CT/15/50
Corporate Services Scrutiny Committee
29 June 2015

TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2014/15

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee notes the report and considers whether it wishes to make any further comments to Cabinet.

1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2012. The Treasury Management and Investment Strategy for 2014/15 was agreed by Council in February 2014 and formed part of the published budget book.

1.2. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2014/15 financial year. The report also includes an update on the 2015/16 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 8th July.

2. Treasury Management Outturn Position 2014/15 - Borrowing

2.1. The overall aims of the borrowing strategy were to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

2.2. The Medium Term Financial Strategy assumption was that no new long-term borrowing would be required, although this would be kept under review. This has been made possible by the current capital financing regime, whereby the Government now provides capital grants rather than supported borrowing, and prudent management of the capital programme.

2.3. Active treasury management and the maintenance of levels of liquidity aim to avoid the need for short term borrowing. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately. However, a temporary shortfall in available cash meant that short-term borrowing was required for a brief period during mid-October 2014. £15m was borrowed for a period of 30 days, but was not required for the whole of the period and the surplus funds were invested at a higher rate, resulting in a small net gain to the authority. No further short-term borrowing was required during 2014/15.

2.4. In accordance with the Medium Term Financial Strategy, no long term borrowing was undertaken during this financial year. Instead all borrowing required to fund capital expenditure was met from revenue balances.

2.5. No opportunities arose during the 2014/15 financial year to repay outstanding debt without incurring substantial premium penalties, which would wipe out the benefit of repaying the debt. This situation will continue to be closely monitored in 2015/16 but it will only be beneficial to repay debt early if the PWLB makes amendments to its early repayment penalty policy.

2.6. At 31st March 2015 the level of long term debt stood at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.14 £'m	Interest Rate %	Current 31.03.15 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

2.7. Please note – the long term debt figure presented in the Statement of Accounts for 2014/15 is £511.45m (£3.60m greater than the figure stated above). This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

3. Treasury Management Outturn Position 2014/15 - Investments

3.1. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

3.2. The investment performance of the County Council's cash continues to be affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch and prevent recession impacting on major world economies. The rates on offer during 2014/15 and going forward into 2015/16 continue to be low and the returns on the County Council's cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

3.3. Revenue lending during 2014/15, including the use of term deposits and call accounts, earned interest of £1.222m against a full year budget of £0.850m. Investment returns of 0.64% have been achieved against a full year budget target return of 0.65%. The interest figure quoted is the return from the Council's Treasury Management activity and is different from the figure presented in the Statement of Accounts which also includes interest generated from a number of other sources.

3.4. Interest income was higher than budgeted, despite the target return of 0.65% not being achieved. This is attributable to higher levels of cash being invested than anticipated when the budget was set.

3.5. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

3.6. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.14 £'m	Interest Rate %	Current 31.03.15 £'m	Interest Rate %
Fixed Rates					
Term Deposits	< 365 days	50.00	0.93	50.00	0.84
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Call & Notice Accounts		72.40	0.62	80.76	0.59
Accounts linked to LIBOR Rates		0.00		0.00	
Money Market Funds (MMFs)		0.00		0.00	
All Investments		**122.40**	**0.75**	**130.76**	**0.68**

The figure as at 31st March 2015 includes approximately £15.9m related to the Growing Places Fund (GPF). Devon County Council is the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council’s investments, will accrue to the GPF and not to the County Council.

4. Prudential Indicators

4.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

4.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

4.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2016/17 is revised as part of the 2016/17 budget setting process.

- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

4.4. During the Budget process, the following Borrowing Limits were set for 2014/15:

- Maximum borrowing during the period (**Authorised Limit**) £744.3m.
- Expected maximum borrowing during the year (**Operational Boundary**) £719.3m.
- **Underlying Borrowing Requirement to Gross Debt** - £100.5m under borrowing.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

4.5. Members are asked to note that during 2014/15 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

5. 2015/16 Update

5.1. As part of the process of setting the Capital Programme for 2015-16 to 2019/20 a review was carried out to determine whether additional borrowing would be required, given that current interest rates are extremely low. However the review determined that a number of high priority schemes could be funded from capital receipts, and would not require additional borrowing to be undertaken. Therefore, the Medium Term Financial Strategy continues to assume that, over the three year period, no new long-term borrowing will be required, although this will be kept under review.

5.2. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

5.3. Forecasting future interest rates is difficult as the factors affecting interest rate movements are outside of the Council's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

5.4. The general consensus among market commentators is that any future interest rate rises will be slow and gradual. Capita's view is that the Bank of England is likely to maintain the current 0.5% rate until June 2016 in order to continue to promote growth and employment.

5.5. A key issue that is likely to affect the Council's Treasury Management Strategy over the next year is the new regulatory environment around the concept of 'bail-in'. A 'bail-out' is when outside investors rescue a borrower by injecting money to help service a debt. Bail-outs of failing banks in the past have been primarily financed by taxpayers. In contrast, a bail-in forces the borrower's creditors to bear some of the burden by having part of the debt they are owed written off. At the height of the financial crisis, governments avoided resorting to bail-ins out of concern that it might cause panic among the creditors of other banks. However, the new regulatory environment is putting more emphasis on the requirement for investors to take a hit by funding a bail-in.

5.6. The credit rating agencies are now adjusting their ratings to reflect the ability and likelihood of sovereigns providing financial support and are removing any previous uplift awarded for this support. Following this, Barclays Plc, one of the County Council's major counterparties for lending, suffered a ratings downgrade by Standard and Poor's, and as a result no longer satisfy the County Council's current lending criteria.

5.7. For the period 2014/15 – 2016/17 it has been assumed that the interest rate earned on short-term lending will be 0.65% p.a. throughout the three years. The addition of overseas counterparties to the list has provided greater flexibility, but the rates offered by a number of banks have reduced over the last year. The target we have set is thought to be one that is achievable.

6. Summary

6.1. No long term borrowing was undertaken during 2014/15. £15m was borrowed on a short-term basis from other local authorities for a period of 30 days at an average rate of 0.33%. It is not envisaged that any new long term borrowing will be required over the next three year period but this will be reviewed annually.

6.2. No opportunities arose during the 2014/15 financial year to repay outstanding debt without incurring substantial premium penalties, which would wipe out the benefit of repaying the debt.

6.3. Investment income of £1.222m was achieved in 2014/15 against a full year budget of £0.850m. This represented a return of 0.64% against a full year budget target return of 0.65%. Successful prudent management of the Council's short term cash reserves has delivered a surplus of £0.372m for the 2014/15 financial year.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
Contact for Enquiries: Mark Gayler / Dan Harris
Tel No: (01392) 383621 Room G97/G99