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<b>Report To:</b>	<b>Policy &amp; Resources Committee</b>	<b>Date:</b>	<b>11 August 2015</b>
<b>Report By:</b>	<b>Chief Financial Officer</b>	<b>Report No:</b>	<b>FIN/59/15/AP/KJ</b>
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<b>Subject:</b>	<b>TREASURY MANAGEMENT – ANNUAL REPORT 2014/15</b>		

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## 1.0 PURPOSE

- 1.1 The purpose of this report is to advise Members of the operation of the treasury function and its activities for 2014/15 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

## 2.0 SUMMARY

- 2.1 As at 31 March 2015 the Council had gross external debt (including PPP) of £284,125,698 and investments of £44,787,396. This compares to gross external debt (including PPP) of £291,875,474 and investments of £48,108,524 at 31 March 2014.
- 2.2 The Council's Capital Financing Requirement at 31 March 2015 was £303,381,000. The gross external debt was £19,255,302 (6.3%) less than the Capital Financing Requirement and so the Council was in an underborrowed position and remains so, having undertaken no borrowing so far in 2015/16.
- 2.3 The average rate of return achieved on investments during 2014/15 was 0.76% which exceeds the benchmark return rate for the year of 0.43% by 0.33% and resulted in £177,000 of additional interest on investments for the Council.
- 2.4 During 2014/15 and in 2015/16 to date the Council did not undertake any debt restructuring and operated within the required treasury limits and Prudential Indicators for the year set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices.

## 3.0 RECOMMENDATIONS

- 3.1 It is recommended that the Committee note the contents of the annual report on Treasury Management for 2014/15, the issues in section 5.2 and 5.3 of the report, and the ongoing work to ensure the delivery of financial benefits for the Council.
- 3.2 It is also recommended that the Annual Report be remitted to the Full Council for approval.

Alan Puckrin  
Chief Financial Officer

## **4.0 BACKGROUND**

- 4.1 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15.
- 4.2 Treasury Management in this context is defined as: "The management of the local authority's 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."
- 4.3 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).
- 4.4 The format and content of the report has been revised following the Audit Scotland report issued in March 2015 on "Borrowing and treasury management in councils" to seek to make the report clearer and more accessible. The Audit Scotland report and supplement for Councillors was submitted to the Policy & Resources Committee on 19 May 2015. A glossary of treasury management terms is attached as Appendix 1.

## **5.0 ANNUAL REVIEW**

- 5.1 The treasury management issues arising during the year were:
  - a. The Council's debt (including PPP) has reduced during the year by £7.751m due to repaying maturing debt without undertaking new borrowing. As a result, there has also been a reduction in the Council's investments.
  - b. As at 31 March 2015 the Council had under borrowed against its capital financing requirement by £19.255m. No borrowing has been undertaken during 2015/16 to date.
  - c. The Council did not undertake any debt restructuring during 2014/15 and remained within its Prudential Indicator and Treasury Management limits during the year.
  - d. The Bank Rate remained unchanged during 2014/15 at 0.50% (unchanged since March 2009). The first increase is forecast by the Council's treasury advisers for Quarter 4 of 2015 and this has recently been confirmed by the Governor of the Bank of England.
  - e. PWLB rates for new borrowing were expected to increase by between 0.60% and 0.70% during the year. Due to economic uncertainty during the year, rates actually fell over the year by just under 1.20% for new borrowing for periods of 10 years up to 50 years.
  - f. Investment returns were expected to remain relatively low and this was indeed the position during the year, primarily due to the effects of the Funding for Lending Scheme.
  - g. The Council's investments earned a rate of return of 0.76% during the year and outperformed the benchmark return of 0.43% resulting in additional income to the Council of £177,000.
  - h. All investments were in accordance with the Council's investment policy and no institutions with which investments were made had any difficulty in repaying those investments and interest in full during the year.
  - i. The Council's investment performance is due to undertaking fixed term investments at interest rates that were above the benchmark with a counterparty which has high creditworthiness (the Bank of Scotland) and in accordance with the Council's investment strategy.

