APPENDIX 'A'
AGENDA ITEM (10)

Annual Treasury Management Review 2013/14

Purpose

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).

During 2013/14 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 26/02/2013)
- a mid-year (minimum) treasury update report (Audit & Scrutiny Committee 10/12/2013)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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 confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Scrutiny Committee before they were reported to the full Council.

Executive Summary

During 2013/14, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2012/13 Actual £000	2013/14 Estimate £000	2013/14 Actual £000
Capital expenditure	£3,772	£7,259	£2,879
Capital Financing Requirement	£0	£0	£0
Gross borrowing	£0	£0	£0
External debt	£0	£0	£0
Investments • Longer than 1 year • Under 1 year • Total	 £2,000 £13,000 £15,000	 Limited to £13,000 No limit set	 £0 £17,035 £17,035
Net Lending	£15,000	No Limit set	£17,035

Other prudential and treasury indicators are to be found in Appendix 1 of this report. The Head of Finance also confirms that no borrowing was undertaken for a capital purpose during 2013/14 and the statutory borrowing limit (the authorised limit) was not breached at any time.

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2013/14 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2013/14

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2013/14

The Council undertakes capital expenditure on 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

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

£m General Fund	2012/13 Actual £m	2013/14 Estimate £m	2013/14 Actual £m
Capital expenditure			
Financed in year	£3,772	£7,259	£2,879
Unfinanced capital expenditure	**£0**	**£0**	**£0**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2013/14 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. No borrowing was taken to finance the 2013/14 capital expenditure.

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2013/14) plus the estimates of any additional capital financing requirement for the current (2014/15) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to either borrow in advance of its immediate capital needs in 2013/14 or reduce its investments. The table below highlights the Council's gross borrowing position against the CFR. The Council has not undertaken any borrowing to date.

	31 March 2013 Actual	31 March 2014 Budget	31 March 2014 Actual
Gross borrowing position	£0m	£0m	£0m
CFR	£0m	£0m	£0m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, 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.

The operational boundary – similarly the operational boundary links to the Council's estimates of other cashflow requirements. The indicator represents a prudent but not 'worst-case' scenario of the Council's need to borrow. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

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.

It highlights the proportion of the revenue budget required to meet borrowing costs. As the Council is in a net investment position [investment income is greater than interest payable] the calculation results in a negative figure.

	2013/14
Authorised limit	£6.5m
Operational boundary	£4.5m
Average gross borrowing position	£0m
Financing costs as a proportion of net revenue stream	-2.52%

3. Treasury Position as at 31st March 2014

The Council's investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the summary. At the beginning and the end of 2013/14 the Council's treasury position was as follows:

Type of Investments	Opening balance 01/04/2013 £	Average Weighed Balance Held in 2013/14 £	Interest Earned in 2013/14 £	% Rate Achieved in 2013/14 %	Closing balance 31/03/2014 £
Fixed Term Deposits	£7,500,000	£10,730,137	105,315	0.98%	£10,000,000
Call Accounts & MMF's	£5,100,000	£10,408,461	63,878	0.62%	£4,605,000
Payden Sterling Reserve Fund	£1,015,467	£1,012,435	9,033	0.89%	£1,011,442
***Federated Sterling Cash Plus Fund**	£1,015,862	£1,019,102	N/A	N/A	1,022,342
Glitnir- Escrow Account	£429,970	£429,970	20,965	4.87%	£429,970
Total Investments	**£15,061,299**	**£23,600,105**	**199,191**	**0.90%**	**£17,068,754**

* Federated Sterling Cash Plus Fund is an accumulated fund. This investment has not figured in the percentage rate achieved as dividends are not paid out, but are accumulated on to the original investment.

4. The strategy for 2013/14

The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during 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 flight to quality into UK gilts.

5. The Economy and Interest Rates

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. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged 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 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.

