ANNUAL TREASURY REPORT 2013/14

1. INTRODUCTION AND BACKGROUND

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).

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy*)* for the year ahead and an annual review report of the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of the treasury management strategy to a specific named body which in this Council is the Finance, Resources and Partnerships Scrutiny Committee.
6. Delegation by the Council of the role of scrutiny of treasury management performance to a specific named body which in this Council is the Audit and Risk Committee, a midyear and year end review report is received by this Committee.

Treasury management in this context 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. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2013/14.

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 has complied with the requirement under the Code to give prior scrutiny to the annual review report by reporting this to the Audit and Risk Committee prior to it being reported to Full Council.

2. THIS ANNUAL TREASURY REPORT COVERS

- The Council's treasury position as at 31st March 2014;
- The strategy for 2013/14;
- The economy in 2013/14;
- Investment rates in 2013/14;
- Compliance with treasury limits and Prudential Indicators;
- Investment outturn for 2013/14;
- Involvement of Elected Members;
- Other issues.

3. TREASURY POSITION AS AT 31 MARCH 2014

The Council's investment position at the beginning and the end of the year was as follows:

	At 31/3/14	Return	Average Life (Days)	At 31/3/13	Return	Average Life (Days)
Total Debt	***£0m***	***N/A***	***N/A***	***£0m***	***N/A***	***N/A***
Total Investments	***£3.55m***	***0.69%***	***8***	***£4.90m***	***0.99%***	***16***

It should be noted that the above table is only a snapshot of the Total Investments as at 31 March. Large fluctuations in cash inflows and outflows that occur throughout the month can have an impact on the figure reported.

4. THE STRATEGY FOR 2013/14

The strategy agreed by Council on 27 February 2013 was that:

- The Council's Borrowing Need (Capital Financing Requirement) was estimated at £1,000,000 to allow for the possibility that the Council may need to borrow to finance capital expenditure which cannot be funded from other revenue or capital resources;

- Short term borrowing would be required in the event to cover any temporary shortfalls in revenue income or to temporarily fund capital expenditure during the interim period before a permanent means of finance became available;

- All borrowing would be kept absolutely within the Authorised Limit of £15m and would not normally exceed the Operational Boundary of £5m (although it could for short periods of time be permitted to rise to a figure between £5m and £15m due to variations in cash flow);

- Temporary surpluses which might arise would be invested, either in short term deposits with the Council's various deposit accounts or in money market investments (cash deposits) if the size warranted this and for an appropriate period in order that these sums would be available for use when required;

- The proportions of loans and investments to be at fixed or variable rates were: fixed rate loans to be between 0% and 100% of the total and variable rate to be between 0% and 100% of the total, thus enabling maximum flexibility to take advantage of interest rate trends;

- Long term investments to be permitted as follows: maturing beyond 31/03/14 £5m, maturing beyond 31/03/15 £5m, maturing beyond 31/03/16, £5m;

- The overriding consideration in determining where to place the Council's surplus funds was to safeguard the Council's capital. Within this constraint the aim was to maximise the return on capital; and,

- Forward commitment of funds for investment is permitted in respect of in house investments.

Changes in strategy and credit Policy during the year

There have been no changes to the Treasury Management Strategy during the year. As approved by Council on 27 February 2013 the Council used the creditworthiness service provided by the Council's treasury management advisors, Sector Treasury Services which uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element, supplemented by additional data (credit watches and outlooks, Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings and Sovereign ratings to select counterparties from only the most creditworthy countries). This modelling approach results in a weighted scoring system providing a series of colour coded bands which indicate the relative creditworthiness of counterparties and a suggested maximum investment duration.

5. THE ECONOMY AND INTEREST RATES - narrative supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

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 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 quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during 2013/14. 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. 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. The 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 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.

6. INVESTMENT RATES IN 2013/14 – narrative supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

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 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.

7. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Annex 1.

8. INVESTMENT OUTTURN FOR 2013/14

Internally Managed Investments
The Council manages its investments in-house and invests with the institutions listed on the Council's approved lending list. The Council invested for a range of periods from overnight to up to three months dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Four of the six fixed investments (excluding use of the Government's Debt Management Office Debt Management Account Deposit Facility) made in 2013/14 were for a period of three months, with the remaining two fixed investments being for less than three months.

The Council used the Government's Debt Management Office (DMO) Debt Management Account Deposit Facility (DMADF) on twelve occasions during the year with the longest deposit being made for fifteen days.

Aside from fixed investments and use of the DMO DMADF, the Council used its various deposit accounts on a frequent basis.