- 5.2 The UK Government are currently undertaking a trading plan to sell their shares in the Lloyds Banking Group which includes the Bank of Scotland who are the Council's bankers and with whom the Council has regularly undertaken fixed term deposits. The removal of government ownership does not affect the strength or stability of the Bank but may cause the Council to reduce the maximum period for investments with the Bank under the Investment Strategy.
- 5.3 In November 2014 the Committee gave approval for the negotiation of a new contract with the treasury advisers due to the previous contract ending on 30 June 2015. The new contract started on 1 July 2015 for 3 years with an option for a further 1 year extension.
- 5.4 The Council's Year End debt position was as follows:

	At 31 March 2014	At 31 March 2015
	£	£
Total Excluding PPP	220,111,474	214,314,698
PPP Debt	71,764,000	69,811,000
Total Including PPP	291,875,474	284,125,698

Further detail is given in the following table:

	At 31 March 2014		At 31 March 2015		Movement 2014/15
	Principal	Rate	Principal	Rate	Principal
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	117,168		111,373		(5,795)
- Market *	55,000		36,000		See * Below
	172,168	3.99%	147,373	3.95%	(5,795)
Variable Rate Funding:					
- PWLB	0		0		0
- Market *	47,900		66,900		See * Below
- Temporary	43		42		(1)
	47,943	4.97%	66,942	4.81%	(1)
Total Debt (Excl PPP)	220,111	4.21%	214,315	4.22%	(5,796)
PPP Debt	71,764		69,811		(1,953)
Total Debt (Incl PPP)	291,875		284,126		(7,751)

\* - Market Loans are shown as variable when they have less than 1 year to go until their next call date. The total value of Market Loans has not changed between financial years, just the split between fixed and variable.

5.5 The Council's investment position was as follows:

	At 31 March 2014		At 31 March 2015		Movement 2014/15
	Principal £000	Return	Principal £000	Return	Principal £000
Investments:					
- Fixed Term Deposits	32,500	1.02%	32,500	0.85%	0
- Deposit Accounts	15,609	0.50%	12,287	0.50%	(3,322)
Totals	48,109	0.85%	44,787	0.76%	(3,322)

Maximum level of investments in 14/15: £61,596,145 on 17 September 2014

Minimum level of investments in 14/15: £44,787,396 on 31 March 2015

Daily average for the year 14/15: £53,653,663.

5.6 2014/15 Outturn Compared to Estimates in 2014/15 Strategy

The 2014/15 outturn compared to the estimates in the 2014/15 strategy:

	2014/15 Estimate	2014/15 Outturn
<u>Borrowing Requirement</u>	£000	£000
New borrowing	1,200	0
Alternative financing requirements	0	0
Replacement borrowing	5,800	0
TOTAL	7,000	0
<u>Prudential/Treasury Management Indicators</u>		
	£000	£000
Gross external debt including PPP (As at 31 March 2015)	290,983	284,126
Capital financing requirement (As at 31 March 2015)	307,429	303,381
(Under)/over borrowing against CFR	(16,446)	(19,255)
Net external borrowing and capital financing requirement (As at 31 March)	£000 (56,638)	£000 (64,042)
Capital expenditure	£000	£000
• Capital Programme	27,872	24,200
• PPP Schools/Finance Leases (incl. accounting adjustments)	(2,109)	(1,953)
Total	25,763	22,247
Ratio of financing costs (including PPP/ Finance Leases) to net revenue stream	12.27%	12.50%
Incremental impact of capital investment decisions - incremental increase in council tax (band D) per annum (use of capital receipts and prudential borrowing for capital expenditure)	£1.12	£1.25

## 5.7 2014/15 Outturn Compared to Limits in 2014/15 Strategy

The 2014/15 outturn compared to limits in the 2014/15 strategy:

	2014/15 Limits	2014/15 Outturn
<u>Prudential/Treasury Management Indicators</u>		
Authorised limit for external debt	£000	£000
• Borrowing	262,000	214,315
• Other long term liabilities	74,000	69,811
	336,000	284,126
Operational boundary for external debt	£000	£000
• Borrowing	255,000	214,315
• Other long term liabilities	72,000	69,811
	327,000	284,126
Upper limit for fixed interest rate exposure (Actual is as at 31 March 2015)	140%	87%
Upper limit for variable rate exposure (Actual is as at 31 March 2015)	40%	13%
Upper limit on sums invested for periods longer than 364 days (Actual is maximum in period)	£000 10,000	£000 0
Limits on fixed rate borrowing maturing in each period (LOBOs included based on call dates and not maturity dates) at 31 March 2015		
• Under 12 months	40%	0.0%
• 12 months and within 24 months	40%	0.5%
• 24 months and within 5 years	40%	35.6%
• 5 years and within 10 years	40%	30.8%
• 10 years and within 30 years	40%	6.0%
• 30 years and within 50 years	40%	27.1%
• 50 years and within 70 years	40%	0.0%
<u>Council Policy Limits</u>		
Maximum Percentage of Debt Repayable In Year (Actual is as at 31 March 2015)	25%	18.7%
Maximum Proportion of Debt At Variable Rates (Actual is as at 31 March 2015)	40%	31.2%
Maximum Percentage of Debt Restructured In Year (Actual is as at 31 March 2015)	30%	0.0%

The forecast Investment Balances for 2014/15 required under Investment Regulation 31 and the actual position at 31 March 2015 is shown in Appendix 2.

5.8 The forecast from the Treasury Advisors in the Strategy for the Bank Rate as at 31 March and the latest forecast are:

	Forecast Per 2014/15 Strategy	Actual/Latest Forecast	
2014/15	0.50%	0.50%	(Actual)
2015/16	0.75%	0.50%	(Forecast)
2016/17	1.75%	1.00%	(Forecast)

5.9 The Council's Loans Fund Pool Rate for Interest is used to allocate interest charges to the General Fund and reflects the actual cost of the Council's Treasury activities. The rates for the last 5 years are as follows:

Year	Loans Fund Pool Rate
2010/11	4.300%
2011/12	4.208%
2012/13	3.811%
2013/14	3.831%
2014/15	3.934%

As interest rates begin to increase gradually it is expected the Pool Rate will continue a small increase in the medium term.

5.10 The Council's investment policy for the year is governed by Scottish Government Investment Regulations, which was implemented in the annual investment strategy approved by the Council on 10 April 2014. This policy sets out the approach for choosing investment categories and 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.

5.11 All investments were in accordance with the policy and no institutions with which investments were made had any difficulty in repaying investments and interest in full during the year.

The result of the investment strategy undertaken by the Council in 2014/15 is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (3 month LIBID un compounded)
£53,653,700	0.76%	0.43%

The Council have outperformed the benchmark by 0.33% resulting in additional income to the Council of £177,000. Opportunities for the Council to out-perform the benchmark rate are becoming fewer due to more standardisation of rates and periods offered.

## **6.0 IMPLICATIONS**

### **Legal**

6.1 None. Any borrowing or lending is done under the Council's legal powers.

Finance: Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £177,000. The Council utilises Treasury Management as part of the overall Financial Strategy. Officers will continue to investigate borrowing and investment opportunities to bring financial benefits to the Council, all within the Treasury Management Policy.

### **Human Resources**

6.2 None

### **Equalities**

6.3 None

### **Repopulation**

6.4 None

## **7.0 CONSULTATIONS**

7.1 This report has been produced based on advice from the Council's treasury advisers (Capita Treasury Solutions Limited).

## **8.0 LIST OF BACKGROUND PAPERS**

8.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition  
Inverclyde Council – Treasury Management Strategy 2014/15.

## Appendix 1

### TREASURY MANAGEMENT GLOSSARY OF TERMS

#### Authorised Limit for External Debt

This is a limit for total Council external debt as set by the Council based on debt levels and plans.

#### Bank of England

The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or “MPC”).

#### Bank Rate

The interest rate for the UK as set each month by the Monetary Policy Committee (“MPC”) of the Bank of England. This was previously referred to as the “Base Rate”.

#### Call Date

A date on which a lender for a LOBO loan can seek to apply an amended interest rate to the loan. The term “call date” is also used in relation to some types of investments with a maturity date where the investments can be redeemed on call dates prior to the maturity date.

#### Capital Expenditure

Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the Code of Practice on Local Authority Accounting in the United Kingdom and for which the Council are able to borrow.

#### Capital Financing Requirement

The Capital Financing Requirement (sometimes referred to as the “CFR”) is a Prudential Indicator that can be derived from the information in the Council’s Balance Sheet. It generally represents the underlying need to borrow for capital expenditure (including PPP schemes).