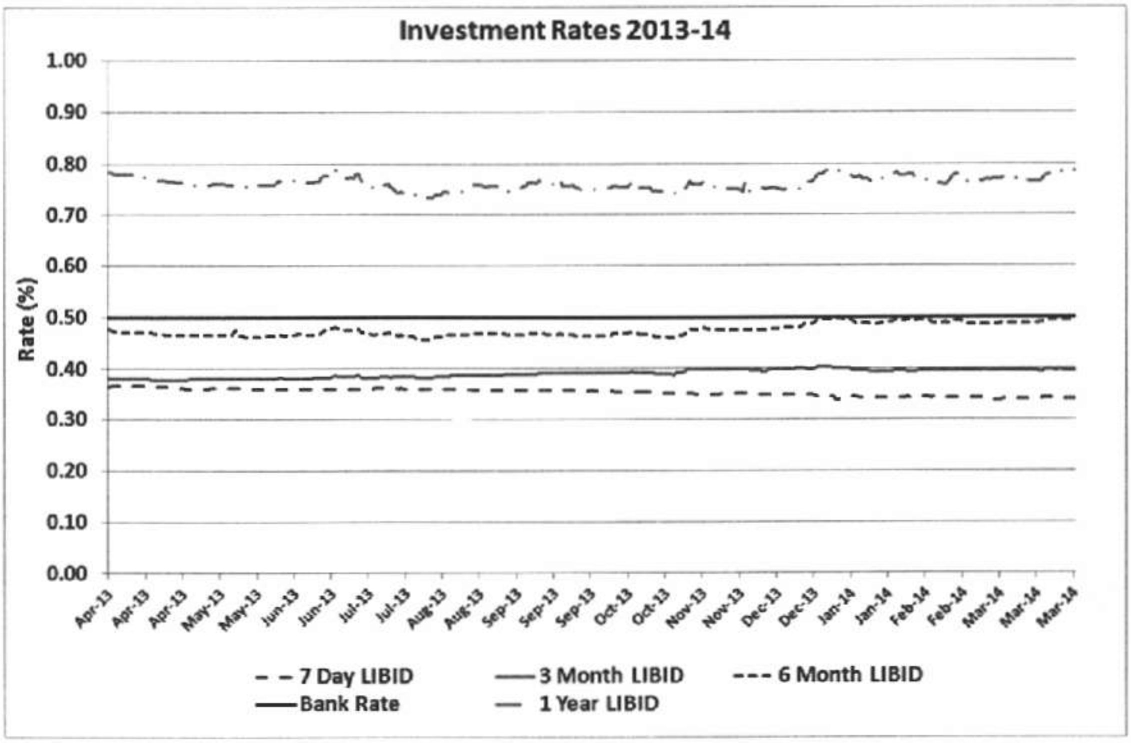
Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That 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 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.

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

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 almost unchanged at around the end of 2014 / start of 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. Investment Outturn for 2013/14

Investment Policy – the Council's investment policy is governed by CLG guidance, which was 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.

The Council maintained an average balance of £23.6m of internally managed funds during 2013/14. The internally managed funds earned an average rate of return of 0.90% which also includes the return on the deposit held in Escrow in Iceland. The comparable performance indicator is the average 3 month LIBID rate which was 0.39%. The Council budgeted for £170,750 investment interest for 2013/14 but made an actual return of £199,190, a surplus of £28,440.

8. Icelandic Bank Defaults

This Council currently has £430,000 frozen in Iceland, currently held in an escrow account, which was part of the Glitnir deposit distributed in March 2012. It cannot be released until Icelandic currency restrictions are lifted. Bevan Brittan continue to liaise with the Central Bank of Iceland on behalf of a number of local authorities but in the meantime these funds remain in Iceland held in an escrow account accruing interest at the rate of over 4%.

9. Prudential and treasury indicators

SUMMARY OF PRUDENTIAL INDICATORS	2012/13 Actual £	2013/14 Estimate £	2013/14 Actual £
Capital Expenditure	£3,772,000	£7,259,000	£2,879,349
Ratio of financing costs to net revenue stream	-2.99%	-1.88%	-2.52%
Gross borrowing requirement - General Fund			
Opening balance - 1 April	£0	£0	£0
Closing requirement - 31 March	£0	£0	£0
In year borrowing requirement	£0	£0	£0
Gross debt	£0	£0	£0
Capital Financing Requirement (CFR)	£0	£0	£0
Authorised limit	£0	£6.5m	£0
Operational boundary	£0	£4.5m	£0
Incremental impact of capital investment decisions (1)			
Increase in council tax (Band D) re. capital spend	£0.66	£0.43	£0.34

(Note 1) Incremental impact of capital investment decisions:

The incremental impact is calculated by calculating the budget requirement arising from the adoption of the proposed capital programme. As the Council is currently debt-free, the increase in cost equates to the lost investment interest that the Council can no longer generate as its capital reserves are consumed. The figure represents the cost to each taxpayer (if the effect of the expenditure were borne by the taxpayer) of the Council spending its capital budget.