Investment Outturn for 2013/14

During 2013/14 an average rate of return of 0.69% was achieved on an average individual investment of £2.066m. This compared with the target of 0.70% included in the departmental service plan.

9. INVOLVEMENT OF ELECTED MEMBERS

Elected members have been involved in the treasury management process during 2013/14 including:

- Scrutiny of the treasury management strategy by the Transformation and Resources Overview and Scrutiny Committee prior to being submitted for approval by the Full Council.
- Scrutiny of treasury management performance by the Audit and Risk Committee through the receipt of a half yearly treasury management report.
- The Portfolio Holder for Finance and Resources received a monthly budget monitoring report which contains details of Treasury Management activity undertaken during the month; this is forwarded periodically to all Members.
- A quarterly budget monitoring and performance report is reported to Cabinet, this contains details of Treasury Management activity undertaken during the quarter.
- The Portfolio Holder for Finance and Resources was part of the interview process to appoint Treasury Management Advisors for a new contract commencing 1 April 2014. The

three year contract (with an option to extend for a further two years) was awarded to Sector Treasury Services for the three years until 31 March 2017.

10. HERITABLE BANK DEFAULTS

This authority currently has the following investment frozen in the Heritable Bank:

- Investment 5092, £2.5m, maturity date 14 September 2009.

Payments up to 31 March 2014 totalled £2,357,691 (94% return).

ANNEX 1: PRUDENTIAL INDICATORS

	Position/Prudential Indicator	2012/13 Actual	2013/14 Original Indicator	2013/14 Actual
1	Capital Expenditure	£2.533m	N/A	£3.283m
2	Capital Financing Requirement at 31st March	(£0.197m)	(£0.350m)	(0.360m)
3	Treasury Position at 31st March: Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £0.0m £0.5m £0.5m (£5.195m) (£4.695m)	 N/A N/A N/A N/A N/A	 £0.0m £0.3m £0.3m (£3.558m) (£3.258m)
4	Authorised Limit (against maximum position)	£0.0m	£15.0m	£2.75m
5	Operational Boundary (against maximum position)	£0.0m	£5.0m	£2.75m
6	Ratio of Financing Costs to Net Revenue Stream	(1.04%)	(0.02%)	(0.48%)
7	Upper Limits on Variable Interest Rates (against maximum position) Loans Investments	 0% 0%	 100% 100%	 0% 0%
8	Actual External Debt	£0.0m	N/A	£0.0m
9	Principal Funds Invested for Periods Longer than 364 days (against maximum position)	£0.0m	£5.0m	£0.0m

GLOSSARY

CPI – Consumer Price Index

The Consumer Price Index (CPI) is the main UK measure of inflation for macroeconomic purposes and forms the basis for the Government's inflation target. It is also used for international comparisons.

DMO and DMADF - Debt Management Office and Debt Management Account Deposit Facility

The DMO is an Executive Agency of Her Majesty's Treasury. The DMO provides the DMADF to support local authorities' cash management by providing a flexible and secure facility to supplement their existing range of investment options whilst saving interest costs for Central Government.

ECB – European Central Bank

The European Central Bank (ECB) is the central bank for the euro and administers the monetary policy of the EU member states which constitute the Eurozone, one of the largest currency areas in the world.

LIBID – London Interbank Bid Rate

Banks in the City of London tend to lend and borrow money from one another in the wholesale money markets. The rate at which a bank is willing to borrow money is called the London Interbank Bid Rate (LIBID).

LIBOR – London Interbank Offered Rate

This is the benchmark used by banks, securities houses and investors to gauge the cost of unsecured borrowing in the money markets. It is calculated each day by asking a panel of major banks what it would cost them to borrow funds for various periods of time and in various currencies, and then creating an average of the individual bank's figures.

MPC – Monetary Policy Committee

Interest rates are set by the Bank's Monetary Policy Committee (MPC). The MPC sets an interest rate it judges will enable the inflation target to be met. The Bank's MPC is made up of nine members – the Governor, the two Deputy Governors, the Bank's Chief Economist, the Executive Director for Markets and four external members appointed directly by the Chancellor. The appointment of external members is designed to ensure that the MPC benefits from thinking and expertise in addition to that gained inside the Bank of England.

PWLB – Public Works Loan Board

The Public Works Loan Board (PWLB) is a statutory body operating within the Debt Management Office and is responsible for lending money to local authorities and other prescribed bodies, as well as for collecting the repayments.

QE – Quantitative Easing

Quantitative Easing is an unconventional monetary policy used by central banks to stimulate the national economy when standard monetary policy has become ineffective. A central bank implements quantitative easing by buying financial assets from commercial banks and other private institutions, thus increasing the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.