#### CIPFA

CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

#### Counterparty

Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the “Counterparty”.

#### Credit Ratings

Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

The highest credit rating is AAA.

#### European Central Bank

Sometimes referred to as “the ECB”, the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

#### Eurozone

This is the name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 19 countries: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.



### Federal Reserve

Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

### Fixed Term Deposit

A Fixed Term Deposit or Fixed Term Investment is an investment with a named bank or financial institution which matures on a set date and which is repaid with interest on the maturity date. Fixed Term Deposits cannot be traded and cannot be terminated before the maturity date without the payment of a penalty (if at all).

### Gilt Yields

A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

### Gilts

Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on Bank Rate expectations, and on market conditions.

### Gross Domestic Product

Gross Domestic Product (“GDP”) is a measure of the output of goods and services from an economy.

### Growth

Positive growth in an economy is an increase in the amount of goods and services produced by that economy over time. Negative growth in an economy is a reduction in the amount of goods and services produced by that economy over time.

### IMF

The International Monetary Fund oversees the world financial system and seeks to stabilise international exchange rates, facilitate development, and provide resources to countries in balance of payments difficulties or to assist with poverty reduction.

### Incremental Impact of Capital Investment Decisions

These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

### Inflation

Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index (“CPI”) or the Retail Prices Index (“RPI”).

### Investment Regulations

The Local Government in Scotland Act 2003 allows the Scottish Ministers to introduce Regulations to extend and govern the rules under which Scottish Councils may invest funds. The Local Government Investments (Scotland) Regulations 2010 came into effect on 1<sup>st</sup> April 2010.

### LIBID

This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

### LIBOR

This is the London Interbank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

### LOBO

This is a form of market loan that the Council has with some lenders. The term is short for the phrase “Lender Option/Borrower Option”.

## MPC

The MPC or Monetary Policy Committee is a committee of the Bank of England that meets each month (in a meeting over 2 days) to set the Bank Rate for the UK.

## Operational Boundary

This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

## Prudential Code

Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators. The Prudential Code was last revised in November 2011.

## Prudential Indicators

Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

## PWLB

The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

## PWLB Certainty Rates

In the Budget in March 2012, the Chancellor of the Exchequer announced that local authorities that provide information on their long-term borrowing and capital spending plans would be eligible for a 0.20% discount rate for new PWLB borrowing. The PWLB Certainty Rates came into effect on 1<sup>st</sup> November 2012.

## PWLB Rates

These are the interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the start of business each day and then updated at least once during the day.

## Quantitative Easing

This is the creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

## Treasury Management Code

This is the "Treasury Management in the Public Services: Code of Practice" and is a code of practice for Council treasury management activities. It is produced by CIPFA and was last revised in November 2011.

## Treasury Management Indicators

These are Prudential Indicators specifically relating to Treasury Management issues.

## Treasury Management Practices (TMPs)

This is a Council document that sets out Council policies and procedures for treasury management as required by the Treasury Management Code. The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

## Yield

The yield is the effective rate of return on an investment.

**FORECAST OF INVESTMENT BALANCES  
ESTIMATE FOR 2014/15 AND ACTUAL AT 31 MARCH 2015**

Investment Regulation 31 requires the Council to provide forecasts for the level of investments. The estimate for 2014/15 and the actual as at 31 March 2015 are:

	<b>2014/15 Estimate</b>	<b>2014/15 Actual At 31 March 2015</b>
Cash balances managed in-house		
- At 1 April 2014	58,899	48,109
- At 31 March 2015	40,192	44,787
- Change in year	(18,707)	(3,322)
- Average daily cash balances	49,546	53,654
Holdings of shares, bonds, units (includes local authority owned company)		
- At 1 April 2014	2	2
- Purchases	0	0
- Sales	0	0
- At 31 March 2015	2	2
Loans made to third parties		
- At 1 April 2014	2,321	2,259
- Advances	14	19
- Repayments	53	38
- At 31 March 2015	2,282	2,240
Total of all investments		
- At 1 April 2014	61,222	50,370
- At 31 March 2015	42,476	47,029
- Change in year	(18,746)	(3,341)