

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2014-2015

**COMMITTEE:
CORPORATE SERVICES SCRUTINY
COMMITTEE**

AGENDA ITEM NO. '
TREASURY MANAGEMENT 2013/14 REVIEW

11th September 2014

REPORT OF :

THE GROUP DIRECTOR, CORPORATE SERVICES

Chris Lee (01443) 424088

1.0 PURPOSE OF REPORT

1.1 This report provides Members with the opportunity to scrutinise the Annual Treasury Management Review presented to Council on 23rd July 2014 (Appendix 1).

2.0 RECOMMENDATIONS

It is recommended that Members:

2.1 Note the content of this report.

2.2 Scrutinise and comment on the information provided.

2.3 Consider whether they wish to receive further detail on any matters contained in the report.

3.0 ANNUAL TREASURY MANAGEMENT REVIEW (Appendix 1)

3.1 This report details the activities undertaken by the Treasury Management function during 2013/14.

3.2 I would like to highlight key points as follows:

- The Council has complied with all relevant Codes of Practice, regulations and guidance (para 3.3).
- The Council appointed Arlingclose as its Treasury Management Advisors (paras 4.1 - 4.3).
- Net Capital Charges for the year were within budget (para 7.3).
- Compliance has been achieved in terms of all Prudential and Treasury indicators (para 8.1).

- The Council continues to adopt a low risk strategy in terms of investing and borrowing (paras 9.2 - 9.3).
- The Council has received all material dividends in respect of the investment in the Icelandic institution, Heritable Bank, that defaulted during October 2008 (paras 10.3 – 10.4).

4.0 CONCLUSION

- 4.1 This report, together with Appendix 1 provides Members with the opportunity to scrutinise the 2013/14 activities of Treasury Management.

APPENDIX 1

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2014-2015 – REPORT NO.

**COMMITTEE:
COUNCIL**

PART 1	AGENDA ITEM NO.
2013/14	ANNUAL TREASURY MANAGEMENT REVIEW

23rd July 2014

REPORT OF :

THE GROUP DIRECTOR, CORPORATE SERVICES
Chris Lee (01443) 424088

1.0 PURPOSE OF REPORT

1.1 This report constitutes the statutory requirement to provide Members with information on :-

- the Council's Treasury Management activity during 2013/14; and
- the actual Prudential and Treasury Indicators for 2013/14.

2.0 RECOMMENDATIONS

2.1 It is recommended that Members note the content of this report.

3.0 INTRODUCTION

3.1 Treasury Management is defined as:

"The management of a local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

3.2 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

3.3 The primary requirements of the Codes are as follows:

- Creation and maintenance of a Treasury Management Policy;
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve stated policies and objectives;

- Approval by Council (by 31st March) of a Treasury Strategy Report (including Prudential and Treasury Indicators and an Investment Strategy) for the year ahead, an Annual Review Report of the previous year and a Mid Year Review; and
- Effective scrutiny of the Treasury Management function.

Rhondda Cynon Taf C.B.C. complies with these requirements and supplements this by including detail of our treasury activities and prudential indicators in the quarterly Council performance reports to Members.

- 3.4 During 2013/14, the Corporate Services Scrutiny Committee has continued to scrutinise the Treasury Management function via quarterly performance reports and reviews of the strategy and mid year position.
- 3.5 This annual report will cover the following areas of treasury activity during 2013/14 :
- Treasury Management advisors;
 - Economic background;
 - Borrowing strategy;
 - Borrowing activity and results;
 - The estimated and actual treasury position and prudential indicators;
 - Investment strategy;
 - Investment activity and results.
- 3.6 It should be noted that the accounting practice to be followed by the Council requires financial instruments in the accounts (debt, investments, etc) to be measured in a method compliant with International Financial Reporting Standards. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the Council's Statement of Accounts.

4.0 TREASURY MANAGEMENT ADVISORS

- 4.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014. The contract is for 3 years with an option to extend for up to a further 2 years.
- 4.2 Although the contract is in its infancy, to date, the service provided has been good. The Council will continue to monitor advisors performance. If any adverse performance or contractual issues arise, Members will be informed accordingly.
- 4.3 The Council recognises that although information and advice is provided via the contract, responsibility for Treasury Management decisions remains with the Council.

