

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2015-2016

**COMMITTEE:
FINANCE AND PERFORMANCE
SCRUTINY COMMITTEE**

| |
|---|
| AGENDA ITEM NO. 3 |
| TREASURY MANAGEMENT 2014/15 REVIEW |

16th September 2015

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE 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 22nd July 2015 (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 2014/15.

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 (in March 2014, 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).

4.0 CONCLUSION

- 4.1 This report, together with Appendix 1 provides Members with the opportunity to scrutinise the 2014/15 activities of Treasury Management.

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2015-2016 – REPORT NO.

**COMMITTEE:
 COUNCIL**

| | |
|----------------|---|
| PART 1 | AGENDA ITEM NO. |
| 2014/15 | ANNUAL TREASURY MANAGEMENT REVIEW |

22nd July 2015

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE 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 2014/15; and
- the actual Prudential and Treasury Indicators for 2014/15.

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 Management 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 2014/15, 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 2014/15 :

- 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 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 2014/15, financial markets were showing signs of recovery due to greater consumer spending and increased activity in the housing market. This growth was expected to be gradual due to declining disposable income and low growth expectation in the Eurozone.
- 5.1.2 During the course of 2014/15, the upward trend continued, evidenced by growth in the service sector and investment from the construction sector. Political uncertainty had a large bearing on market confidence. The possibility of Scottish independence, together with the UK general election, were concerns to the financial markets.
- 5.1.3 The European Central Bank announced in January its much anticipated quantitative easing in an effort to steer the Euro area away from deflation and invigorate its economies. The Bank of England Monetary Policy Committee maintained interest rates at 0.5% and reiterated the fact that any increases in the Bank Rate would be gradual and limited.
- 5.1.4 The Council continued to maintain a low risk strategy throughout the year to ensure exposure to any 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.
- 5.3.2 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.
- 5.3.3 PWLB rates during 2014/15 were as follows (these are the "certainty rates"):

| | 5 years | 10 years | 20 years | 50 years |
|---------|----------------|-----------------|-----------------|-----------------|
| Average | 2.36% | 3.08% | 3.65% | 3.72% |
| Highest | 2.87% | 3.66% | 4.22% | 4.28% |
| Lowest | 1.71% | 2.18% | 2.74% | 2.82% |

6.0 BORROWING STRATEGY

- 6.1 The borrowing strategy for 2014/15 approved by Council in March 2014 stated that the borrowing requirement to fund the 2014/15 Capital Programme was £32.4m. In line with the capital programme, the borrowing requirement decreased to £31.7m 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 Affordability and the cost of carry remained important influences on the Authority’s borrowing strategy alongside the consideration that for any borrowing undertaken ahead of need, the proceeds would have to be invested at rates of interest significantly lower than the cost of borrowing. As short term interest rates have remained, and are likely to remain lower than longer term rates, the authority determined it was more cost effective in the short term to utilise short term loans. The benefits of internal borrowing and short term borrowing were monitored regularly against the potential implications of deferring borrowing into future years and the timing of long term borrowing rates rising.
- 6.4 It was also reported that the Council may reschedule debt where there is an opportunity to generate savings. However, changes in PWLB rate calculations have 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 2014 | 109.824 | 87.500 | 0.487 | 197.811 |
| Repayments | (0.150) | 0 | (0.150) | (0.300) |
| New borrowing | 0 | 0 | 11.942 | 11.942 |
| Closing Bal 31 st March 2015 | 109.674 | 87.500 | 12.279 | 209.453 |

- 7.2 Short term loans were taken to meet day to day cashflow requirements at an average rate of 0.34% (£11.8m as at 31st March 2015). 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 2014/15.
- 7.3 During the year there was a net saving on the Council's Net Capital Charge Budget (£23.8m) of £0.423m. This has been achieved as a result of prudent and effective 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 | 5.258 | 4.302 | 0.005 | 9.565 |
| Average Debt £M | 109.750 | 87.500 | 6.382 | 203.632 |
| Average Interest % | 4.79% | 4.92% | 0.08% | 4.70% |

- 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 2014/15, the Council operated within its limits set out in the Prudential Code report approved in March 2014. Details of limits and actual performance are as follows:

| | | |
|---|--|---------------------------------|
| | | 2014/15 Actual £ |
| Capital Expenditure 14/15 | | 71.527M |
| Capital Financing Requirement (CFR) as at 31 st March 2015 | | 386.419M |

| Limit / Indicator | 2014/15 Limit / Indicator | 2014/15 Actual |
|---|---|--|
| Authorised Limit (£) (Limit beyond which borrowing is prohibited) | 380.000M | 234.974M (at highest point in year) |
| Operational Boundary (£) (Indicator to ensure Authorised Limit not breached) | 280.000M | 234.974M (at year end) |
| External Debt (£) | 255.521M | 208.950M |
| Other Long Term Liabilities | <u>0.900M</u> | <u>0.503M</u> |
| Sub total | 256.421M | 209.453M |
| Other : PFI and Finance Lease | <u>25.521M</u> | <u>25.521M</u> |
| Borrowing + Other Long Term Liabilities | 281.942M | 234.974M |
| Ratio of Financing Costs to Net Revenue Stream | 5.36% | 5.32% |
| Limit on Fixed Interest Rates | 55% - 125% | 100% |
| Limit on Variable Interest Rates | -25% - 45% | 0% |
| Funds invested for greater than 1 year (£) | 15M | 1m (refer to section 11) |
| LOBO Limit | £100M / 45% of debt portfolio | £85.5M / 37% 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 41% 12 mths – 2 yrs 0% 2-5 years 1% 5-10 years 0% 10-20 years 12% 20-30 years 0% 30-40 years 39% 40-50 years 7% |

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 26th March 2014. 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 2014/15. 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 2014/15, 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 | 0.074 | 18.393 | 0.40 | 0.35 |

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

- 10.2 Despite our low risk strategy our return on investments is above the benchmark return. The key contributory factor is the return on the £1M 5-year deposit with Lloyds in respect of the Local Authority Mortgage Scheme (see paragraph 11). 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 on investments remain low.

11.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

- 11.1 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 continued to be extremely challenging in relation to Treasury Management and this report highlights for Members that all related activities have operated effectively and within budgetary and prudential limits.
