Treasury Management Annual Report 2013/14

1.1 Introduction

1.1.1 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 **[Appendix 1]**. 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).

1.1.2 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;
- a mid-year treasury update report; and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, treasury management update reports have been presented to each meeting of the Audit Committee throughout the 2013/14 financial year. Treasury performance is also considered at the Finance, Innovation and Property Advisory Board through the regular Financial Planning and Control reports.

1.1.3 Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is 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.

1.1.4 This Council also 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 Committee before they were reported to full Council. Training on treasury management issues was undertaken in January 2014 to support Members' scrutiny role.

1.2 The Economy and Interest Rates

1.2.1 The original expectation for 2013/14 was that the Bank Rate would not rise during the year and for it to start rising, albeit slowly, from quarter 1 of 2015. This forecast rise has now been pushed back to start in quarter 3 of 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the 2013/14 financial year. As a consequence, no additional quantitative easing was introduced during 2013/14 and the 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 at or slightly below target over the next two years.

1.2.2 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. The Funding for Lending Scheme, announced by the Bank of England 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. Returns being offered by Banks and other financial institutions continued at abnormally low rates throughout 2013/14 (see chart at paragraph 1.5.1).

1.2.3 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a reduction in the forecast for total borrowing (the most recent Autumn Statement and March Budget) of £97bn over the next five years, culminating in a £5bn surplus in 2018/19.

1.2.4 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 prompted a move away from only very short term investment. 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.

1.3 Treasury Position at 31 March 2014

1.3.1 At the beginning and the end of 2013/14 the Council‘s debt and investment position was as follows:

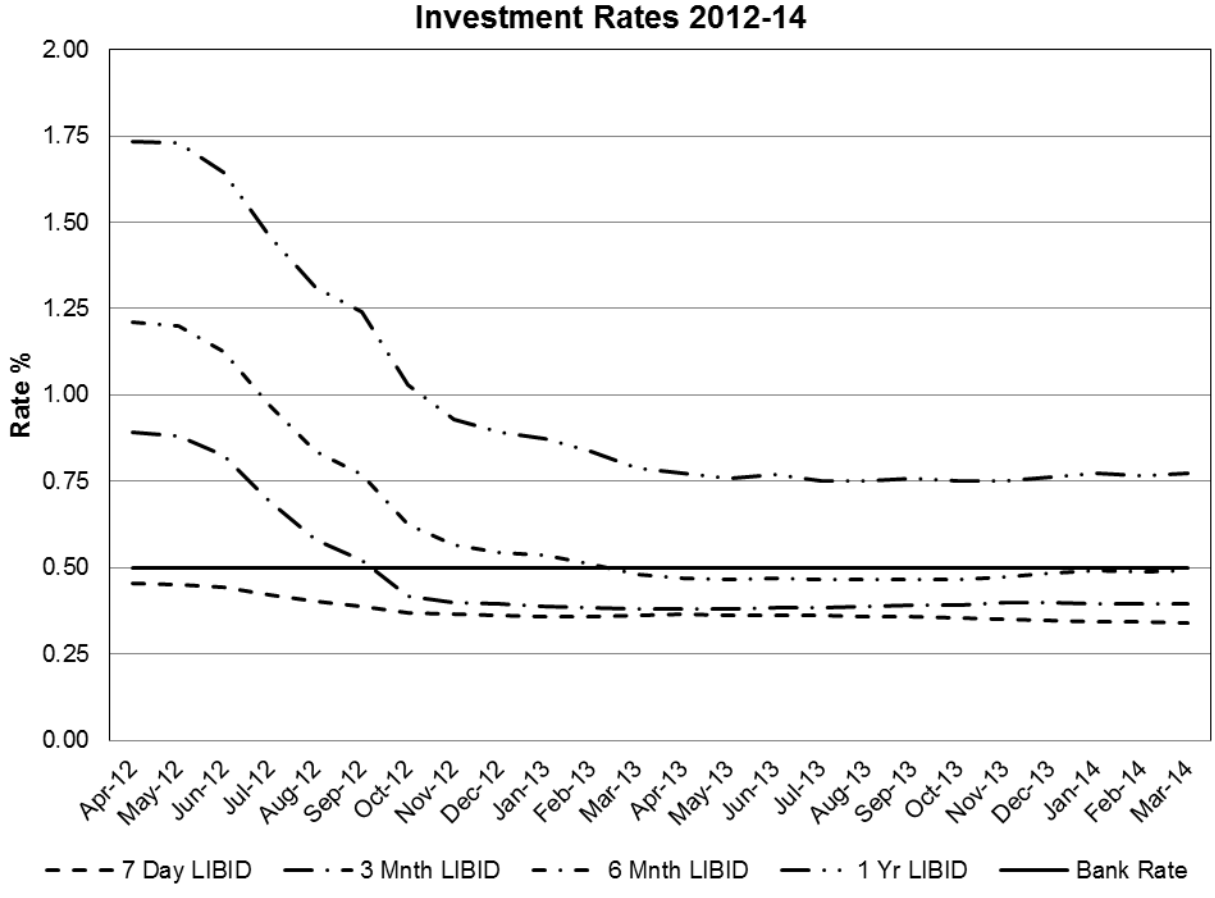
	31 March 2013 £m	Rate / Return %	Average duration Years	31 March 2014 £m	Rate / Return %	Average duration Years
Variable rate debt:						
Overdraft	0.00	-	-	0.00	-	-
Total debt	**0.00**	-	-	**0.00**	-	-
Fixed rate investments:						
In-house cash flow	2.00	3.00	0.03	2.00	1.10	0.03
In-house cash flow Landsbanki	0.51	-	-	-	-	-
Externally managed core fund	2.06	0.32	0.01	0.64	0.35	0.17
Variable rate investments:						
In-house cash flow	3.44	0.54	0.01	3.55	0.74	0.01
Externally managed core fund	13.33	0.53	0.18	12.76	0.62	0.81
Total Investments	**21.34**	**0.75**	**0.12**	**18.95**	**0.68**	**0.56**

