on behalf of other authorities (£52m as at 31/3/14)			
Confirmation that total borrowing net of investments, does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current year and next two financial years.	Confirmed	Confirmed	Confirmed
Authorised limit for external debt (£m) (the maximum that the authority will borrow)			
Borrowing	£804m	£742m	£742m
Operational boundary for external debt (£m) (the anticipated level of borrowing)			
Borrowing	£603m	£593m	£593m
Financing costs as a percentage of net revenue stream %)			
General	8.76%	8.76%	8.58%
HRA	9.47%	9.47%	9.34%
Incremental Impact of Capital Investment Decisions			
Impact on the council tax	Nil	Nil	Nil
Impact on HRA rent	Nil	Nil	Nil
Exposure to changes in interest rates (%)			
Upper limit on (net) variable rate debt	30%	30%	0%
Lower limit on (net) variable rate debt	0%	0%	0%
Upper limit on (net) fixed rate debt	100%	100%	100%
Lower limit on (net) fixed rate debt	70%	70%	100%
Maturity structure of borrowing (% Range)			
Less than 12 months	0-20%	0-20%	0%
1-2 years	0-20%	0-20%	0%
2-5 years	0-40%	0-40%	1%
5-10 years	0-40%	0-40%	4%
Over 10 years	25-100%	25-100%	95%
Maximum principal sums invested > 364 days	£30.0m	£30.0m	£30.0m
The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services	YES	YES	YES