5.0 ECONOMIC BACKGROUND

5.1 General Economic Background

- 5.1.1 At the beginning of 2013/14, financial markets were concerned with the low growth in various global economies including the UK. The Bank of England's Monetary Policy Committee (Bank Rate setting body) was concerned with the low growth, low business investment and falling "real" wages (ie after inflation).
- 5.1.2 During the course of 2013/14, the recovery in the UK was evidenced by strong economic activity and growth. There was an increase in household consumption, increasing consumer confidence, greater availability of credit and a strengthening housing market which was partly boosted by the "Help to Buy" initiative.
- 5.1.3 During August, the Governor of the Bank of England, Mark Carney, stated that **consideration** would not be given to raising interest rates until unemployment fell below 7%. The fall in unemployment was faster than forecast and in February 2014, the Bank stepped back from relying upon the single unemployment factor to a more complex set of measures.
- 5.1.4 The credit rating agency, Moody's downgraded the UK's credit rating from AAA to Aa1 during February 2013. Other agencies attributed a "negative watch" to the government and subsequently Fitch downgraded the UK from AAA to AA+ during April 2013. This was as a result of concerns over the expectations of growth in the economy and a reflection of the challenges faced by the government in its debt reduction programme. Despite the downgrades, both Moody's and Fitch deemed the outlook as "stable". These ratings continue to date.
- 5.1.5 The Council continued to maintain a low risk strategy throughout the year to ensure exposure to capital loss was minimised.

5.2 Short term investment rates

- 5.2.1 The Council's investment income is subject to changes in short term interest rates. The level of the Bank Rate is one of the main determinants of the rate of interest the Council receives on its short term investments. The Bank of England continued to maintain the Bank Rate at 0.5% throughout the year as it has done since 2009.

5.3 Longer term interest rates

- 5.3.1 The majority of the Council's borrowing is from the PWLB (Public Works Loans Board). Long-term borrowing rates are influenced by gilt yields which are driven by inflation and demand/supply considerations. Gilt yields, and therefore PWLB rates, ended the year higher than they were in April 2013.
- 5.3.2 Members will recall that local authorities were presented with an unexpected change of policy by the PWLB in October 2010. This resulted in an increase of new borrowing rates of approximately 0.9% without an

associated increase in early redemption rates. This makes borrowing more expensive and early repayment less attractive.

5.3.3 During August 2012, HM Treasury introduced “the certainty rate”, whereby local authorities are able to access borrowing at 0.2% cheaper than published PWLB rates. In order to access the discounted rate, authorities were required to provide Welsh Government (and onward, the Debt Management Office) with an indication of their potential borrowing requirements for the next 3 years.

5.3.4 PWLB rates during 2013/14 were as follows (these are the “certainty rates”):

	5 years	10 years	25 years	50 years
Average	2.26%	3.38%	4.23%	4.26%
Highest	2.80%	3.91%	4.48%	4.51%
Lowest	1.50%	2.51%	3.71%	3.84%

6.0 BORROWING STRATEGY

6.1 The borrowing strategy for 2013/14 approved by Council in March 2013 stated that the borrowing requirement to fund the 2013/14 Capital Programme was £21.8m. In line with the capital programme, the borrowing requirement increased to £28.8m during the year. It was also reported that the cheapest borrowing will be “internal borrowing” by running down cash balances and foregoing interest earned at historically low rates. This also minimises counterparty risk (risk that an investment may become irrecoverable).

6.2 The strategy also reported that the Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, taking into account advice provided by our advisors.

6.3 It was also reported that the Council may reschedule debt where there is an opportunity to generate savings. However, as stated in paragraph 5.3.2 above, changes in PWLB rates calculations has reduced the attractiveness of early repayments associated with rescheduling.

7.0 BORROWING ACTIVITY AND RESULTS

7.1 A summary of the Council's borrowing activity (excludes PFI and Finance Leases) can be seen in the table below:

£'M	Fixed Rate Debt	Market Debt	Variable Debt	Total
Opening Bal 1 st April 2013	109.973	87.500	0.464	197.937
Repayments	(0.152)	0	(0.129)	(0.281)
New borrowing	0.003	0	0.152	0.155
Closing Bal 31 st March 2014	109.824	87.500	0.487	197.811

- 7.2 In accordance with our low risk strategy as detailed in section 6 above, to minimise investment exposure and counterparty risk on cash balances held, no long term borrowing was undertaken during 2013/14.
- 7.3 During the year there was a net saving on the Council's Net Capital Charge Budget (£24.3m) of £0.3m. This has been achieved as a result of proactive and close management of the Council's cash-flows (enabling delays to borrowing being taken), despite the challenges faced with investment income and maintaining our low risk strategy.
- 7.4 There were no opportunities to further reduce the cost of our borrowing via rescheduling during the year.
- 7.5 The results (interest payable) for the year can be summarised as follows:

	Fixed Rate Debt	Market Debt	Variable Rate Debt	Total
Total Interest £M	5.259	4.328	0.003	9.590
Average Debt £M	109.899	87.500	0.475	197.874
Average Interest %	4.78%	4.95%	0.58%	4.85%

- 7.6 Members will also recall the previously reported position with regard to the accounting arrangements and treatment of LOBO's (Lender Option / Borrower Option). These loan instruments have enabled the Council to realise significant short-term and further ongoing reductions in its capital charges. These savings have been invested into key service improvements and the Treasury Management Reserve, which have helped not only to reduce risk around future financial market changes, but also as pump priming to produce more efficient and effective on-going front line services for the taxpayer.