1.4 The Strategy for 2013/14

1.4.1 The expectation for interest rates within the strategy for 2013/14 anticipated a low but rising Bank Rate (starting in quarter 1 of 2015). 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.

1.5 Investment Rates in 2013/14

1.5.1 The Bank Rate remained at its historic low of 0.5% throughout the year and has now remained at that level for five years. Market expectations as to the start of monetary tightening showed little change over the course of the year with an expectation that the first Bank Rate rise would take place 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 that part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014 support for lending to businesses continues.



1.6 Investment Outturn for 2013/14

1.6.1 The Council's investment policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies. This is supplemented by additional market information including rating outlooks and credit default swap data. The 2013/14 Annual Investment Strategy was approved by the Council in February 2013 and subjected to a mid-year review in October 2013. In undertaking the review, no changes were made to the Council's minimum counterparty credit requirement or counterparty exposure limits. However, because of the continuing impact of Funding for Lending the review did warn that investment returns for 2013/14 would be lower than originally anticipated. Investment return expectations were formally reduced as part of the budget setting process in January and February 2014. Total investment income was reduced from £236,050 by £71,650 to £164,400.

1.6.2 All investment activity during the financial year complied with the requirements of the approved strategy. No liquidity issues were experienced resulting in nil borrowing throughout 2013/14.

1.6.3 **Cash Flow Investments held by the Council**. The Council maintained an average balance of £10.9m of internally managed cash flow funds. These funds earned an average rate of return of 0.69%. The comparable performance indicator is the average 7-day LIBID rate which was 0.41%. The return achieved also compares with a revised budget assumption of £10.3m investment balances earning an average rate of 0.70%.

1.6.4 The majority of cash flow funds are required to meet our regular payment obligations and as a consequence are invested overnight in bank deposit accounts and money market funds which allow next day access. However, the opportunity to invest for longer durations and generate additional yield is taken when cash flow surpluses permit.

1.6.5 **Core Fund Investments held by the Fund Manager**. The Council uses Investec Asset Management to invest its core fund cash balances. Including unrealised losses (mainly related to gilt purchases) the manager earned an average rate of return of 0.56% on an average balance of £15.1m against a benchmark return of 0.41%. This compares with a revised budget assumption of an average investment balance of £15.4m at a return of 0.60%.

1.6.6 Unlike cash flow, core fund balances are not required to meet our regular payment obligations and are available to invest for longer durations including durations exceeding one year. This added flexibility should allow core funds to generate a better return relative to cash flow investments, however, this norm was not realised in 2013/14.

1.6.7 Performance for the financial year as a whole, excluding the Landsbanki investment, is summarised in the table below:

	2013/14 Average Balance £m	Return %	2013/14 Interest Earned £	2013/14 Revised Estimate £	Variance Better (worse) £
In-house Cash Flow	10.9	0.69	75,150	72,000	3,150
Externally Managed Core Fund	15.1	0.56	84,500	92,400	(7,900)
Total	26.0	0.61	159,650	164,400	(4,750)

1.6.8 The performance of both internally and externally managed funds fell short of our revised estimate predictions by £4,750 (£76,400 worse than expected when measured against the original 2013/14 estimates).

1.6.9 The figures in the table at paragraph 1.6.7 are then adjusted at year end to incorporate notional interest on the defaulted Landsbanki investment. Taking this adjustment into account, investment income for year-end reporting purposes is calculated at £179,800 against a revised estimate of £164,400 which is £15,400 better than expected.

1.7 Icelandic Bank Defaults

1.7.1 The Council invested £1m in a three month fixed term deposit with the Icelandic bank, Landsbanki. The bank went into administration a few days prior to the investments intended maturity in October 2008. Members will be aware from reports to the Finance, Innovation and Property Advisory Board and Audit Committee of the Council's intention to sell its claim via a competitive process. The Council's claim was sold at an auction of claims held in late January and proceeds from the sale were received in early February 2014. The combination of partial payments and auction proceeds brought the total amount recovered to just over 95% of the original £1m investment.

1.7.2 The Council's participation in a joint action, co-ordinated by the Local Government Association (LGA), has ensured our legal costs have been minimised whilst allowing the Council to advance the strongest possible arguments to secure recovery. Participation in the auction has ensured the risks associated with pursuing full recovery (which would take many more years) have been avoided. Officers are satisfied that the price achieved at auction represents a good outcome for the Council.

Financial Services
May 2014