8.0 ESTIMATED AND ACTUAL TREASURY POSITION, PRUDENTIAL AND TREASURY INDICATORS

- 8.1 During the financial year 2013/14, the Council operated within its limits set out in the Prudential Code report approved in March 2013. Details of limits and actual performance are as follows:

		2013/14 Actual
Capital Expenditure 13/14		67.498M
Capital Financing Requirement (CFR) as at 31 st March 2014		370.244M

Limit / Indicator	2013/14 Limit / Indicator	2013/14 Actual
Authorised Limit (£) (Limit beyond which borrowing is prohibited)	360.000M	225.863M (at highest point in year)
Operational Boundary (£) (Indicator to ensure Authorised Limit not breached)	245.000M	224.827M (at year end)
External Debt	217.112M	197.305M
Other Long Term Liabilities	<u>0.900M</u>	<u>0.506M</u>
Sub total	218.012M	197.811M
Other : PFI and Finance Lease	<u>26.671M</u>	<u>26.671M</u>
Borrowing + Other Long Term Liabilities	244.683M	224.482M
Ratio of Financing Costs to Net Revenue Stream	5.57%	5.48%
Limit on Fixed Interest Rates	55% - 125%	64%
Limit on Variable Interest Rates	-25% - 45%	36%
Funds invested for greater than 1 year	£15M	£1m (refer to section 11)
LOBO Limit	£100M / 45% of debt portfolio	£85.5M / 38% of debt portfolio
Maturity Structure of Fixed Rate Debt	Under 12 mths 0-60% 12 mths – 2 yrs 0-60% 2-5 years 0-60% 5-10 years 0-70% 10-20 years 0-90% 20-30 years 0-90% 30-40 years 0-90% 40-50 years 0-90%	Under 12 mths 38% 12 mths – 2 yrs 0% 2-5 years 1% 5-10 years 0% 10-20 years 13% 20-30 years 0% 30-40 years 36% 40-50 years 12%

9.0 INVESTMENT STRATEGY

- 9.1 The Council manages its investments in-house, investing in line with the Council's approved lender criteria as approved by Council on the 20th March 2013. Investment policy is governed by Welsh Government guidance.
- 9.2 Members will recall that following the onset of the unprecedented national and international economic crisis in 2008, all of this Council's cash flows are currently being invested in the Debt Management Account Deposit Facility and other Government backed public sector bodies, in line with the aforementioned approved strategy. This low risk strategy was formed balancing risk and return. It is acknowledged that low risk investment strategies result in lower than benchmark investment returns.
- 9.3 I have kept this under constant review subsequently with a view to returning to market investment activity at an appropriate time. To date, the Council has not returned to market investments but has set up a number of AAA rated money market funds to provide further diversification options when the opportunity does arise. These accounts have not been used during 2013/14. Members will be kept informed of any changes as part of the Council's quarterly performance reports.
- 9.4 During the year, the Council has complied with the approved strategy and there have been no liquidity difficulties.
- 9.5 During 2013/14, the Council has not invested funds for longer than 364 days (other than in respect of the Local Authority Mortgage Scheme as detailed below at paragraph 11).

10.0 INVESTMENT ACTIVITY AND RESULTS

- 10.1 The following table shows the overall result of the investment activities undertaken by the Council:

	Interest Received	Average Cash Balance	Return on Investments	Benchmark Return
	£M	£M	%	%
Cash Balances	0.107	32.464	0.33	0.41

The benchmark for Local Authority internally managed funds is the average 7-day LIBID rate.

- 10.2 Despite our low risk strategy and lower than benchmark return on investments, we have managed to be within budget for overall capital charges (refer to para 7.3). The Economic Background section of this report set out the continuing difficulties in economic conditions during this period. As a result of these conditions and our low risk strategy, interest

rates remain low impacting adversely, but not unexpectedly, on investment returns.

10.3 The failure of the Icelandic banking system in October 2008 had a major impact on local authority investments across the UK. Over 100 local authorities had deposits of almost £1bn with these institutions.

10.4 Members will be aware that the Council has £3.0M invested with Heritable Bank Plc (in administration). With regards to the Council's £3M investment with the Icelandic institution, Heritable Bank, the administrators have stated that it is unlikely that creditors will receive any further material dividend. The Council has received repayments (dividends) which amount in total to £2.829M.

11.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

11.1 As approved by Council on 4th July, during September 2012, the Council launched the Local Authority Mortgage Scheme which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.

12.0 CONCLUSION

12.1 The last financial year has been a further extremely challenging year for Treasury Management and this report highlights for Members that Treasury Management activities have operated effectively and within budgetary and prudential limits.
